

# **REFORMING INSURANCE LAW: IS THERE A CASE FOR REVERSE TRANSPORTATION?**

## **A REPORT FOR THE ENGLISH AND SCOTTISH LAW COMMISSIONS ON THE AUSTRALIAN EXPERIENCE OF INSURANCE LAW REFORM**

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The views expressed in this paper are those of the author alone.

The paper is published by the English and Scottish Law Commissions as a contribution to the on-going debate on the reform of insurance law. However it does not represent the policy of either Commission.

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# REFORMING INSURANCE LAW: IS THERE A CASE FOR REVESE TRANSPORTATION?

*Robert Merkin*

## 1 INTRODUCTION

**1.1** In January 2006 the English and Scottish Law Commissions, prompted by an investigation conducted by the British Insurance Law Association in 2002 and by strong indications from Brussels that a European Union directive on the harmonisation of insurance law is under consideration, announced a review into insurance law. The process was initiated by a Scoping Paper, launched by a meeting at Lloyd's, by which the Law Commissions sought views on the matters to be investigated. The responses received by the Law Commissions over the following months covered virtually all aspects of the law, and the Law Commissions announced in August 2006 the adoption of a wide-ranging investigatory programme. Issues Papers have to date been published on utmost good faith and warranties, a further paper is to be published in the first half of 2007 on the role of intermediaries. The present paper is for the most part confined to these issues, although certain other aspects of the law, such as late payment of claims, are relevant to good faith in the wider sense and are considered in what follows. A series of working seminars have been held to discuss particular issues within the review. The present author suggested to the Law Commissions at an early stage that it would be worthwhile investigating the Australian experience of the reform of insurance law by the Insurance Contracts Act 1984 (Cth), and the present offering is the result of those investigations.<sup>1</sup> The key provisions of Australian

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<sup>1</sup> A good deal of the research was conducted in Sydney to coincide with the Australian Insurance Law Association Annual Congress, and thanks are owed to a number of people and organisations in that jurisdiction. Michael Gill of DLA Phillips Fox and Peter Mann of Clayton Utz were kind enough to organise and host open forums at their respective offices, and at those events the author was able to pose questions to leading lawyers, underwriters, brokers and academics. Nancy Milne, who conducted the recent reviews of the Australian legislation, willingly answered my detailed questions. Frank Hoffmann, a consultant to the Australian Law Reform Commission, generously gave the author a mass of background papers as well as an original copy of the ALRC's 1984 Report. The chairman of the ALRC, Justice Michael Kirby, provided the author with valuable insights into the thinking behind the Report. Of the numerous people who gave up their time, special mention may be made of Oscar Shub and Fred Hawke. Many of the opinions expressed in this paper are based upon information obtained from the Open Forums and from interviews conducted in Sydney. Kate Lewins' article *Reforming Non-Disclosure in Insurance Contracts*, forthcoming in the *Journal of Business Law*, is a valuable source of information: Kate was also kind enough to read the paper in draft and made a series of valuable comments. Samantha Traves of the Faculty of Law, QUT and of Barry & Nilsson both attended the DLA Phillips Fox seminar in Sydney and read the paper in draft, also making many valuable points. Alison Hay of Berwin Leighton Paisner was yet another of the people generous enough to read the paper and provide thoughts on it. Thanks are also owed to my Southampton colleague Johanna Hjalmarsson, who made sure that I had not missed any relevant authorities.

legislation as it relates to substantive insurance law<sup>2</sup> will be discussed, and any benefits and shortcomings will be identified. It is not the purpose of this paper to make comprehensive, or indeed any, recommendations for the reform of domestic law: instead the focus is on Australian provisions, although inevitably it has been necessary to consider some issues which are not dealt with at all by the Australian legislation but which are significant in this jurisdiction. The author's general conclusion is that there is much to learn from Australia. The insurance markets in the two countries are different in certain respects, in particular given London's pre-eminence as a centre for the insurance of global and other major risks and for reinsurance, but certainly in the consumer and non-international contexts there are few appreciable variations.

**1.2** In preparing this paper the author acknowledges a significant debt to Peter Mann's comprehensive text, *Annotated Insurance Contracts Act*, 4th edition<sup>3</sup> and also to the late Professor Kenneth Sutton's major work *Insurance Law of Australia*, 3rd edition.<sup>4</sup>

**1.3** The decision to reform the law in Australia in 1984 was greeted with a chorus of disapproval from the industry, which feared for its future. Twenty plus years on, the system appears to have bedded down with relatively little difficulty, and there has undoubtedly been a change not just in the law but in the entire culture which surrounds the insurance industry.<sup>5</sup> Doubtless any attempt to change the law in the UK will be met with protests from some quarters: the Australian experience shows that the market adapts very easily to new laws as long as they strike a fair balance between the interests of the parties. Many jurisdictions have revised their insurance laws, and the London market may find itself becoming less sought after if there are rival centres with a more benign legal environment.

**1.4** One further introductory comment should be made. Many of the technical defences which remain a part of English law are rarely taken on their own merits. In the vast majority of cases there is a background dispute, often not articulated in the court,<sup>6</sup> which has prompted the decision to contest liability. Of those background disputes, the most obvious is suspected but unproven – and indeed often unprovable – fraud. While it is the case that fraud is notoriously hard to prove, it might be thought that the legal system should not shy away from reform simply to allow suspicious claims to be disposed of other than on their merits.

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<sup>2</sup> Much of the 1984 Act is concerned with regulatory matters, although the regulation of insurers generally is dealt with by other legislation.

<sup>3</sup> Henceforth, "Mann".

<sup>4</sup> Henceforth, "Sutton".

<sup>5</sup> To the extent that the author found underwriters to be more generous in their approach to various issues, in particular fraudulent claims, than their lawyers.

<sup>6</sup> Or sometimes being aired as an apparent makeweight. See *Feasey v Sun Life Assurance of Canada* [2003] Lloyd's Rep IR 637, argued as a case on insurable interest but at root about the alleged misconduct of an underwriting agent who had carried on writing despite having his authority terminated.

## 2 HISTORY OF THE AUSTRALIAN REFORMS

**2.1** Until 1984 Australian insurance law was to a large extent modelled<sup>7</sup> on English law.<sup>8</sup> The English Marine Insurance Act 1906 was adopted for all intents and purposes word for word in the Australian Marine Insurance Act 1909, and the small number of English statutes relating to insurance – the Life Assurance Act 1774, the Fire Prevention (Metropolis) Act 1774 and the Marine Insurance Act 1788 – all formed a part of the law. The common law principles adopted in the two jurisdictions as applied to non-marine insurance contracts was, with some minor variations, all but identical, although Australia had passed specific legislation protecting the rights of the holders of life policies.<sup>9</sup> Even the pattern of consumer protection measures was similar in the two jurisdictions. The UK insurance industry adopted Statements of Insurance Practice in 1977, renewed in a modified form in 1986, under which members of the Association of British Insurers accepted the duty<sup>10</sup> to handle claims in accordance with good insurance practice rather than in accordance with strict law. The Statements were applied by the Insurance Ombudsman Bureau, a voluntary body established in 1981 whose membership expanded over the years until it obtained statutory status as the Financial Ombudsman Service under the Financial Services and Markets Act 2000. The Australian Insurance Ombudsman was created in December 1993 and, now named the Insurance Ombudsman Service Ltd, performs a similar statutory function under the Financial Services Reform Act 2001 (amending the Corporations Law 2001 (Cth)). In both jurisdictions there are Statements of Practice which govern dealings between insurers and their policyholders.<sup>11</sup>

**2.2** Paths nevertheless began to diverge significantly from the 1970's onwards. The English Law Commission, prompted by a draft EC insurance directive, issued a Report in 1980<sup>12</sup> which recommended changes<sup>13</sup> to the law relating to utmost good faith and warranties. The draft directive fell into abeyance before it was finally abandoned in 1991, and the Law Commission's proposals were themselves not implemented. Law reform proposals in Australia had a very

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<sup>7</sup> Individual States adopted their own legislation on a number of issues, but those specific laws are beyond the scope of this paper. Life insurance also possessed its own regime, and indeed still does in the sense that although life insurance is also regulated by the Insurance Contracts Act 1984 there are a number of provisions within it which apply only to life insurance, for example s 29, which provides the remedy for a breach of duty by the assured in relation to a life policy.

<sup>8</sup> This paper is concerned only with insurance contract law in a general sense and not with regulation or compulsory insurance, although it should be said that in both the UK and Australia the reform of financial services law has extended the jurisdiction of regulators from solvency maintenance measures to some aspects of policy holder protection.

<sup>9</sup> Life Assurance Act 1945.

<sup>10</sup> Almost certainly unenforceable: the point has never been resolved. See *James v CGU Insurance plc* [2002] Lloyd's Rep IR 206.

<sup>11</sup> The ABI Statement of General Insurance Practice 1986 has now been incorporated into the Insurance Conduct of Business Rules set out in the Financial Services Authority Handbook. The Statement of Long-Term Practice 1986 has been retained. The Australian Code of Practice for General Insurance was first issued in 1994 and was replaced in July 2005.

<sup>12</sup> *Insurance Law: Non-Disclosure and Breach of Warranty*, Cmnd 8064.

<sup>13</sup> The Report was a watered down version of the Law Commission's original proposals published in a 1979 Working Paper, *Non-Disclosure and Breach of Warranty*, WP No 73.

different fate. On 9 September 1976 the Attorney General made a reference to the Australian Law Reform Commission, under the chairmanship of Justice Michael Kirby, for a thoroughgoing investigation of insurance law. The ALRC produced its seminal Report No 20,<sup>14</sup> *Insurance Contracts*, in 1982, which included a draft bill. The reference and the report, unlike that in the UK, was not confined to good faith and warranties, but covered virtually every aspect of insurance law from formation to claims. The Australian Government, unlike its UK counterpart, responded positively and passed the Insurance Contracts Act 1984 in much the same form as the ALRC's draft bill,<sup>15</sup> but with some important changes. That Act covers the field of insurance generally<sup>16</sup> but does not apply to marine insurance,<sup>17</sup> so that the Marine Insurance Act 1909 continues to operate in that field. Also, the 1984 Act does not apply to reinsurance,<sup>18</sup> which is governed by common law principles,<sup>19</sup> or to workers' compensation,<sup>20</sup> export credits and – unless otherwise provided – compulsory third party motor vehicle insurance. These forms of cover have their own regimes. The 1984 Act has to date remained in force more or less as originally enacted, the main changes being regulatory (the transfer of extended functions to the Australian Securities and Investment Commission, ASIC<sup>21</sup>). Two substantive changes of note, which are considered below, relate to the removal of the need for insurable interest at inception stage and the virtual abolition of the duty of disclosure in certain forms of domestic policies.

<sup>14</sup> The ALRC had in fact produced an earlier report, *Insurance Agents and Brokers*, Report No 16. That Report was implemented by the Insurance (Agents and Brokers) Act 1984 (Cth), although that Act has now been repealed and re-enacted as Part 7 of the Corporations Law 2001 under amendments made by the Financial Services Reform Act 2001 (Cth).

<sup>15</sup> The ALRC Report is regarded as authoritative in the interpretation of the 1984 Act: *Commercial Union Co of Australia Ltd v Ferrcom Pty Ltd* (1991) 22 NSWLR 389, 391, *per* Kirby P; *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384.

<sup>16</sup> The Act is not, however, a complete code (other than in respect of the duty of utmost good faith and pre-contractual non-disclosure and misrepresentation by the assured) and those matters omitted from it are regulated by the common law: Insurance Contracts Act 1984, s 7. There are, accordingly, substantial similarities between English and Australian law.

<sup>17</sup> Although the Act was amended in 1998 by the insertion of section 9A, the effect of which is to apply the 1984 Act to "pleasure craft", namely a ship owned by individuals and used or intended to be used: wholly for recreational activities, sporting activities or both; and otherwise for reward. The distinction is not always clear: see *Gibbs Holdings v Mercantile Mutual Insurance (Australia) Ltd* [2003] HCA 39.

<sup>18</sup> Insurance Contracts Act 1984, s 9.

<sup>19</sup> Most reinsurance is conducted in overseas markets, so the view in Australia is that any changes to reinsurance law should be generated by those countries in which the industry is most significant. The author was told that any changes to Australian law would depend upon changes made in the UK.

<sup>20</sup> Insurance Contracts Act 1984, s 9. The exclusion for workers' compensation has caused some difficulties. In *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149 it was held that a policy which covered compulsory liability under the workers' compensation scheme and also non-compulsory common law liability was within the 1984 Act insofar as the cover related to non-compulsory risks. Treasury Review II, 2004, has recommended the reversal of this decision in workers' compensation cases but not for other cases of bundled policies: Recommendations 1.3 and 1.4. The draft Insurance Contracts Amendment Bill 2007 implements this recommendation by removing from the scope of the Act any policy which covers both workers' compensation and employer's liability (new s 9(1)(f)) and then adding two new provisions, s 9(1A) and 9(1B) so as to provide that in the case of a "bundled" contract each element of the policy is to be considered separately. Accordingly, if a policy covers both workers' compensation and employer's liability, the former aspect will be outside the Act but the latter will be within it. This process is rather inelegantly referred to as "unbundling".

<sup>21</sup> Treasury Review II, 2004, has recommended in recommendation 3.1 that ASIC should be given a statutory right to intervene in any proceeding relating to matters arising under the 1984 Act, a recommendation taken up in the draft Insurance Contracts Amendment Bill 2007.



**2.3** These reforms aside, the Australian legislation has been subject to a good deal of consideration. In January 2000 the Attorney General asked the Australian Law Reform Commission to investigate the operation of the Marine Insurance Act 1909 and to consider: whether any part of it restricted competition; the desirability of having a regime consistent with international practice in the marine insurance industry and whether any change might result in a competitive disadvantage for the Australian insurance industry; the effects on the environment, welfare and equity, occupational health and safety, economic and regional development, consumer interest, the competitiveness of business, including small business and efficient resource allocation; and compliance costs on small business. The ALRC was also asked to: identify the nature and magnitude of the social, environmental or economic problems that the Act sought to address; clarify the objectives of the Act; assess alternatives, including non-legislative alternatives to the Act; and analyse and quantify the benefits, costs and overall effects of the Act and any proposed alternatives to it. The ALRC duly reported in February 2001<sup>22</sup> and identified a whole series of changes, although the ALRC was clearly constrained by the considerations that the primary market for marine insurance was elsewhere<sup>23</sup> so that a complete rewrite of the legislation would create confusion, possibly make Australian risks more difficult to place in international markets and that the primary focus of the Insurance Contracts Act 1984 was consumer insurance. Accordingly, and primarily, in the interests of continuity, the ALRC recommended that the 1909 Act be retained, but in a reformed state.<sup>24</sup>

**2.4** As far as non-marine insurance is concerned, in September 2003 the Australian Treasury instituted a review of the Insurance Contracts Act 1984. The purpose of the review was to determine whether the Act was in any way ambiguous and whether the rights and obligations under the Act continued to be appropriate in the light of product, regulatory and judicial developments. The Treasury's starting point was that the Act had worked well and that, at most, minor modifications might be required. The Treasury Review was conducted by Alan Cameron and Nancy Milne. In October 2003 they produced a report on section 54, a provision which has given rise to particular problems in respect of "claims made and notified" liability policies ("Treasury Review I"), and in June 2004 they produced a report on the Act's provisions other than section 54 ("Treasury Review II"). The Panel agreed with the assumption in the terms of reference that the Act had for the most part been a success, and although a large number of recommendations for changes were put forward these were for the most part relatively minor. The underlying policy of the legislation was not under challenge. Much of Treasury Review II is concerned with regulatory rather than contractual matters, including the promulgation and enforcement of codes of practice. The recommendations of the two Treasury Reviews have been accepted by the Australian Government, and in February 2007 five consultative documents were published, consisting of draft amendments to the Insurance Contracts Act 1984 in the form of an Insurance Contracts Amendment Bill 2007, amendments to the Regulations made under the 1984 Act and accompanying explanatory documents to both sets of amendments. This material is

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<sup>22</sup> ALRC 91.

<sup>23</sup> And primarily in the UK: ALRC 91, paras 3.41-3.46. Chapter 7 reviews the history of the adoption of the Marine Insurance Act 1906 in other jurisdictions.

<sup>24</sup> ALRC 91, Chapter 3.

invaluable in that it was devised after lengthy consultation with all interest groups and provides concrete evidence on the strengths and weaknesses of the Australian system.

### 3 THE NATURE OF THE DUTY OF UTMOST GOOD FAITH

#### The duty of utmost good faith in English law<sup>25</sup>

**3.1** The relevant principles, which are codified in ss 18 to 20 of the Marine Insurance Act 1906 may be stated briefly. The criticisms of the existing law are fully stated in the Law Commissions' first Issues Paper and are not repeated here.

**3.2** First, the assured is under a pre-contractual duty to disclose material facts to the insurers and is also under a pre-contractual duty not to make material misstatements. A fact is material if it would influence the judgment of a prudent underwriter in deciding whether to insure and, if so, on what terms and at what premium,<sup>26</sup> although it remains necessary for the insurers to prove that they have been induced by the assured's presentation of the risk. The English courts have recognised that these rules may operate unfairly in the modern context, and have narrowed the definition of materiality<sup>27</sup> while at the same time expanding the concept of inducement.<sup>28</sup> Any breach of the duty renders the policy voidable *ab initio*.

**3.3** Secondly, the insurers are under a corresponding pre-contractual duty of utmost good faith to disclose or not to misrepresent material facts to the assured.<sup>29</sup> There is no decided case in which the insurers have been held to be in breach of this obligation, and there is a debate as to the scope of materiality, although it has been said by the Court of Appeal that "the duty falling upon the insurer must at least extend to disclosing all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer."<sup>30</sup> However, given that the remedy of the assured is avoidance *ab initio*, the point is really only of significance if the assured wishes to resile from a policy before there has been any loss under it.

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<sup>25</sup> And also in Australian marine insurance and reinsurance law.

<sup>26</sup> Marine Insurance Act 1906, ss 18(2) and 20(2).

<sup>27</sup> By confining the definition to facts which relate to the risk, as opposed to other considerations which may have influenced the insurers (eg, the creditworthiness of the assured): *North Star Shipping Ltd v Sphere Drake Insurance plc* [2006] Lloyd's Rep IR 519. For a further narrowing, see *Norwich Union Insurance v Meisels* [2006] EWHC 2811 (QB).

<sup>28</sup> By requiring the insurers to show that would have acted differently had the true facts been stated accurately: *Drake Insurance Co v Provident Insurance Co* [2004] Lloyd's Rep IR 277.

<sup>29</sup> Marine Insurance Act 1906, s 17

<sup>30</sup> *La Banque Financière de la Cite SA v Westgate Insurance Co. Ltd* [1989] 2 All ER 952, 990. No comment was made on appeal to the House of Lords, [1990] 2 All ER 947. See also *Aldrich v Norwich Union Life, Norwich Union Life v Qureshi* [2000] Lloyd's Rep IR 1.

**3.4** Thirdly, the assured is under a continuing duty of utmost good faith, to disclose material facts during the currency of the policy and to avoid making misrepresentations.<sup>31</sup> However, as a result of a series of Court of Appeal decisions<sup>32</sup> it has become clear that the continuing duty of utmost good faith does not extend to fraudulent claims and that the duty of disclosure applies only where there is an express disclosure obligation under the policy which the assured has broken in a fashion which amounts to a repudiation of the entire policy assuming that the assured acted other than with the utmost good faith and that the insurers were induced to act in a different fashion: in such a case, the insurers have the alternative rights to treat the policy as repudiated or to avoid the policy *ab initio*. However, as there is no case in which it has been held that breach of a notification obligation is a repudiation of the policy as a whole,<sup>33</sup> the assured's continuing duty is to all intents and purposes non-existent. The only manner in which an independent duty of disclosure can affect an assured is where the courts regard it as appropriate to imply a term in the policy requiring disclosure of a particular matter: such a duty was imposed with respect to disclosure of placing and claims material in the hands of the assured's brokers which had already been seen by the insurers.<sup>34</sup> A false statement by the assured in the course of the policy and which induces the insurers to act in a particular fashion may be actionable misrepresentation, but this is nothing to do with utmost good faith.

**3.5** Fourthly, the insurers are under a continuing duty of good faith. The duty is one manufactured by the English courts in the past decade, and from unpromising material. As a matter of principle, and given that avoidance *ab initio* is the only remedy recognised by the law for breach of the duty of utmost good faith, it is difficult to think of any situations in which the continuing duty could be of much use to the assured. However, the courts have held that there are various continuing duties on insurers. Those duties were initially expressed as emanating from the continuing duty of utmost good faith<sup>35</sup> or by way of implied term,<sup>36</sup> or both,<sup>37</sup> although ultimately they have been rationalised as implied terms whose content is coloured by the fact that a contract of insurance is one of utmost good faith.<sup>38</sup> The insurers' continuing duty of utmost good faith to date has been applied to: the obligation of a liability insurer to negotiate with the third party claimant against the assured in good faith and to avoid conflicts of interest;<sup>39</sup> the obligation of reinsurers (and, by extension, liability insurers) not to take into account irrelevant considerations (ie, to act rationally, the standard for judicial review, as opposed to acting reasonably, which would be an objective standard which the courts would not be able to police)

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<sup>31</sup> *Black King Shipping v Massie, The Litsion Pride* [1985] 2 Lloyd's Rep 437, overruled on its precise facts by *The Star Sea* [2001] Lloyd's Rep IR 227.

<sup>32</sup> *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters* [2001] Lloyd's Rep IR 802; *Agapitos v Agnew* [2002] Lloyd's Rep IR 573.

<sup>33</sup> The doctrine of partial repudiation was rejected by the Court of Appeal in *Friends Provident Life and Pensions Ltd v Sirius International Insurance Corp* [2006] Lloyd's Rep IR 45.

<sup>34</sup> *Dedicated Ltd v Tyser & Co Ltd* [2006] EWCA Civ 54.

<sup>35</sup> *Insurance Corporation of the Channel Islands v McHugh (No.1)* [1997] LRLR 94.

<sup>36</sup> *Gan v Tai Ping (Nos 2 and 3)* [2001] Lloyd's Rep IR 667; *Bonner v Cox Dedicated Corporate Member Ltd* [2006] Lloyd's Rep IR 385.

<sup>37</sup> *Eagle Star v Cresswell* [2004] Lloyd's Rep IR 437.

<sup>38</sup> *Goshawk Dedicated Ltd v Tyser & Co Ltd* [2006] EWCA Civ 54.

<sup>39</sup> *Groom v Crocker* [1939] 1 KB 194; *K/S Merc-Skandia XXXXII v Certain Lloyd Underwriters* [2001] Lloyd's Rep IR 802.

in deciding whether or not to approve a settlement reached by the reinsured<sup>40</sup> and whether or not to exercise a claims control clause;<sup>41</sup> and the obligation of insurers not to avoid a policy for the assured's failure to disclose material facts when they are aware<sup>42</sup> at the time of avoidance that the facts in question were untrue<sup>43</sup> or where the insurers had failed to ask the right questions on placement.<sup>44</sup> In the same way it has been suggested that if a policy term confers a discretion on insurers to waive strict compliance any request made by the assured to the insurers must be given due consideration and resolved in good faith.<sup>45</sup> It will be seen that English law is embryonic, in that the obligations to which the insurers' continuing duty of utmost good faith are applicable have yet to be fully articulated, in that it is unclear whether damages are awardable and in that the test to date is based on rationality rather than reasonableness.

### **The Australian concept of utmost good faith<sup>46</sup>**

**3.6** The Insurance Contracts Act 1984 retains the concept of utmost good faith. Indeed, it is stated by s 12 to be a paramount requirement to which the remainder of the 1984 Act and other laws are subject. However, the legislation fundamentally alters the nature of good faith. The following paragraphs explain the structure of the legislation. Its detailed operation is considered thereafter.

**3.7** The starting point is the separation of non-disclosure and misrepresentation on the one hand, and utmost good faith on the other. The duty of utmost good faith is expressed by s 13 of the 1984 Act in the following terms:

A contract of insurance is based on the utmost good faith and there is implied in such a contract a provision requiring each party to it<sup>47</sup> to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.

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<sup>40</sup> *Gan v Tai Ping (Nos 2 and 3)* [2001] Lloyd's Rep IR 667.

<sup>41</sup> *Eagle Star Insurance Co Ltd v Cresswell* [2004] Lloyd's Rep IR 437.

<sup>42</sup> Or, in the formulation of Pill LJ, ought reasonably to have been aware.

<sup>43</sup> *Drake Insurance Co v Provident Insurance Co* [2004] Lloyd's Rep IR 277, confirming the decision of Colman J in *Strive Shipping Corporation v Hellenic Mutual War Risks Association* [2002] Lloyd's Rep IR 669 and rejecting by implication the contrary view of the Court of Appeal in *Brotherton v Aseguradora Colseguros SA (No.2)* [2003] Lloyd's Rep IR 758, a case which is now to be treated only as authority for the proposition that the court cannot overturn an avoidance: an application by the insurers to the court for avoidance is, however, subject to the *Drake* principle. It may also be the case that if the avoidance is found to have been in bad faith, damages might be awardable for breach of an implied term.

<sup>44</sup> *WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA* [2004] Lloyd's Rep IR 764, thereby classifying pre-contract waiver as a post-contractual aspect of utmost good faith.

<sup>45</sup> *Diab v Regent Insurance Co Ltd* [2006] Lloyd's Rep IR 779; *Anders & Kern Ltd v CGU Insurance plc* [2007] EWHC 377 (Comm).

<sup>46</sup> Sutton, paras 3.8 to 3.14.

<sup>47</sup> The wording appears to preclude a duty of good faith owed by insurers to a third party who is not a contracting party but who may have rights under the policy: cf Sutton, para 3.19. However, insurers were held to owe a duty of good faith to a third party in a series of cases: *Wyllie v National Mutual Life Association of Australasia Limited* (1997) 217 ALR 324; *Hannover Life Re of Australasia Limited v Sayseng* [2005] NSWCA 214; *Dumitrov v S C Johnson & Son Superannuation Pty Ltd* [2006] NSWSC 1372. If English law was to adopt something along the lines

Utmost good faith is, therefore, an implied term which applies to both parties to the contract. Accordingly it regulates their dealings with each other during the currency of the policy, although the phrase “in relation to” suggests that it may also apply pre-contractually. Moreover, under s 14 of the Act, reliance on any policy term other than in accordance with the requirement of utmost good faith is not permitted. It follows that breach of the duty of good faith is a breach of contract which either gives rise to damages or to an estoppel, and does not give rise to avoidance *ab initio*. The duty of utmost good faith, although bilateral, plainly has a greater effect on the insurers than on the assured, in two respects. First, it is inherent in the notion in s 14 of reliance on policy terms that such reliance will normally be by the insurers rather than by the assured. Secondly, the insurers’ duty is more onerous than that of the assured in that under s 12 the assured is not required to make any disclosure to the insurers unless it falls within the assured’s entirely distinct pre-contractual obligation of disclosure. This wording is not straightforward, in that it assumes that the duty of disclosure is capable of falling within ss 12 and 13 even though the duty of disclosure is pre-contractual whereas the duty of utmost good faith is a contractual term. The relationship between utmost good faith and the duty of disclosure has indeed given rise to some difficulty under the 1984 Act. Accordingly, if the UK is to adopt legislation along these lines, clearer drafting would be required. The point of the Australian drafting is to remove the argument that a post-contractual failure to disclose by the assured (eg, a variation in the risk) amounts to a breach of the duty of utmost good faith by him thereby putting him in breach of contract. The wording means that, unless the insurer specifically requires post-contractual disclosure by the assured they cannot rely upon s 13 to imply a term to that effect for their benefit. It would obviously be necessary to preserve this intention in any UK implementation.

**3.7** Having laid down the concept that the parties must act with the utmost good faith in their dealings with each other under the policy, the 1984 Act goes on to regulate the pre-contractual obligations of the parties. As regards disclosure, the assured’s duty of disclosure is retained by s 21, but is subject to three significant restrictions: the test of materiality is no longer based on the prudent underwriter but rather focuses on the prudent assured; under s 21A the duty of disclosure is waived in respect of most forms of domestic policy unless the insurers have asked specific questions; and under s 22 the insurers are under a duty to inform the assured of the duty of disclosure, failing which they cannot rely on it unless the assured has been fraudulent. Section 21A was added in 1999, and has diminished the need for s 22 which was until the enactment of s 21A the major form of protection for the assured. As will be seen, there is a potential overlap between the duty of disclosure in s 21 and the obligation of the assured to act with the utmost good faith under s 13. Insurers are granted remedies for non-disclosure under s 28, but only if the non-disclosure made a difference to the insurers, and then only to the extent of that difference: for example, if the insurers would have charged a higher premium if they had known the undisclosed fact then the assured’s claim will be reduced by the amount of extra premium that would have been charged. If the non-disclosure was fraudulent, the insurers may avoid the contract.

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of s 13, it would be necessary to clarify this point so as to produce consistency with the principle in the Contracts (Rights of Third Parties) Act 1999 that a third party beneficiary has the same rights and liabilities as the contracting party himself.

**3.8** As regards misrepresentation, the assured remains under a duty to avoid making false statements. The duty is, however modified in that: (a) ambiguous questions are to be construed as they would be understood by a reasonable person (s 23); (b) a false statement by the life insured under a life policy is to be treated as having been made by the policyholder himself if a different person (s 25); (c) a statement of belief reasonably held is not a misrepresentation (s 26(1)); (d) a statement is not to be regarded as a misrepresentation unless it satisfies the prudent assured test as adopted for non-disclosure (s 26(2)); and (e) failure to answer a question is not to be taken as a misrepresentation (s 27). The insurers are given remedies in respect of misrepresentation under s 28, but only where the insurers have been induced to enter into the contract as a result of it. In addition to these rules, s 24 provides that any statement made by the assured is to be treated as a representation and not a warranty, so that any representation is to be treated as such and the test for whether any remedy flows from the misrepresentation is the same as for any other misrepresentation. Warranties are considered separately later in this paper.

**3.9** Non-disclosure and misrepresentation are self-contained concepts and appear not to overlap, other than possibly in the situation in which the assured has made a statement which is false because it is misleadingly incomplete.<sup>48</sup>

**3.10** Remedies for non-disclosure and misrepresentation are governed by s 28. The basic rule is that even if the insurers can prove relevance and inducement (which now forms a part of the law relating to remedies rather than implied into the definition of the duty to disclose) sufficient to give rise to a breach of duty, their rights depend upon the assured's state of mind. In the absence of fraud, the insurers' liability is reduced to the amount so as to place them in the position which they would have been in but for the breach of duty. If there is fraud, the insurers have the right to avoid but subject to the discretion of the court to disallow avoidance as regards the claim in question if it would be harsh and unfair for avoidance to be permitted.

**3.11** The rules are varied by ss 29 and 30 in respect of life insurance. A distinction is drawn between cases in which the facts withheld or misstated relate to age and those in which age is not at stake. As far as age is concerned, the right to avoid is lost and replaced by a proportionality rule. As regards other breaches of duty, the insurers retain their right to avoid for fraud (subject to the court's discretion to disallow avoidance under s 31), but in the case of non-fraudulent breach the policy becomes incontestable after three years.

## Comparisons

**3.12** It will be seen that the Australian reforms adopt an approach completely different to that of English law. The latter regulates the rights of the parties purely by a duty of utmost good faith, which encompasses pre-contract misrepresentation and disclosure (primarily imposed on the assured but in exceptional cases capable of applying to the insurers) and post-contractual obligations (primarily imposed on the insurers but in exceptional cases capable of applying to the

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<sup>48</sup> *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* (2001) 50 NSWLR 679; *Schaffer v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] QCA 182.

assured). By contrast Australian law draws a distinction (albeit not sufficiently clearly) between pre-contract duties of disclosure and the avoidance of misrepresentation (primarily imposed on the assured) and the post-contractual duty of utmost good faith (primarily imposed on the insurers). The incidence of the duties is thus much the same, but the Australian approach is far more logical in that post-contractual duties are governed by the contract and are enforced by contractual remedies<sup>49</sup> rather than by the artificial scrabbling around for remedies which has characterised the English post-contractual duty of utmost good faith.

**3.13** In the following paragraphs the operation of Australian law is outlined and comparisons with English law are made.

## 4 NON-DISCLOSURE AND MISREPRESENTATION

### The duty of disclosure

#### *Structure of the legislation*

**4.1** The Insurance Contracts Act 1984 draws a distinction between disclosure and utmost good faith: the former is a pre-contractual obligation set out in s 21, while the latter is an implied term provided for by s 13 which operates post-contractually. The point is emphasised by s 12, which makes the duty of disclosure (defined in s 11 as the s 21 duty) paramount but specifically states that the assured is under no further duty of disclosure. The distinction between pre- and post-contractual matters is not as clear as it might be, because s 13 refers to utmost good faith applying to both “matters arising under or in relation to” the policy, the latter phrase clearly being wide enough to encompass pre-contractual matters.<sup>50</sup> Accordingly, the courts have suggested that a failure to disclose may fall within the duty of utmost good faith in s 13.<sup>51</sup> Mann comments that in practice insurers rely upon both ss 13 and 21 in non-disclosure cases,<sup>52</sup> and this was the general view put to the author. If the UK was to adopt similar provisions it would make sense to ensure that pre-contract disclosure and post-contact good faith are kept quite distinct. The following analysis is concerned with the operation of s 21.

**4.2** The duty of disclosure has to be read in conjunction with s 21A, which effectively removes the duty for domestic insurance, and s 22, which imposes a duty on the insurers to inform the assured in writing of the nature and effect of the duty of disclosure and, if s 21A applies, also clearly inform the assured in writing of the general nature and effect of s 21A. If the assured is not notified, the insurers may not exercise any right in respect of the assured’s failure to comply

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<sup>49</sup> Subject to the operation of s 54 of the 1984 Act.

<sup>50</sup> Similarly worded arbitration clauses have been so construed. For the authorities, see Merkin, *Arbitration Law*, para 5.52 *et seq.*

<sup>51</sup> *CIC Insurance Ltd v Barwon Region Water Authority* (1999) 10 ANZ Ins Cas 61-425.

<sup>52</sup> Para 12.120.1. See also para 13.201., where the point is made that s 13 alone is not in practice relied upon in non-disclosure cases. Cf Sutton, paras 3.199 to 3.200.

with the duty of disclosure unless the assured has been fraudulent: s 22(3), subject to limited exceptions in s 69.

**4.3** Both Australia and New Zealand<sup>53</sup> have rejected the notion that the broker should, for placement purposes, be treated as the agent of the insurers rather than as the agent of the assured.

#### *Pre-contract disclosure*

**4.4** *The criteria.* The ALRC analysed the operation of the doctrine of disclosure at common law<sup>54</sup> and concluded<sup>55</sup> that changes in the incidence of knowledge since the doctrine was developed in the eighteenth century called for a revision of the law. The ALRC did not recommend abolition, but preferred modification. Its recommendations were, with one significant variation, adopted by the 1984 Act. Section 21 of the 1984 Act lays down the basic principle of disclosure, which replaces the common law.<sup>56</sup> Under s 21(1):<sup>57</sup>

an insured has a duty to disclose to the insurer, before the relevant contract is entered into, every matter that is known to the insured, being a matter that:

- (a) the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms; or
- (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant.

**4.5** *The knowledge of the assured.* Under s 21(1), the fact must be “known to the assured”. The Marine Insurance Act 1906 requires disclosure of facts which “are known to the assured, and the assured is deemed to know every circumstance which in the ordinary course of business ought to be known to him.” The English courts have established that the word “known” means actual or at the very least blind-eye knowledge (in that the assured has shut his eyes to facts that would otherwise be obvious) but there is no duty on the assured to undertake any inquiries to discover things which are not known by him.<sup>58</sup> The deemed knowledge of the assured necessarily applies only if he is carrying on business, and here the courts have ruled that a fact possessed by an agent of the assured only falls within the deemed knowledge of the assured if the agent was under

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<sup>53</sup> For the latter, see the review of the Ministry of Economic Development, published in September 2006 and discussed below in the context of good faith. The review specifically recommended a clarification of New Zealand law to confirm that the broker is the agent of the assured during the placement process.

<sup>54</sup> ALRC 20, paras 150-165.

<sup>55</sup> ALR 20, paras 175-183.

<sup>56</sup> The common law is accordingly no longer relevant: *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606. For a comparison, see Kirby, “Marine Insurance: Is the Doctrine of “Utmost Good Faith” Out of Date?” (1995) 13(1) Australian Bar Review 1.

<sup>57</sup> At present, in the case of a life policy, where the policyholder and the life assured are different persons, false statements by the life assured in response to express questions by the insurers as to his health and other relevant matters are treated as having been made by the policyholder himself: s 25. Treasury Review II, 2004, recommendations 4.4 and 4.5, have proposed that the life assured should be under a duty of disclosure, although only if he is warned of its existence in accordance with the provisions of s 22. See *infra*.

<sup>58</sup> *Economides v Commercial Union* [1997] 3 All ER 636.



some form of duty to disclose that fact to him<sup>59</sup> or if the agent was the alter ego of the assured.<sup>60</sup> The Australian legislation does not attempt to define “known” and does not contain the additional deemed knowledge provision in respect of an assured acting in the course of a business.<sup>61</sup> The cases on this aspect of s 21(1) are not fully consistent but the weight of them more or less reflects the common law position.<sup>62</sup> The main issue for the UK is the effect of the knowledge of an insurance broker, a matter discussed below.

**4.6 Fact relevant.** The most important change made to the common law by s 21(1) is the abolition of the prudent underwriter test and its replacement by a prudent assured test.<sup>63</sup> Materiality to a notional underwriter has become relevance<sup>64</sup> to the particular underwriter, and the word “materiality” has been dropped from the insurance vocabulary. Assuming that the assured is aware of the matter itself, it must be disclosed if: (a) the assured knows it be relevant to the decision of the insurer whether or not to accept the risk and, if so, on what terms; or (b) a reasonable person in the circumstances could be expected to know it to be so relevant. Both tests focus on the insurer in question<sup>65</sup> and are not concerned with insurers in general.<sup>66</sup> This nevertheless means that a fact will be relevant if the assured knew or ought to have known that it would have been relevant to the insurer because it was a fact of interest to all insurers,<sup>67</sup> and a fact will also be relevant if the assured knew or ought to have been aware of particular considerations taken into account by the insurer in question. In the same way, if a fact of general significance is thought by the assured not to be relevant to the insurer in question, there is no obligation to disclose it. What is clear is that the prudent insurer test has been abolished,<sup>68</sup> a point

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<sup>59</sup> *ECR Frankona Reinsurance v American National Insurance Co* [2006] Lloyd’s Rep IR 157.

<sup>60</sup> See *Simner v New India Assurance Co* [1995] LRLR 240. For attribution within companies, see *Meridian Global Management Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500.

<sup>61</sup> The point was left open by ALRC 20, para 151. ALRC 91’s recommendations for the amendment of marine insurance law omit any reference to the assured “knowing” the facts, although plainly knowledge of the facts themselves is implicit in the obligation to disclose.

<sup>62</sup> Mann, para 21.10.5; Sutton, paras 3.26-3.28. See in particular: *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1987) 4 ANZ Ins Cas 60 – 813; *CIC Insurance Ltd v Midaz Pty Ltd* (1998) 10 ANZ Ins Cas 61-394; *Porter v GIO Australia Ltd* [2003] NSWSC 668. *QBE Mercantile Mutual Ltd v Hammer Waste Pty Ltd* [2003] NSWCA 356; *A & D Douglas Pty Ltd v Lawyers Private Mortgages Pty Ltd* [2006] FCA 520.

<sup>63</sup> Fung, “Section 21 of the Insurance Contracts Act 1984 – The death and rebirth of the “prudent insurer” test?” (2001) 13 Ins LJ 108.

<sup>64</sup> Sutton, para 3.69.

<sup>65</sup> *General Accident Insurance Co Australia Ltd v Kelaw Pty Ltd* (1997) 9 ANZ Ins Cas 61-369; *Permanent Trustee Australia Co Ltd v FAI General Insurance Co Ltd* (2001) 50 NSWLR 679; *McCabe v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] WASCA 162.

<sup>66</sup> It was held (by a majority) in *Permanent Trustee Australia Co Ltd v FAI Insurance Co Ltd* (2003) 197 ALR 364 that relevant facts are confined to facts which relate to the risk, and do not extend to extraneous matters such as, in the case itself, the decision of the assured not to renew following the expiry of the cover for which he had applied. Although the decision has found disfavour with some commentators, it is consistent with the approach of the Court of Appeal in *North Star Shipping v Sphere Drake Insurance* [2006] Lloyd’s Rep IR 519.

<sup>67</sup> To that extent, the prudent insurer concept has been retained: *Toikan International Insurance Broking v Plasteel Windows Australia Pty Ltd* (1989) 94 ALR 435; *Ayoub v Lombard Insurance Co (Aust) Pty Ltd* (1989) 166 CLR 606; *Thompson v Government Insurance Office of New South Wales* 1994, unreported, NSW Supreme Court. See Sutton, para 3.67.

<sup>68</sup> See the authorities cited by Mann, para 21.10.7, cf Sutton, para 3.67. The most important case is *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606. See also: *Twenty First Maylux v Mercantile Mutual*

confirmed by s 28 which requires the actual inducement of the insurer in question before any remedy is available. One clear advantage of this approach is that it removes the common law difficulty that the insurer's own method of assessing the premium had no parallel elsewhere in the market and accordingly could not be subjected to an objective materiality test.<sup>69</sup>

**4.7** Actual knowledge under (a) refers to what the assured believed to be relevant.<sup>70</sup> One important issue arising from the test of actual knowledge is the extent to which the knowledge of an agent can be imputed to the assured. On ordinary common law principles, as stated above, imputation is possible only where the agent is employed to transmit that information to the assured or is the alter ego of the assured.

**4.8** The alternative test of relevance, what a reasonable person in the circumstances could be expected to know to be relevant to the insurers, was substituted for the ALRC's preferred formulation of "a person in the circumstances of the assured", which was to encompass the assured's position in life, mental condition and ability, education, literacy, knowledge, experience and cultural background.<sup>71</sup> There has been a good deal of debate as to whether the revised statutory formulation has the effect of excluding from consideration "intrinsic" factors relating to the assured, so that the test of deemed knowledge is that of a reasonable person in the light of external factors such as the nature of the policy and the nature of the negotiations leading up to it, or whether the test incorporates the assured's own proclivities and comprehension. The balance of authority is that the ALRC's formulation is not part of the law and that only extrinsic factors are relevant to the determination of reasonableness,<sup>72</sup> although there is no unanimity on the point.<sup>73</sup> An issue also arises as to whether the test focuses on the knowledge which could be held by a reasonable person or on the knowledge which could be expected to be held by a reasonable person.<sup>74</sup> Treasury Review II, 2004, felt that it was important to lay down a clear test

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*Insurance (Australia) Ltd* [1990] VR 919; *Macquarie Bank Ltd v National Mutual Life Association of Australasia Ltd* (1996) 40 NSWLR 543; *Commercial Union Assurance Co of Australia Ltd v Beard* (2000) 47 NSWLR 735.

<sup>69</sup> A point noted but not expanded upon in *Drake Insurance Co v Provident Insurance Co* [2004] Lloyd's Rep IR 277.

<sup>70</sup> *Permanent Trustee Australia Co Ltd v FAI General Insurance Co Ltd* (2001) 50 NSWLR 679; *GIO General Limited v Wallace* [2001] NSWCA 299; *McCabe v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] WASCA 162.

<sup>71</sup> ALRC 20, para 183.

<sup>72</sup> See the authorities cited in Mann, para 21.10.8, and in particular *Twenty-First Maylaux Pty Ltd v Mercantile Mutual Insurance (Aust) Ltd* (1990) VR 919; *Dew v Suncorp Life and Superannuation Ltd* [2001] QSC 252. See, by way of illustration, *GIO General Ltd v Wallace* [2001] NSWCA 299.

<sup>73</sup> See in particular: *Delphin v Lumley General Insurance Ltd* (1989) 5 ANZ Ins Cas 60-941, and *Plasteel Windows Aust Pty Ltd v C e Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cas 60 – 926. See Sutton, para 5.70.

<sup>74</sup> See Derrington and Ashton, "What have they done to the Common Law? Disclosure and Misrepresentation" (1988) 1 *Insurance Law Journal* 1, who comment that the question under s 21(1)(b) is not whether a reasonable person could have the relevant knowledge but whether a reasonable person could be expected to have the knowledge. They suggest that the correct test is "is it reasonably possible that a reasonable person would probably (or most probably) know of the relevance of the fact?" Cf *Delphin v Lumley General Insurance Ltd* (1989) 5 ANZ Insurance Cases 60-941. The point was left open in *GIO General Limited v Wallace* [2001] NSWCA 299. Derrington and Ashton, "What have they done to the Common Law? Disclosure and Misrepresentation" (1988) 1 *Insurance Law Journal* 1, who comment that the question under s 21(1)(b) is not whether a reasonable person could have the relevant knowledge but whether a reasonable person could be expected to have the knowledge. They suggest that the correct test is "is it reasonably possible that a reasonable person would probably (or most probably)

which could be applied consistently by the courts. It deliberated on whether the objective test in s 21(1)(b) imposed too high a burden on the assured and whether the original view of the ALRC opting for a substantially subjective test would be preferable. Its conclusion was that s 21(1)(b) imposed an undue burden on consumer assureds but that the law worked satisfactorily in the context of commercial insurance. Its recommendation<sup>75</sup> was that the test should remain the same but that it should be applied by reference to considerations such as the nature and extent of the cover provided by the contract of insurance, the class of persons who would ordinarily be expected to apply for cover of that type and the circumstances in which the contract of insurance is entered into including the nature and extent of any questions asked by the insurer. The Treasury agreed with this conclusion and the proposed new version of s 21(1)(b), set out in the Insurance Contracts Amendments Bill 2007 lays down a non-exhaustive list of factors to which the court is to have regard when determining whether a reasonable person in the circumstances could be expected to know a matter was relevant to the decision of the insurer whether to enter the contract of insurance. The revised s 21(1) would require the assured to disclose every matter known to him, being a matter:

- (a) *the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms, or*
- (b) *a reasonable person in the circumstances could be expected to know to be a matter so relevant, having regard to factors including, but not limited to:*
  - (i) *the nature and extent of the insurance cover to be provided under the relevant contract of insurance; and*
  - (ii) *the class of persons for whom that kind of insurance cover is provided in the ordinary course of the insurer's business; and*
  - (iii) *the circumstances in which the relevant contract of insurance is entered into, including the nature and extent of any questions asked by the insurer.*

In accepting the recommendations of Treasury Review II, the Treasury specifically rejected the alternative possibility that the duty of disclosure should be abolished entirely: the evidence was that the duty remained important in the commercial insurance and life markets. As far as UK reform is concerned, clarification on which test is to be adopted would be necessary.

**4.9** The ALRC's recommendations in its 1991 report on marine insurance are at variance with this approach. The ALRC was persuaded that the 1984 Act was primarily aimed at consumers<sup>76</sup> and has suggested that in the commercial context of marine insurance the "prudent insurer" test should be retained over the prudent assured test. Accordingly, under its recommendations, a fact has to be disclosed by the assured only if he knew or ought to have known that it was material, that term being defined as it is presently, namely "Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether it will take the risk." It may here be pointed out that the prudent assured test is self-policing, in that a

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know of the relevance of the fact?" Cf *Delphin v Lumley General Insurance Ltd* (1989) 5 ANZ Insurance Cases 60-941. The point was left open in *GIO General Limited v Wallace* [2001] NSWCA 299.

<sup>75</sup> Recommendation 4.1.

<sup>76</sup> It has to be said that this does not appear from the 1984 Act itself, although the Regulations made under it do, for specific purposes, treat certain forms of policy which are primarily non-commercial differently.

reasonable proposer for a marine policy is almost certainly going to have a far higher degree of knowledge of what might be material than a reasonable proposer for a general policy, so that by definition the duty will operate at an enhanced level. For the same reason, the prudent assured test will operate in a rather different fashion in reinsurance contracts, it would be almost impossible for a reinsured to deny that it was unaware that facts were relevant in the sense laid down by s 21 of the 1984 Act. It should also be remembered that virtually all marine and reinsurance contracts are placed by brokers, and the ALRC in drawing a distinction between marine and non-marine insurance does not appear to have given consideration to the question whether a marine reinsurance should be treated in the same way as all other reinsurances.

**4.10** The test of relevance as it stands has been tested in only a relatively small number of cases.<sup>77</sup> Perusal of the decisions shows that the main impact has been on matters which go to the moral hazard:<sup>78</sup> where the physical hazard is affected there is little difficulty in demonstrating that the relevance test has been satisfied.<sup>79</sup> That said, it is arguable that the common law materiality test, at least in the hands of the present generation of English judges, would probably ultimately meander its way to much the same outcome despite the different starting point.<sup>80</sup>

**4.11** *Fact not excluded.* Four classes of fact are excluded from the disclosure requirement.<sup>81</sup> These exclusions echo what is presently s 18(3) of the Marine Insurance Act 1906, with the omission of s 18(3)(d) concerning matters covered by express warranties.<sup>82</sup>

**4.12** First, the assured is not required to disclose any fact which diminishes the risk (s 21(2)(a)). This simply reflects the point that the definition of disclosable fact refers to a premium sensitive fact, and prevents insurers from arguing that a fact which would point to a lower premium has to be disclosed.

**4.13** Secondly, the assured is not required to disclose a matter of common knowledge (s 21(2)(b)). This is a modernised version of the existing principle that the assured is not required to disclose matters which are of common notoriety.

**4.14** Thirdly, the assured is not required to disclose any fact which the insurers know or ought to know. This replaces the existing formulation that the assured is not required to disclose “matters which an insurer in the ordinary course of his business, as such, ought to know” (s 21(2)(c)). The

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<sup>77</sup> These are helpfully listed in Sutton, paras 3.105 to 3.106.

<sup>78</sup> *Lumley General Insurance Ltd v Delphin* (1990) 6 ANZ Ins Cas 60-986; *Fruehauf Finance Corporation Pty Ltd v Zurich Australian Insurance Ltd* (1990) 6 ANZ Ins Cas 61-104; *Von Braun v Australian Associated Motor Insurers Ltd* (1998) 10 ANZ Ins Cas 61-419.

<sup>79</sup> See, eg: *Orb Holdings Pty Ltd v Lombard Insurance Co (Australia) Ltd* [1995] 2 Qd R 51; *Prime Forme Cutting Pty Ltd v Baltica General Insurance Co Ltd* (1991) 6 ANZ Ins Cas 61-028. It was held in *Permanent Trustee Australia Co Ltd v FAI Insurance Co Ltd* (2003) 197 ALR 364 that relevance means relevant to the risk and not merely to the commerciality of the contract, an approach similar to that in England in *North Star Shipping v Sphere Drake Insurance plc* [2006] Lloyd’s Rep IR 519.

<sup>80</sup> *North Star Shipping Ltd v Sphere Drake Insurance plc* [2006] Lloyd’s Rep IR 519; *Norwich Union Insurance v Meisels* [2006] EWHC 2811 (QB).

<sup>81</sup> Sutton, paras 3.74 to 3.81.

<sup>82</sup> ALRC 91 recommended the retention of the existing list of exceptions, modifying s 18(3)(d) to refer to policy terms rather than to warranties (given the abolition of warranties as recommended in ALRC 91).

Law Commissions have proposed amplification of this provision so as to provide that insurers are deemed to know the contents of their own files, and the Issues Paper also discusses whether insurers should be treated as knowing the contents of databases readily available to them. These points are not dealt with by the Australian legislation<sup>83</sup> and it would be desirable to clarify them.

**4.15** Fourthly, the assured is not required to disclose a matter as to which compliance with the duty of disclosure has been waived by the insurers (s 21(2)(d)). This general provision is amplified by s 21((3), which provides that where a person has failed to answer, or has given an obviously incomplete answer to, a question in a proposal form<sup>84</sup> the insurers are deemed to have waived compliance unless they follow the matter up. This is to be read with s 27, which states that failing to answer, or providing an incomplete answer to, a question on a proposal form is not to be regarded as a misrepresentation: this section quite properly reverses the common law<sup>85</sup> and also precludes insurers from deeming these matters as misrepresentations.<sup>86</sup> There is a considerable body of English law on the waiver principle as set out in the Marine Insurance Act 1906, and it is settled that there can be waiver where insurers ask limited questions or fail to follow up where what the assured has disclosed is plainly not the full story. It remains the case in both jurisdictions that the insurers cannot be taken to have waived information unless the assured has given the impression of having provided full details.<sup>87</sup> The major unresolved issue in English law is whether the insurers are deemed to have waived disclosure where they have failed to ask any relevant questions at all, although the weight of authority is opposed to waiver in such circumstances.<sup>88</sup> That issue has to a large extent become redundant under Australian law, because s 21A of the 1984 Act – discussed below – now provides that in the case of prescribed policies there is waiver where no questions are asked

#### *Disclosure of obligation to disclose*

**4.16** An important counterweight to the retention of the duty of disclosure by the 1984 Act is the obligation in s 22 of the Act on insurers to “clearly inform the insured in writing of the general nature and effect of the duty of disclosure”, failing which the insurers may not exercise any right in respect of a failure to comply unless the assured was fraudulent.<sup>89</sup> Treasury Review II, 2004, drawing attention to the fact that there is often a lengthy period between the giving of the warning and the making of the contract, has recommended that s 22 be expanded so as to remind the assured that the duty of disclosure continues up to the date the policy is entered into and does not come to an end when the proposal is submitted. This approach was thought to be preferable to the alternative of requiring the insurers to issue a clear warning at the time that the duty of utmost good faith continued up to the making of the contract. The recommendation is enshrined

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<sup>83</sup> It has indeed been held that access to a source of knowledge is not the same as possessing the knowledge itself: *Commercial Union Assurance Co of Australia Pty Ltd v Beard* (2000) 11 ANZ Ins Cas 61-458.

<sup>84</sup> There is no obvious reason why this concept has been confined to answers to questions in proposal forms.

<sup>85</sup> *Roberts v Avon Insurance* [1956] 2 Lloyd’s Rep 240.

<sup>86</sup> ALRC 20, para 184.

<sup>87</sup> *Orb Holdings Pty Ltd v Lombard Insurance Co (Aust) Ltd* [1995] 2 Qd R 51; *New Hampshire Insurance Co v Oil Refineries Ltd* [2003] Lloyd’s Rep IR 386; *Stowers v GA Bonus plc* [2003] Lloyd’s Rep IR 402.

<sup>88</sup> *WISE Underwriting Agency v Grupo Nacional Provincial SA* [2004] Lloyd’s Rep IR 962.

<sup>89</sup> ALRC 20, para 43; Sutton, paras 3.35 to 3.46.

in the revised version of s 22 set out in the Insurance Contracts Amendment Bill 2007. Proposed new s 22(1) provides that the insurer must, before a contract of insurance is entered into, clearly inform the assured in writing of the general nature and effect of the duty of disclosure and that the duty of disclosure applies from the date the information is received by the assured until the proposed contract is entered into. Where this duty has been complied with, then proposed new s 22(3) states that if the contract is made more than two months afterwards, “the insurers must give to the insured, with the acceptance or counter-offer, a reminder notice stating that the duty of disclosure applies until the proposed or other contract is entered into.”<sup>90</sup>

**4.17** There is much authority on what constitutes clear information,<sup>91</sup> although the form of words for disclosure is now prescribed by Regulation.<sup>92</sup> It is uncertain whether s 22 requires the assured to be informed of the nature and effect of the duty of disclosure or whether it is necessary to go further and inform the assured of the consequences of any breach. There is authority supporting the latter, wider view,<sup>93</sup> although the point has since been left open.<sup>94</sup> If it is not reasonably practicable to give notice in writing, it suffices if the information is given orally, eg, by telephone,<sup>95</sup> as long as the notice is confirmed in writing within 14 days of the contract being entered into.<sup>96</sup> The burden of proving that notice was given rests on the insurers.<sup>97</sup> There is no obligation, by s 71, for the insurers to give notice to the assured if the assured has used a broker.<sup>98</sup>

#### *Special treatment of “eligible” policies*

**4.18** Review of the legislation led to the conclusion that warning the assured of the duty of disclosure was not enough to enable him to appreciate its scope and significance. What was required was a provision which placed the onus on insurers to ask specific questions rather than to rely upon disclosure, failing which the duty was to be treated as having been waived. For this reason s 21A was inserted into the 1984 Act with effect from 15 June 2000, replacing an earlier version which came into effect on 1 September 1999.<sup>99</sup> The section draws a distinction between consumer and commercial assureds, in that it applies only to an “eligible” contract of insurance.

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<sup>90</sup> Other amendments to s 22 relate to the proposed new s 31A, which for the first time imposes a duty of disclosure on a person whose life is insured but who is not the policyholder: see *infra*.

<sup>91</sup> Mann, para 22.40.

<sup>92</sup> Insurance Contracts Regulations 1985, reg 3(1) and sched 1, which lay down different forms of wording for life and non-life policies, and also for policies prescribed under s 21A (domestic policies – see *infra*). The Regulations are to be modified to meet the extended duty of disclosure under s 22: see the draft Insurance Contracts Amendment Regulations 2007,

<sup>93</sup> *Suncorp General Insurance Ltd v Cheihk* (1999) 10 ANZ Insurance Cases 61-442.

<sup>94</sup> *GIO General Limited v Wallace* [2001] NSWCA 299.

<sup>95</sup> See *Ghamrawi & Anor v GIO General Ltd* [2005] NSWCA 467.

<sup>96</sup> Insurance Contracts Act 1984, s 69. The Insurance Contracts Regulations 1985, reg 3(2) and sched 2 lay down a form of words to be used when oral information is given in respect of a prescribed policy. Treasury Review II, 2004, recommendation 4.6, recommends that this form of wording be extended to all policies whether or not prescribed: this is to be implemented on the adoption of the draft Insurance Contracts Amendment Regulations 2007.

<sup>97</sup> *Suncorp General Insurance Ltd v Cheihk* [1999] NSWCA 238

<sup>98</sup> The assured would, however, presumably have a cause of action against the broker if he was not informed of his duty. See *supra* on the issue of notice generally.

<sup>99</sup> Sutton, paras 3.82 to 3.86.

That term is defined in reg 2B of the Insurance Contracts Regulations 1985 as referring to: motor vehicle insurance; home buildings insurance; home contents insurance; sickness and accident insurance; consumer credit insurance; and travel insurance. The section only applies to new business and not to renewals, and provides in s 21A(2) that the insurers are deemed to have waived compliance with the duty of disclosure unless they have taken one of two routes.

**4.19** The first route, set out in s 21A(3), is that before the contract has been entered into the insurers have requested the assured to answer one or more specific questions that are relevant to the decision of the insurers to accept the risk and, if so, on what terms. Faced with such specific questions, the assured is treated as having satisfied the duty of disclosure in respect of the contract if he discloses every matter that is known to him and which a reasonable person in the circumstances could be expected to have disclosed by way of answer: s 21A(6). If the assured does not comply with his obligations under s 21A(6), then the duty of disclosure is not waived and the assured will be in breach of it.

**4.20** The second route, set out in s 21A(4), is to protect insurers who believe that there may be exceptional matters of which the assured is aware. The insurers must take two steps. The first step is that in s 21A(3), namely that before the contract has been entered into the insurers have requested the assured to answer one or more specific questions that are relevant to the decision of the insurers to accept the risk and, if so, on what terms. The second step is that the insurers have expressly requested the assured to disclose any exceptional circumstance that: (i) is known to the assured; (ii) the assured knows, or a reasonable person in the circumstances could be expected to know, is a matter relevant to the decision of the insurers whether to accept the risk and, if so, on what terms; (iii) is not a matter that the insurers could reasonably be expected to make the subject of an express question; and (iv) is not excluded from disclosure under s 21(2) (see the discussion, *supra*). Faced with a request for disclosure of exceptional circumstances coupled with specific general questions, the assured is treated as having satisfied the duty of disclosure in respect of the contract if he discloses every matter that is known to him and which a reasonable person in the circumstances could be expected to have disclosed by way of answer, and if he complies with the request to disclose exceptional circumstances: s 21A(7). If the assured does not comply with his obligations under s 21A(7), then the duty of disclosure is not waived and the assured will be in breach of it.

**4.21** It follows that, in the ordinary course of events, if no specific questions have been asked, there is no duty of disclosure at all. It is only when questions are asked that a duty of disclosure arises. The section attempts to discourage general open-ended questions requiring disclosure of other matters that the assured may think relevant. While insurers remain free to ask such general questions, if they do so then the duty of disclosure is deemed to have been waived in respect of such matters and the only possible dispute is as to the correctness of the assured's answers (s 21A(5)).

**4.22** The obligation of the insurers to inform the assured of his duty of disclosure is extended by s 21A to requiring the insurers to inform the assured of the general nature and effect of s 21A.

**4.23** The section is hardly a model of clarity, and Treasury Review II, 2004, has proposed two major reforms which have been adopted by the revised version of s 21A in the draft Insurance Contracts Amendment Bill 2007. First, the section should extend to renewals:<sup>100</sup> the reason why it was initially confined just to placement is uncertain. As is noted in the explanatory notes to the 2007 Bill, the change will mean that insurers will have to ask specific questions both on placement, renewal and on any variation or reinstatement of the policy,<sup>101</sup> a duty which could be satisfied by, for example, providing the assured with a copy of his previous answers, although that approach is not to be mandatory. Secondly, and far more importantly, Treasury Review II recommended the repeal of the exceptional circumstances provisions of s 21A(4)(b) in order to match its proposed amendment of the “prudent assured” test in s 21(1)(b) which is to take into account specific questions asked by insurers.<sup>102</sup> The effect of the proposed amendment is to remove entirely the right of insurers to ask “catch all” questions even to pick up information about exceptional circumstances: instead the risk that such exceptional circumstances might exist is to be borne by the insurers. The draft revised, and far more clear and logical, version of s 21A is as follows

**21A.—***(1) This section applies to an eligible contract of insurance.*

*(2) The insurer is taken to have waived compliance with the duty of disclosure in relation to the contract unless, before the contract is entered into, the insurer requests the insured to answer one or more specific questions that are relevant to the decision of the insurer whether to accept the risk and, if so, on what terms.*

*(3) If:*

- (a) in accordance with subsection (2), the insurer requests the insured to answer one or more specific questions; and*
- (b) the insurer asks the insured to disclose to the insurer any other matters that would be covered by the duty of disclosure in relation to the contract;*

*the insurer is taken to have waived compliance with the duty of disclosure in relation to those matters.*

*(4) If:*

- (a) in accordance with subsection (2), the insurer requests the insured to answer one or more specific questions; and*
- (b) in answer to each specific question, the insured discloses each matter that:*
  - (i) is known to the insured; and*
  - (ii) a reasonable person in the circumstances could be expected to have disclosed in answer to that question;*

*the insured is taken to have complied with the duty of disclosure in relation to the contract.*

*(5) In this section: eligible contract of insurance means a contract of insurance that is specified in the regulations.*

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<sup>100</sup> Recommendation 4.2.

<sup>101</sup> The definition of entering into a contract of insurance includes extension or variation: Insurance Contracts Act 1984, s 11(9).

<sup>102</sup> Recommendation 4.2.



**4.24** The practical effect of s 21A as it stands is to require insurers to ask specific questions rather than to rely on disclosure with regard to prescribed policies. That will be confirmed by the draft amendments. Although the duty is framed as one to disclose, in effect the duty is not to misrepresent. The question then becomes whether insurers should be under a duty to ask the right questions in respect of all policies and not simply in respect of prescribed policies. The Australian approach has been to maintain this distinction, the assumption being that specialist commercial risks and life are more difficult to assess by insurers unaided by disclosure on the part of the assured and that the variable relevant factors are far more numerous in commercial cases than could be contemplated by the insurers in framing their questions. The distinction was criticised as illogical by some Australian lawyers interviewed by the author, although the evidence to the Treasury Review confirmed the need for the distinction and for the right of commercial and life insurers to rely upon disclosure of factors of which they could not possibly have been aware and in respect of which they were not in a position to raise questions. The balance of the argument appears to be in favour of retaining a residual duty of disclosure for bespoke commercial policies and in the life industry and not precluding a general question as other matters which might be covered by the duty of disclosure. That approach was specifically confirmed by the Treasury in its explanatory documents accompanying the draft Insurance Contracts Amendment Bill 2007.

**4.25** That said, it is also to be noted that, in the English market, brokers place the vast majority of policies which would be classified as non-prescribed. If the law remains as it is at present and the broker is treated as the agent of the assured for placement purposes, there is a powerful argument that a broker who failed to ask the right questions or to encourage disclosure would be in breach of duty to the assured, so that if the assured's failure to disclose was the fault of the broker (as opposed to that of the assured in withholding facts known or which ought to be known to be relevant) the insurers would be off risk but the broker would face liability.

## **Misrepresentation**

### *Materiality and inducement*

**4.26** As has been seen above, the duty of disclosure as retained by the Insurance Contracts Act 1984 is a greatly restricted principle: the prudent assured test has replaced the prudent insurer test as the touchstone for what must be disclosed, there is no duty of disclosure in the absence of clear warnings and in the case of "eligible" policies the insurers must ask questions if they wish to have any information. The focus for information-gathering has accordingly switched to misrepresentation. The 1984 Act has dramatically altered the law on misrepresentation, in particular by abolishing the long-established requirement that the insurers must prove that the judgment of a prudent underwriter would have been affected by the misrepresentation and its replacement with a prudent assured test which echoes that applicable to disclosure. Under s 26(2), a false statement is not to be taken as a misrepresentation unless its maker knew, or a reasonable person in the circumstances ought to have known, that the statement would be

relevant to the decision of the insurer whether to accept the risk and, if so, on what terms.<sup>103</sup> Once again the view of the ALRC that the test of knowledge should take account of factors intrinsic to the assured<sup>104</sup> was rejected in favour of a more objective approach based on a reasonable person in the circumstances, although it has been held that hindsight is not a part of the test.<sup>105</sup> Section 26(2) does provide some leeway to an assured who makes a false statement in the belief that it doesn't matter. If, for example, an assured aged 60 is asked his age, which he states to be 59 while unaware of the fact that the insurers do not insure people aged 60 or more, he would not be guilty of misrepresentation under s 26(2).<sup>106</sup> The change does not apply to marine insurance, and the ALRC in its 2001 Report on marine insurance felt that it would be correct to retain the existing law.<sup>107</sup>

**4.27** It is to be assumed that the 1984 Act has not abolished the common law principle that a statement is to be treated as a representation only if, viewed objectively, it can be taken to be such. Pre-contract puffery is not treated as the making of a representation, and there seems no reason why the law should be any different under a statutory regime.

### *Statements of fact*

**4.28** An assured who is asked a straight factual question which he answers incorrectly is not necessarily guilty of misrepresentation. He has the enhanced protection of s 26(2) in place of the common law objective materiality principle, so that his statement is only capable of being treated as a misrepresentation if he knows or a person in his position ought to have known that it would have been relevant to the insurers. That is not the end of the matter, because even if the assured was or should have been so aware, the insurers are under s 28 entitled to a remedy only if they were induced, and even the remedy then varies depending upon the assured's state of mind – only fraud gives a right of avoidance. The protection for the assured is thus switched from objective materiality to subjective intentions.

**4.29** Section 23 of the 1984 Act regulates the position where the assured falsely answers an ambiguous question. The key words are in s 23(b): if the assured gives a false answer to a question, and “a reasonable person in the circumstances would have understood the question to have the meaning that the person answering the question apparently understood it to have, that meaning shall ... be deemed to be the meaning of the question”. This is a watered down version of the ALRC's proposal that the focus should be on a person in the assured's position rather than on a reasonable person,<sup>108</sup> so that once again “intrinsic” factors are omitted from consideration. The section probably reflects the common law requirement for actual rather than manufactured ambiguity,<sup>109</sup> the use of the word “would” confirming that the question was ambiguous and not

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<sup>103</sup> Sutton, paras 3.127 to 3.129. The burden of proof is on the insurers: *Plasteel Windows Aust Pty Ltd v C E Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cas 60-926

<sup>104</sup> ALRC 20, para 184.

<sup>105</sup> *Manchester Utility Total Care Building Society v MGICA Ltd* (1991) 6 ANZ Ins Cas 61-062.

<sup>106</sup> Notes to the draft Insurance Contracts 1982 Bill, cl 27, cited in Mann, para 26.10.

<sup>107</sup> ALRC 91, para 10.97.

<sup>108</sup> ALRC 20, para 184.

<sup>109</sup> The cases are too numerous to cite. See, eg, *Youell v Bland Welch (No 1)* [1992] 2 Lloyd's Rep 127.

merely that it was possible to give the question more than one meaning.<sup>110</sup> Section 23(b) appears to operate whether the proposal form is drafted by the insurers or by the broker, although the common law by treating the broker as the agent of the assured strips *contra proferentem* protection from the assured in this case.<sup>111</sup>

### *Statements of opinion/belief*

**4.30** The common law requires an opinion to be honestly held. A statement of the opinion or belief is a factual statement, but it relates to the state of the assured's mind rather than to the objective correctness of what he has said. The English cases are not fully consistent on the point, but they seem to indicate that honesty is not the entire story,<sup>112</sup> in that there probably has to be some objective basis on which the assured's opinion or belief is held.<sup>113</sup> Perhaps a better way of looking at the matter is to say that the more outrageous the belief, the less likely it is to be honestly held. The 1984 Act deals specifically with this matter. Section 26(1)<sup>114</sup> provides that if the assured makes a statement as to his belief, then as long as the assured did indeed hold that belief and a reasonable person in the circumstances would have held that belief,<sup>115</sup> the statement is to be regarded as true. Section 26(1) thus appears to be a dilution of the assured's rights when set against the common law, but it may be thought to be a change which is justified.<sup>116</sup>

**4.31** The 1984 Act also deals with the specific problem which arises where the assured is asked to state his belief as to the existence or otherwise of pre-existing defects in insured property or pre-existing medical conditions. The 1984 Act contains two sections concerned with the problem of pre-existing defects.<sup>117</sup> Section 46 states that the insurers under a policy falling within a specified class – the relevant classes being construction, commercial, mechanical breakdown, products liability and accidental loss<sup>118</sup> – cannot rely upon any clause excluding liability for a pre-existing defect if the assured was not aware of the defect and a reasonable person in the circumstances would not have been aware of the defect. The principle is extended to life policies by s 47.<sup>119</sup> Although these provisions are on their face directed to policy terms, their purpose is to prevent insurers from sidestepping the rule in s 26(1) that an untrue statement is not to be

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<sup>110</sup> Sutton, paras 3.115 to 3.118; *Fruehauf Finance Corp Pty Ltd v Zurich Aust Insurance Ltd* (1990) 20 NSWLR 359; *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1987) 4 ANZ Ins Cas 60-813.

<sup>111</sup> *Pearson v Excess Insurance* 1988, unreported.

<sup>112</sup> Even though s 20(4) of the Marine Insurance Act 1906 seems to imply that honesty is the only issue.

<sup>113</sup> *Economides v Commercial Union Assurance plc* [1997] 3 All ER 635; *Rendall v Combined Insurance Co of America* [2006] Lloyd's Rep IR 732.

<sup>114</sup> Sutton, paras 3.124 to 3.126.

<sup>115</sup> Once again departing from the view in ALRC 20 that the matter should be looked at from the point of view of a person in the assured's actual position. See *Fruehauf Finance Corp Pty Ltd v Zurich Australian Insurance Ltd* (1990) 6 ANZ Ins Cas 61-104.

<sup>116</sup> It is unclear where the burden of proof lies: the point was left open in *Plasteel Windows Aust Pty Ltd v C E Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cas 60-926 and again in *Schaffer v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] QCA 182.

<sup>117</sup> Adopting ALRC 20, para 184.

<sup>118</sup> Insurance Contracts Regulations 1985, SR 1985 No 162, reg 30.

<sup>119</sup> See *Asteron Life Ltd v Zeiderman* [2004] NSWCA 47, in which it was held that a policy term which excluded the liability of the insurers for certain diseases first diagnosed within the first three months of cover was within the mischief which s 47 sought to remedy.

treated as misrepresentation if it was made on the basis of a belief held by the assured and which would have been held by a reasonable person in the circumstances. The use of a clause excluding liability in these circumstances would render s 26(1) of little effect.<sup>120</sup>

**4.32** Section 25 seeks to overcome a particular problem faced by life insurers where the policyholder and the life assured are different persons. The abolition of warranties by s 24 of the 1984 Act removes the possibility of the insurers obtaining a warranty from the policyholder as to the health of the life assured. They remain free to ask the policyholder questions about the life assured, but necessarily these can only be answered to the best of the policyholder's knowledge and belief and all that is required of the policyholder under s 26 is honesty. The solution may be to ask questions of the life assured himself. When warranties were available to insurers, they were free to ask the policyholder to warrant the health of the assured. The abolition of warranties removed this protection from them, and it was accordingly recommended by the ALRC<sup>121</sup> that if insurers were to ask questions directly of the life assured, any false answers by him<sup>122</sup> should be treated as having been made by the policyholder himself.<sup>123</sup> At present there is no duty of disclosure imposed upon the life assured, although the draft Insurance Contracts Amendment Bill 2007 will amend the Act to this effect: the suggested provision is discussed below.

**4.33** In practice an extensive medical is required in Australia. The author is uncertain of the extent to which insurers do seek information directly from the life assured in this jurisdiction, but if this is a widespread practice then the section, and arguably its extension to non-disclosure, is clearly an important protection for insurers.

#### *Misrepresentation by placing brokers*

**4.34** The Insurance Contracts Act 1984 does not make express provision for the situation in which a placing broker has misrepresented an inducing fact to insurers, and it is not clear whether the knowledge of relevance and truth referred to in s 26 is that of the assured or that of his broker. It is suggested below in the discussion of the role of brokers that a false statement by a broker which does not originate from the assured should not amount to a breach of duty by the assured himself.

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<sup>120</sup> These sections were analysed by Treasury Review II, 2004, Chapter 8, but were found to be working satisfactorily.

<sup>121</sup> ALRC 20, para 185.

<sup>122</sup> English practice in life insurance, at least since the first ABI Statement of Practice in 1977, has been to confine answers on health to the best of the proposer's knowledge and belief.

<sup>123</sup> This problem is not confined to life insurance. In the case of business interruption insurance taken out by the promoters of sporting, musical or other events, there will generally be a question concerning the assured's knowledge as to the health of the performer. It is not usual to ask questions of the performer, who is probably unaware that the insurance is in place. See, for a case where the performer was probably unable to appreciate much beyond playing slide guitar, *Gerling Konzern General Insurance v Polygram Holdings Inc*[1998] 2 Lloyd's Rep 544.

## Brokers<sup>124</sup>

### *Disclosure by placing brokers*

**4.35** As the law in the UK stands at the moment, the assured is under s 18 of the Marine Insurance Act 1906 required to disclose what he actually knows, which includes the knowledge of any agent who was under a duty to know that information and to provide it to the assured. Further, where insurance is placed by an agent to insure (normally a placing broker), the agent is under s 19 of the Marine Insurance Act 1906 required to disclose not just what the assured knows (s 19(b)) but also what the agent knows or ought to have known in the ordinary course of his business (s 19(a)). Difficulties have arisen under s 19(b) in respect of fraud by the agent, in respect of the definition of agent to insure and also in respect of the type of knowledge disclosable by the agent, in particular whether it is confined to information known to him by reason of his agency agreement with the assured or whether it extends to information of which he is aware by reason of his status as a market professional.<sup>125</sup>

**4.36** In the context of non-marine insurance law in Australia, section 21 of the Insurance Contracts Act 1984 does not contain any express provision with regard to the knowledge of agents or with regard to the placing of risks by brokers. As far as imputation of knowledge to the assured from an agent is concerned, insurers have the benefit of the common law imputation of knowledge principle from agent to principal. Section 21 says nothing specific about this, but it is inherent in the legislation that information known to a broker or other agent employed by the assured to place the risk is deemed to be known to the assured and thus has to be disclosed if it meets the other requirements of s 21.<sup>126</sup> Moreover, as far as the test for knowledge of relevance are concerned, the broker will almost inevitably be aware of the relevance of information to the insurer in question, the assured will be bound by that knowledge,<sup>127</sup> and even if the broker is not actually aware of the relevance of the information, it is apparent that – in the terms of the fallback test in s 21(1)(a) – a reasonable broker in his position ought to have been so aware.<sup>128</sup> The question whether the broker's knowledge of the relevance of a fact rendered the fact one which had to be disclosed under s 21 is unresolved, the New South Wales Supreme Court holding in *Permanent Trustee Australia Co Ltd v FAI Insurance Co Ltd*<sup>129</sup> that this is the case, with that approach being strongly doubted<sup>130</sup> but not actually rejected on appeal.<sup>131</sup> In short,

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<sup>124</sup> Sutton, paras 3.179 to 3.194

<sup>125</sup> The leading authorities are *PCW Syndicates v PCW Reinsurers* [1996] 1 All ER 774 and *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 All ER 791.

<sup>126</sup> *Ayoub v Lombard Insurance Co (Aust) Pty Ltd* (1989) 5 ANZ Ins Cas 60-933; *Lindsay v CIC Insurance Ltd* (1989) 16 NSWLR 673; *Macquarie Bank Ltd v National Mutual Life Association of Australasia Ltd* (1996) 40 NSWLR 543. Cf *Smits v Roach* [2006] HCA 36.

<sup>127</sup> *Evans v Sirius Insurance Co Ltd* (1986) 4 ANZ Ins Cas 60-755.

<sup>128</sup> The test applied in *Plasteel Windows Aust Pty Ltd v C E Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cas 60-926.

<sup>129</sup> (1998) 44 NSWLR 186.

<sup>130</sup> The High Court was clearly not enamoured with the decision of the lower court on this point.

<sup>131</sup> (2003) 197 ALR 364. Treasury Review II, 2004, considered this issue but decided that the law should not be changed and that the question should be resolved on its merits: paras 4.38 and 4.39. The issue was in effect ducked. The February 2007 proposals for amending legislation are silent on the point.

therefore, an assured who uses a broker to place the risk may find that he is guilty of non-disclosure by reason of facts known to his broker but not known to him, or by reason of the broker's knowledge of the relevance of facts to the particular insurer which was not appreciated by the assured himself.

**4.37** As far as the marine market is concerned, the operation of s 19 was considered by the ALRC in its 2001 Report, but somewhat surprisingly the Report did not address any of the matters of doubt raised by the English cases which have discussed the section. Instead the ALRC focused on the decision of Ormiston J in *Helicopter Resources Pty Ltd v Sun Alliance Insurance Ltd*,<sup>132</sup> in which it was held that insurers were entitled to avoid a policy by reason of the placing broker's failure to disclose the manner in which helicopters were secured and lashed on board the insured vessel, a fact not known to the broker but which the judge held he ought to have been aware. The judge went on to find that the broker was in breach of his duty to the assured, which included an obligation to inform himself of the nature of his client's business activities. The ALRC felt that this case placed the broker's duty too high, and recommended reforming s 19(a) so that the broker was required to disclose only facts which he actually knew to be material, or that a reasonable person in the circumstances would know to be material.<sup>133</sup> The ALRC also recommended that the concluding words of 19(a), requiring the broker to disclose facts which ought to have been communicated to him but which he did not otherwise know, should be repealed. This recommendation is a limited one, not the least because if the fact is material and known to the assured<sup>134</sup> then the broker's duty to disclose it arises under s 19(b), and s 19(a) is not engaged at all: the effect of the recommendation would be to retain the duty of disclosure as far as the insurers are concerned, but to remove the broker's liability to the assured in circumstances where the assured had not communicated the true facts to the broker (the issue in *Helicopter Resources*). ALRC 16 and ALRC 91 did not recommend any change in the law with respect to the agency of brokers in the placement process. Following the repeal of the Insurance Agents and Brokers Act 1984 and its replacement with self-regulation, brokers are governed by a Code of Practice monitored by the Insurance Brokers' Compliance Council and by a dispute resolution mechanism, the Insurance Brokers' Dispute Facility. The Code deals with consumer policies and small business policies (defined in terms of the number of employees [no more than five] and turnover [not exceeding A\$350,000]). The Code contemplates that the broker is the agent of the assured for most purposes, in particular for the placing of cover.

**4.38** If there is to be any move to the introduction of a prudent assured test of materiality in the UK, it is obvious from *Permanent Trustee* that there are immediate implications for s 19. If it remains the case that the knowledge of the broker is the knowledge of the assured, then any assured who uses a broker will be deemed to be aware of facts which are known to the broker but not to the assured, and he is also to be judged by the standard of a reasonable broker's appreciation of the relevance of the facts to the insurers. In short, without reform of s 19 any move to a prudent assured test would – at least in commercial insurance and reinsurance – be negated. There are various solutions to this question: (a) leave the law as it is, so that a

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<sup>132</sup> Unreported, Supreme Court of Victoria 26 March 1991.

<sup>133</sup> ALRC 91, paras 10.30-10.35, 10.96.

<sup>134</sup> As will be seen below, ALRC 91 recommended that the test of materiality be altered to that of prudent assured, but this does not alter the point being made here.

“prudent broker” test can be used, leaving the assured to recover from the broker in the event of any failure to disclose by the broker; (b) repeal s 19 entirely so that the broker is no longer under a duty to disclose facts known to him but not known to the assured;<sup>135</sup> (c) retain s 19 but in a modified form, so that the broker remains in breach of duty to the insurers if he fails to disclose relevant facts of which he knows, but that the insurers’ remedy is not to avoid the policy but to sue the broker for any loss suffered; or (d) reverse the existing presumption that the broker is the agent of the assured for placement purposes. Brokers in their everyday activities carry out functions for both parties, and the law seems to accept that the commission received by brokers is payment by underwriters for finding business.<sup>136</sup> The relationship between brokers and underwriters in the London market is typically a close one, and the existing principle maintains the notion that a broker should be treated as the agent of a person, the assured, where his day to day relationship with the underwriters is likely to be much closer. These points were made by the Court of Appeal in *Roberts v Plaisted*.<sup>137</sup>

### *Misrepresentation by placing brokers*

**4.39** As the law stands at present in both England and also in Australia under the Insurance Contracts Act 1984, any false statement by the broker to the insurers in respect of a fact which induces them in some respect puts the assured in breach of duty. This is so whether the source of the falsehood is the broker himself, or the assured in his responses to the broker. What is less certain is whether the knowledge of the broker as to the relevance and truth of facts misstated is to be imputed to the assured or whether the knowledge is to be regarded as held by the broker on behalf of the assured.

## **Remedies**

### *Outline*

**4.40** The ALRC discussed in detail the operation of the avoidance remedy for non-disclosure and misrepresentation at common law. The ALRC’s view<sup>138</sup> was that avoidance was often a disproportionate remedy in that the loss suffered by the insurers – possibly a small increase in premium – would bear no relation to depriving the assured of the entire benefit of the policy. The ALRC noted that avoidance outside insurance law worked more or less fairly in that the parties would be restored to their pre-contractual position with all property retransferred, whereas in insurance the avoidance would almost inevitably take place after a loss had occurred. However, the right of avoidance should be retained where the assured had been fraudulent, given that insurers were entitled to refuse to contract with fraudsters and also that any other approach would not provide an appropriate disincentive to fraud, subject nonetheless to a discretion in the court to make some award in appropriate circumstances. Outside fraud cases the ALRC felt that

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<sup>135</sup> Alternatively, such facts could be deemed immaterial.

<sup>136</sup> See the discussion in *Carvill America Inc v Camperdown UK Ltd* [2005] Lloyd’s Rep IR 55.

<sup>137</sup> [1989] 2 Lloyd’s Rep 341.

<sup>138</sup> ALRC 20, paras 186-199.

the matter could be resolved by an award of damages to the insurers. It rejected any form of proportionality, eg, by awarding the assured that proportion of the loss which his actual premium bore to the premium which would have been charged, or by requiring the assured to pay the additional premium, on the ground that it might not be easy to work out what the actual premium would have been. Instead it recommended the contractual measure of damages. All remedies were, however, to be subject to the overriding need of the insurers to prove that the assured's presentation of the assured had a causal effect on the insurers, ie, that they had been induced to act differently by the assured's non-disclosure or misrepresentation.

**4.41** The ALRC's recommendations were adopted by the 1984 Act. An initial distinction is drawn between general and life insurance. As far as general insurance is concerned, the insurers must initially prove inducement (s 28(1)). If that is shown, then there is a right to avoid for fraud (s 28(2)) subject to the discretion of the court to disregard the avoidance (s 31), and in the absence of fraud the insurers are held to damages (s 28(3)).<sup>139</sup> The insurers also have the right to cancel the policy, but not with retroactive effect (s 60). Life insurance is treated a little differently: the same basic rules apply, with the modification that even in the absence of fraud a life insurer who would not have entered into the contract with a fair presentation by the assured is entitled to avoid within three years (s 29), and cancellation is not possible. Life is considered separately below. No other remedies, including other remedies potentially available at common law, can be used in insurance cases.<sup>140</sup>

**4.42** The ALRC's subsequent report on the reform of marine insurance law rejected some elements of the 1984 Act.<sup>141</sup> The right to avoid for fraud, and without return of premium has been endorsed. If the breach is not fraudulent, the ALRC recommended that the insurers should have the right to avoid the contract (coupled with a return of premium) if they can prove that it would not have entered into the contract at all: this was regarded as preferable to damages plus a right to cancel. In the absence of proof that the insurers would have refused to issue the policy but it is shown that they would have written the risk on different terms, the insurers are to remain on risk but they are not liable to indemnify the assured for any loss proximately caused by the undisclosed or misrepresented circumstances and they may cancel the policy.

### *The inducement requirement*

**4.43** At the time of the 1982 Report of the ALRC the common law had not taken the step of requiring proof by the insurers not just of materiality but also of their inducement in the form of reliance on the presentation made by the assured. That proposition was not confirmed until *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*<sup>142</sup> in 1994. The ALRC nevertheless thought that inducement was a necessary requirement, and chose to incorporate this change in

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<sup>139</sup> See Pickering "Proving Underwriting Practices in Court on Issues of Non-Disclosure and Breach of Contract" (1989) 4 Ins LJ 52.

<sup>140</sup> Insurance Contracts Act 1984, ss 15 and 33.

<sup>141</sup> ALRC 91, paras 10.118-10.120.

<sup>142</sup> [1994] 2 Lloyd's Rep 427.



the section of the legislation dealing with remedies rather than in the definition of what had to be disclosed. This is really a drafting matter and nothing appears to turn on the point.<sup>143</sup>

**4.44** English law has taken important steps to define inducement. *Drake Insurance v Provident Insurance*<sup>144</sup> decides that the question to be asked in considering inducement is whether the insurers would have acted differently had the true facts been known to them, a process which requires making the assumption that there had been a proper presentation of the risk and that – in response to the insurers’ refusal of the risk or demand for an increased premium or different terms – there would have been a dialogue between the insurers and the assured which might ultimately have led to insurance on the original terms. Plainly this could not have been contemplated by the ALRC, and although the decision is not free from criticism<sup>145</sup> it now seems to be established.<sup>146</sup> The definition of inducement in s 28(1) is plainly capable of the same interpretation. It provides that the insurer has no remedy if:

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.

To prove inducement, insurers need to have evidence of their office practice and underwriting guidelines to show that a different decision would have been reached.<sup>147</sup>

## *Fraud*

**4.45** *What is fraud?* The right of insurers to avoid for non-disclosure or misrepresentation depends upon proof of fraud. There is no definition of fraud in s 28.<sup>148</sup> Professor Sutton’s definition of fraud as “a deliberate decision by the assured to mislead or conceal something from the insurer, or recklessness amounting to indifference about whether this occurs”<sup>149</sup> has been adopted by the courts<sup>150</sup> and accords with English law.<sup>151</sup> There is an element of double-counting

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<sup>143</sup> ALRC 91 adopted the same approach for marine insurance: para 10.97. This was to make it clear that under its proposals materiality was primarily objective whereas inducement was entirely subjective, and it was necessary to separate out the two concepts to avoid confusion.

<sup>144</sup> [2004] Lloyd’s Rep IR 277.

<sup>145</sup> The argument was rejected at first instance by Moore-Bick J and by Pill LJ in the Court of Appeal, each of whom felt that the approach ultimately adopted by the majority (Clarke and Rix LJ) simply piled speculation on speculation.

<sup>146</sup> *Bonner v Cox* [2006] Lloyd’s Rep IR 385; *Meisels v Norwich Union* [2007] Lloyd’s Rep IR 00

<sup>147</sup> *Delphin v Lumley General Insurance Ltd* (1989) 5 ANZ Ins Cas 60- 941. For the meaning of inducement, see *Hendry Rae and Court v FAI General Insurance Co Ltd* (1991) 5 WAR 376 (Supreme Court of Western Australia), where it was held that if the matter not disclosed would have been the subject of a policy exclusion had it been disclosed, there was the necessary inducement to enter into the contract on different terms. See also *McNeill v O’Kane* [2002] QSC 144.

<sup>148</sup> Recklessness may suffice. See the authorities discussed in Mann, para 28.20.1. The extension of fraud to reckless conduct is consistent with English law, both in respect of misrepresentation and in respect of fraudulent claims. In both jurisdictions negligence is not fraud: *Australian Casualty & Life Ltd v Hall* (1999) 151 FLR 360.

<sup>149</sup> Sutton, para 3.138.

<sup>150</sup> *Von Braun v Australian Associated Motor Insurers* (1998) 135 ACTR 1; *NRG Victory Australia Ltd v Hudson* [2003] WASCA 291.

here, in that there can be non-disclosure or misrepresentation by the assured under the prudent assured test only when he knew or ought to have known that the fact withheld or misstated was relevant to the insurers. Some degree of fraud is to that extent incorporated into the very definition of the assured's duties. However, a finding of fraud is not inevitable in every case. There can only be fraud if the assured: (a) knew of the fact, or at the very least shut his eyes to its existence; and (b) knew it to be relevant to the insurers; and (c) deliberately chose to withhold or to misstate it.<sup>152</sup> Knowing a fact but choosing not to disclose it is not fraud if the assured did not know of its relevance.<sup>153</sup>

**4.46** In non-disclosure cases requirements (a) and (b) are almost by definition required to establish non-disclosure in the first place, so that the question of fraud may focus on (c). What is the position where the assured has disclosed the relevant facts to his broker, but the broker, in the knowledge that the facts are relevant, has fraudulently withheld them from the insurers. The point was considered in *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd*,<sup>154</sup> and it was assumed – without the point being decided – that the assured was to be treated as himself being fraudulent in that scenario. In such a case it seems harsh to describe the assured himself as having acted fraudulently, but even if that is wrong it may be that the court would provide relief under s 31.

**4.47** In misrepresentation cases only element (b) is part of the definition of misrepresentation. The assured may make a false statement even though he is unaware that it is false, while at the same time appreciating that his answer was relevant to the insurers. It follows that there is a lesser connection between misrepresentation and fraud than there is between non-disclosure and fraud. The same broker problem arises here as arises with non-disclosure, in the case where the broker with knowledge of the relevance of a fact transmits a false answer to the insurers.

**4.48** *The right of avoidance and its limits.* Although the right of avoidance for fraud is on the face of s 28 unlimited, it is subject to what seems to be a controversial limitation in s 31. The ALRC accepted that avoidance should normally be allowed, but was concerned that in some cases avoidance would be a disproportionate remedy. The ALRC accordingly recommended<sup>155</sup> that the court should have an ultimate power of adjustment. Section 31 thus provides that a court may disregard an avoidance and order the insurers to pay some or all of a claim<sup>156</sup> consistently with what is just and equitable in the circumstances. The section is curiously drafted, and contains cautions at every step. Payment can be ordered if avoidance would be “harsh and unfair”; the amount payable has to be “just and equitable in the circumstances”; the insurers must not have been prejudiced at all or at most only to a minimal or insignificant degree by the misrepresentation or non-disclosure; the court must have regard to the need to deter fraudulent conduct in relation to insurance; and the culpability of the assured must be weighed against the magnitude of the loss that he would suffer if avoidance was permitted. The power has been

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<sup>151</sup> *Derry v Peek* (1889) 14 App Cas 337.

<sup>152</sup> See, for an example, *Muggleston v National Mutual Life Association of Australasia Ltd* [2004] NSWSC 913.

<sup>153</sup> *Australian Casualty and Life Ltd v Hall* (1999) 151 FLR 360.

<sup>154</sup> (2001) 187 ALR 380 (NSWCA).

<sup>155</sup> ALRC 20, para 196.

<sup>156</sup> Apart from payment, the avoidance holds good: s 31(4).

exercised sparingly and the section will not be of assistance if the insurers would not have taken the risk had there been full disclosure.<sup>157</sup> Indeed, s 31 appears to be most helpful to an assured whose fraud was relevant only to a small element of the risk<sup>158</sup> or who has suffered through the fraud of his broker,<sup>159</sup> and it has also been held that the fact that the assured might have a good claim against his broker in the event he that made no recovery from his insurers did not affect the power of the court to grant s 31 relief.<sup>160</sup>

**4.49** The Law Commissions have thus far rejected the Australian approach, but s 31 has not given rise to serious practical problems,<sup>161</sup> its desirability has been recognised by underwriters in Australia and as a matter of principle providing an absolute rule probably does more harm than good. Indeed, Treasury Review II, 2004, noted that the bulk of the evidence received by it was in favour of retaining s 31.<sup>162</sup>

**4.50** *Effect of avoidance on settlement contracts.* The 1984 Act does not attempt to resolve the restitutionary issue which arises where a claim has been agreed by the insurers and they then discover their right to avoid the policy. English law has taken the view that the settlement is a contract entirely separate from the policy itself so that unless the settlement contract has itself been induced by misrepresentation it remains valid despite the avoidance of the policy.<sup>163</sup> This seems to hold good even though the assured has been fraudulent in his presentation of the risk for the policy.<sup>164</sup> There is a debate to be had on whether this is an appropriate outcome. The matter is complicated by the fact that not all settlements are contracts. In some cases, mainly domestic, insurers just pay. Whether sums are recoverable here depends upon the complex rules relating to change of position in respect of money paid under mistake.<sup>165</sup>

**4.51** *Effect of fraud on premium.* The insurers are not required to refund the premium if they avoid for fraud,<sup>166</sup> a rule which in this jurisdiction is enshrined in s 84 of the Marine Insurance Act 1906

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<sup>157</sup> See *Burns v MMI-CMI Insurance* (1995) 8 ANZ Ins Cas 61-287; *Plasteel Windows Aust Pty Ltd v C E Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cas 60-926; *Boekenstein v Tyndall Life Insurance Co Ltd* 1997, unreported, NSW Sup Ct; *Tyndall Life Insurance Co Ltd v Chisholm* (2000) 11 ANZ Ins Cas 90-104; *Porter v GIO Australia Ltd* [2003] NSWSC 668.

<sup>158</sup> As in *Von Braun v Australian Associated Motor Insurers Ltd* (1989) 10 ANZ Ins Cas 61-419 where the assured claimed that he had paid A\$70,000 for his vehicle when in fact he had probably paid only A\$56,000. The court held that if the truth had been told, the parties would have reached an agreed valuation of around A\$60,000 and the assured should be allowed to recover the lowest possible value of his vehicle, A\$56,000.

<sup>159</sup> *Evans v Sirius Insurance Co Ltd* (1986) 4 ANZ Ins Cas 60-755.

<sup>160</sup> *Plasteel Windows Aust Pty Ltd v C E Heath Underwriting Agencies Pty Ltd* (1989) 5 ANZ Ins Cas 60-926;

<sup>161</sup> See Sutton, paras 3.164 to 3.166.

<sup>162</sup> Chapter 8. Section 31 is, under the draft Insurance Contracts Amendment Bill 2007, to be extended to non-fraudulent breaches of duty: see *infra*.

<sup>163</sup> Most settlements are expressed to be “full and final”, although the principle does not appear to be limited to those cases

<sup>164</sup> All of this follows from the overruling of *Magee v Pennine Insurance Co* [1969] 2 QB 507 by *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] 2 Lloyd’s Rep 653.

<sup>165</sup> See *Scottish Equitable plc v Derby* [2001] 2 All ER (Comm) 274.

<sup>166</sup> *Nasser v AAMI Insurance P/L (General)* [2005] NSWCTTT 478.

### *Cases other than fraud: damages*

**4.52** The ALRC recommended that for non-fraudulent claims the insurers should be entitled to damages based on the contract measure. Accordingly, s 28(3) provides that “the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure [to disclose] had not occurred or the misrepresentation had not taken place”. The ALRC summarised the contract measure in the following propositions:<sup>167</sup>

- (1) where the insurer would not have accepted the risk on any terms at all, its loss is the total amount of the claim made against it;
- (2) where the insurer would have accepted the risk for a different premium, its loss is the difference between the two premiums;
- (3) where the insurer would have accepted the risk on different terms, its loss is the difference between the amount for which it would have been liable but for its statutory entitlement to reduce the claim and the amount for which it would have been liable under a contract incorporating the different terms.

**4.53** Proposition (1) has proved controversial because it entails the suggestion that liability for the claim under s 28(3) can be reduced to nil, although the insurer will remain liable to repay the premium to the assured on the basis that the risk would never have been accepted. After a good deal of vacillation on the point,<sup>168</sup> it is now clear that proposition (1) holds good and that liability can be reduced to nil if the insurers would never have insured had the full facts been known.<sup>169</sup> Proposition (2) has yet to be tested, and there is a view that the amount of the claim to be paid is the proportion of the total premium that would have been charged which is represented by the amount of the premium actually paid,<sup>170</sup> a suggestion at variance with the ALRC’s own rejection of proportionality. The alternative suggestion<sup>171</sup> that the correct measure is the amount of additional premium that the assured would have paid on full disclosure, so that the insurers have to pay the full claim minus that additional premium, is not good law.

**4.54** The Australian approach is far from satisfactory. It has generated a mass of confusing and not particularly logical case law and has left the courts to develop their own principles on the assessment of damages.<sup>172</sup> Further, as seen below, proportionality is the approach adopted in life insurance cases. It is also unclear exactly when the premium is to be refunded: the Act is silent on the point, although it seems to be accepted that the premium is to be refunded in the absence of fraud.<sup>173</sup> A further problem is that fraudulent assureds may be treated better than non-

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<sup>167</sup> Cited by Kate Lewins, *op cit*.

<sup>168</sup> The cases are analysed in Mann, paras 28.30.1 to 28.40 and in Sutton, paras 3.140 to 3.142.

<sup>169</sup> Sutton, paras 3.142 to 3.145. See in particular: *Lindsay v CIC Insurance Limited* (1989) 16 NSWLR 673; *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1987) ANZ Ins Cas 60-813; *Unity Insurance Brokers Pty Ltd v Rocco Pezzano Pty Ltd* (1998) 193 CLR 603; *McNeill v O’Kane* [2002] QSC 144; *GIO General Ltd v Wallace* [2001] NSWCA 299; *Anderson v Aon Risk Services Australia Ltd* [2004] QSC 049.

<sup>170</sup> Lewins, *op cit*.

<sup>171</sup> By Deane J in *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606.

<sup>172</sup> The same problems have arisen under s 54(3): see *infra*.

<sup>173</sup> *Anderson v Aon Risk Services Australia Ltd* [2004] QSC 049.

fraudulent assureds: a fraudster may have the policy avoided under s 28 but he may receive the benefit of avoidance being disregarded under s 31, whereas in the case of non-fraudulent breach of duty the court may assess damages as reducing the assured's recovery to zero: this potential inconsistency was addressed by Treasury Review II, 2004, which recommended that s 31 should be extended to cases of non-fraudulent breach of duty, so that in exceptional circumstances innocent or negligent breach of duty could be excused entirely.<sup>174</sup> This recommendation has been accepted by the Treasury, and the draft Insurance Contracts Amendment Bill 2007 sets out a new version of s 31 which extends the discretion in s 31 to cases of innocent or negligent breach of duty. The revised provision applies where "the liability of the insurer in respect of the loss that is the subject of the proceeding has been significantly reduced (including being reduced to nil), under subsection 28(3) on the ground of a failure to comply with the duty of disclosure or a misrepresentation" (revised draft s 31(1)). In those circumstances, under revised draft s 31(1A)

- (a) *the court may, if it would be harsh and unfair not to do so, disregard the avoidance or reduction of liability; and*
- (b) *if it does so, the court must allow the insured to recover the whole, or such part as the court thinks just and equitable in the circumstances, of the amount that would have been payable if the contract had not been avoided or the insurer's liability had not been reduced.*

In determining whether or not to exercise this discretion the court, under revised draft s 31(3):

- (b) *must weigh the extent of the culpability of the insured in relation to the failure or misrepresentation against the magnitude of the loss that would be suffered by the insured if the avoidance or reduction of liability were not disregarded;*

**4.55** Even with the implementation of these proposed amendments, it might be thought that clearer guidance on what is to happen in the absence of fraud is necessary. Those in the Australian market interviewed by the author were dismissive, on the ground of undue complexity, of the Law Commissions' recommended approach of distinguishing between innocent and negligent breach of duty and of taking into account proportionality, the availability of other policies and the like. Their own approach has, to English eyes, equal complexity and, arguably, undue harshness. The proposals made by ALRC 91 in respect of marine insurance are more logical, in that they do seem to reflect precisely the consequences of a breach of duty by the assured: fraud is fatal; non-fraud is dealt with by reference to how the insurers would have reacted with full disclosure. What is of interest is that both ALRC Reports have rejected the need to distinguish between types of non-fraudulent conduct in the manner suggested by the Law Commissions.

### *Cancellation*

**4.56** Under s 60 of the Insurance Contracts Act 1984 the insurers (other than life insurers) are entitled to give notice of cancellation of the policy in the event of the assured's failure to disclose

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<sup>174</sup> Recommendation 8.2.

relevant facts or the assured's misstatement of relevant facts, contrary to the above provisions. Cancellation is not automatic but has to be preceded by notice under s 59: 14 days for general insurance and 20 days in the case of life insurance. This means that if the insurers are unable to avoid (avoidance only being open to them in the case of fraud) the policy remains valid and the assured is entitled to be paid his claim subject to any relevant deduction under s 28(3). The right to cancel on its face appears to be a very blunt weapon and the author is of the view that there should be some restriction on the right, perhaps confined to cases in which the insurers would never have insured at all had the true position been known. There is certainly an argument that permitting the policy to continue on varied terms is a far better prospect in cases where the insurers would not have declined cover.

#### *Life insurance: misrepresentation*<sup>175</sup>

**4.57** It was noted earlier that s 25 of the Insurance Contracts Act 1984 deals with the situation in which the policyholder and the life assured are not the same person, and that the effect of s 25 is to treat any false statement by the life assured as if it had been made by the policyholder. As will be seen below, it is proposed to extend this principle to non-disclosure by the life assured.

**4.58** Life policies are commonly made incontestable after a fixed period, commonly three years. This principle was enshrined in legislation in Australia by s 84 of the Life Insurance Act 1945, which prevented the avoidance of a life policy for written misrepresentation after three years from its inception. The section did not apply to oral misrepresentation or to non-disclosure. The ALRC felt that the provision should be retained in order to protect the beneficiaries of life policies, but that it should be extended to oral misrepresentation and non-disclosure and that it should apply in the absence of fraud so that negligence would be encompassed. The ALRC also thought it right to protect an insurer who would not have contracted at all, by allowing avoidance within three years.<sup>176</sup> In other cases the proportionality approach rejected for general insurance should be applied to life insurance. These recommendations take the form of s 29 of the Insurance Contracts Act 1984, which differs in some significant respects from s 28. The section does not apply to misrepresentations of age, which are dealt with separately in s 30. In respect of a life policy<sup>177</sup> insurers must initially prove that they would not have entered into a contract on any terms<sup>178</sup> but for misrepresentation or non-disclosure, ie, that they were induced by the presentation of the risk. This is so even if there is fraud.<sup>179</sup> If the inducement requirement is

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<sup>175</sup> Boyd, "The duty of disclosure in life insurance: is the balance struck by Part IV of the Insurance Contracts Act appropriate?" (2001) 13 Ins LJ 59; Sutton, paras 3.161 to 3.163.

<sup>176</sup> ALRC 20, para 198.

<sup>177</sup> Treasury Review II, 2004, recommended that where a policy covers life and non-life elements, it should be "unbundled" so that s 29 applies only to the life elements: recommendation 7.1. This recommendation is adopted in the 2007 proposals for reform.

<sup>178</sup> This is apparent from the use of the phrase "the contract" as opposed to "a contract": *Hoare v Mercantile Mutual Life Assurance Co Ltd* (2002) 12 ANZ Ins Cas 90-110; *Tyndall Life Insurance Co Ltd v Chisholm* (2000) 11 ANZ Ins Cas 90-104; *Schaffer v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] QCA 182. Treasury Review II, 2004, noted in paras 7.21 and 7.22 that the test was pitched at a high level in that there is no inducement if insurers would have entered into a contract on different terms. The Review's recommendation 7.2 was that the provision should be recast to refer to "the contract" as opposed to "a contract".

<sup>179</sup> *Schaffer v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] QCA 182.

satisfied, insurers have the right of avoidance for fraud, although this is subject to the court's power to disapply the remedy under s 31. In the absence of fraud, the right of avoidance is retained for an insurer who would not have entered into the contract on any terms irrespective of the state of mind of the assured in presenting the risk,<sup>180</sup> although it must be exercised within three years failing which it is lost. An insurer who would have entered into the contract but on different terms has no right of avoidance in the face of an innocent or negligent misrepresentation or failure to disclose.<sup>181</sup> If there is no right of avoidance, or if the insurers choose not to exercise that right, they may within three years<sup>182</sup> in accordance with s 29(4) give notice to the assured varying the sum payable which is at least equal to the sum insured multiplied by the premium paid, that figure divided by the premium that would have been charged: the variation is backdated to the inception of the policy. Accordingly, where there is no avoidance, the insurers are entitled to scale down the amount of recovery by reference to the proportion which the actual premium bears to the premium that would have been charged.

**4.59** Misstatements of age are treated separately by s 30, re-enacting with modifications s 83 of the Life Insurance Act 1945 as recommended by the ALRC.<sup>183</sup> The right of avoidance is removed in all cases, including those of fraud. Instead, the apportionment principle is applied.<sup>184</sup> Treasury Review II recommended a minor variation to this section, under which the insurers would be given the additional option of changing the expiration date of the policy to the date that would have been the expiration date if the contract had been based on the correct date of birth. This recommendation has been adopted by the Treasury, and appears as draft new s 30(3A) to be inserted by Insurance Contracts Amendment Bill 2007.

**4.60** Although they have been criticised, these sections appear to work reasonably well in Australia, and they were indeed retained and re-enacted in modified form by the 1984 Act due to their earlier success. There is nevertheless some illogicality in distinguishing between life and general insurance, applying proportionality to the former but not to the latter. The ALRC's explanation for the distinction was based on evidence from the life insurance industry that the principle could be applied in life cases with little difficulty. It may be, however, that the ALRC had given too much weight to evidence from the non-life market that proportionality would not work there. Treasury Review II noted that the special proportionality rules applied to life insurance by s 29 were drafted at a time (1945) when the life market issued only death policies

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<sup>180</sup> *McCabe v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] WASCA 162.

<sup>181</sup> *Schaffer v Royal & Sun Alliance Life Assurance Australia Ltd* [2003] QCA 182, which also decides that, if absent misrepresentation the insurers would not have made an immediate decision but would have deferred pending further inquiries, they have not established that they would have refused to enter into the contract.

<sup>182</sup> This period was considered by Treasury Review II, 2004, paras 7.23 to 7.26. It was pointed out to the Review that the rationale of the three-year period was to prevent the avoidance of a policy with a surrender value, but that since 1982 it is rare for policies to contain surrender values. Further, not all illnesses would become apparent within three years. No change was recommended in respect of policies covering mortality or containing surrender values: see paras 7.38 and 7.39 and recommendation 7.3.

<sup>183</sup> ALRC 20, para 197.

<sup>184</sup> The only changes recommended by Treasury Review II, 2004, were that the formula for determining the amount recoverable should be calculated by reference to interest at the Treasury 10 year-bond rate rather than at the 11% presently stipulated, and that insurers should be allowed to change the expiration date of contracts where that date had been calculated with reference to the assured's (incorrectly stated) date of birth: recommendations 7.4 and 7.5. This recommendation is taken up in the draft Insurance Contracts Amendment Regulations 2007.

and investment policies with surrender values. Since then, other forms of life cover, including income protection and total permanent disablement and bundled contracts, have developed, and it may not be appropriate to apply the old life rules to these new forms of agreement. This point has been picked up in the draft Insurance Contracts Amendment Bill 2007, which has introduced a series of new provisions. Most importantly, a distinction has been drawn between life and investment policies and other forms of life cover. Section 29 is to be amended to be confined to: “(a) a contract of life insurance the primary purpose of which is to provide insurance cover in respect of the death of a life insured; or (b) a contract of life insurance that has a surrender value” (new s 29(1A)). Other forms of life insurance, those which do not provide cover on death or have a surrender value, are to be governed by a new s 28A which brings them into line with the general rules on remedies in s 28.<sup>185</sup> Draft s 28A provides as follows

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

- (a) failed to comply with the duty of disclosure; or*
- (b) made a misrepresentation to the insurer before the contract was entered*

*into;*

*but does not apply if 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) This section does not apply if the contract is a contract of life insurance within the meaning of section 29.*

*(3) If the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract.*

*(4) If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under subsection (3) or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made.*

**4.61** Draft s 28A is subject to the general power of the court in s 31 to grant relief in cases of fraud (and, if the rest of the 2007 Bill is adopted, in all cases).

#### *Life assurance: non-disclosure*

**4.62** It is the practice in Australia for life insurers, when faced with an application for life insurance on a person who is not to be the policyholder, to make inquiries about the health of the life assured and to require that person to undergo a medical examination. To that end, s 25 of the Insurance Contracts Act 1984 states that if the life assured makes a relevant false statement to the insurers, they are entitled to treat the statement as if it had been made by the policyholder

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<sup>185</sup> This distinction is supplemented by draft new 27A of the 1984 Act, which unbundles policies providing both life risks within s 29 and other life risks outside s 29 or non-life risks. In those circumstances, the legislation applies, in relation to each of those kinds of insurance cover, as if the contract provided only that kind of insurance cover.



himself. This issue has not arisen in England, and it must be thought doubtful that the life assured could be treated as the agent of the policyholder at least in the absence of some form of wording in the policy which requires truthful statements by the life assured as a condition of cover. Section 25 is not concerned with non-disclosure, so the law as it stands in Australia does not give insurers any remedies against the policyholder in the event that the life assured withholds material facts. Treasury Review recommended<sup>186</sup> that insurers should be protected against this eventuality, and accordingly the draft Insurance Contracts Amendment Bill has recommended the addition of a new s 31A to deal with the point. The draft section states that:

*If:*

- (a) *during the negotiations for a contract of life insurance but before it was entered into, a person (other than the insured) who would become a life insured under the contract failed to disclose a matter to the insurer; and*
- (b) *the matter was of a kind that the insured would have been required to disclose to the insurer to comply with the duty of disclosure;*

*this Act has effect as if the failure to disclose the matter had been a failure by the insured to comply with the duty of disclosure.*

Given the imposition of a new duty of disclosure, s 22 has been amended so as to require the insurers to inform both the policyholder and the life assured of the effect of s 31A.

## **A New Zealand excursus**

**4.63** Law reform is also under way in New Zealand. There has in the past been piecemeal reform of the common law on disclosure and misrepresentation. The Insurance Law Reform Act 1977, the Insurance Law Reform Act 1985 and the Contractual Remedies Act 1979 all have some impact on the law, in particular by restricting the right of avoidance for misrepresentation and replacing it with prospective cancellation, although the interrelationship between these measures and the prevailing common law is complex. In the absence of coherent legislative activity, judges in New Zealand have encouraged the Government to legislate along the lines of the Australian legislation.<sup>187</sup>

**4.64** In May 1998 the New Zealand Law Commission published its report *Some Insurance Law Problems*,<sup>188</sup> in which it rehearsed the problems raised by the current law and proposed an Insurance Law Reform Amendment Act. The Australian approach was rejected on the grounds that: (a) there was avoidable uncertainty about the extent of the duty of disclosure, eg, what constituted fraudulent non-disclosure; and (b) Australian law created the need “to make and prove difficult hypothetical and retrospective assessments of an insurer’s likely response to the assured having disclosed a matter, a process sardonically referred to in some of the Australian literature as retrospective underwriting.” To that it may be said that English law as it has

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<sup>186</sup> Recommendation 4.4.

<sup>187</sup> *State Insurance v McHale* [1992] 2 NZLR 399, 404 (Cooke P); *Quinby Enterprises Ltd v General Accident Ltd* [1995] 1 NZLR 736, 740 (Barker J).

<sup>188</sup> Report 46.

developed has raised exactly the same issues, the former in relation to exclusion of remedies<sup>189</sup> and the latter in relation to the meaning of inducement.<sup>190</sup> Nevertheless, the Law Commission proposed to retain the duty of disclosure: it rejected the arguments that it would not be possible for insurers to ask the right questions, that higher premiums would result from the increased risk of “sharp practice” and that self-regulation would be an appropriate substitute, but was swayed decisively by the suggestion that in cases of temporary cover it would not be possible for insurers to ask the right questions at the right time.

**4.65** The proposals were not taken up. Subsequently, in November 2004, the New Zealand Law Commission published a further report, *Life Insurance*,<sup>191</sup> which reaffirmed the principles set out in the 1998 Report and sought to extend them to the life market. The Law Commission did, however, recognise that there was some merit in the Australian approach and that it would be useful to review the matter once the Australian Treasury had published its review of the 1984 Act. To that extent the proposals were provisional. In outline, the proposals emanating from the Law Commission, which affected only non-disclosure and not misrepresentation, the latter being governed by existing New Zealand legislation, were as follows.

- (1) The duty of disclosure is to be retained, so that the assured must disclose material facts.
- (2) The test of materiality for non-disclosure is a hybrid of prudent assured and prudent insurer, the test being that the assured knew, or in the circumstances a reasonable person could have been expected to know, both the undisclosed fact and that disclosure of the undisclosed fact would have influenced the judgment of a prudent insurer in accepting the risk or the terms of such acceptance.
- (3) The right to avoid a policy for non-disclosure or misrepresentation would be limited to the following situations:
  - (a) fraud or recklessness on the part of the assured with respect to a material fact;
  - (b) material non-disclosure in response to a specific question, irrespective of the assured’s state of mind but as long as the materiality test is satisfied (general questions are permitted, but any false answer to a general question does not give rise to the right to avoid but only to a remedy under (4) below);
  - (c) avoidance within 10 days, a provision designed to protect insurers unable to make full inquiry at the outset;
  - (d) where the contract is one of reinsurance, on the basis that the parties to a reinsurance agreement can protect themselves.
- (4) In other cases the insurers are not entitled to avoid and are limited to damages and to cancelling the policy prospectively or staying on risk while imposing new premium and new terms.
- (5) In the special case of misstatement of age, a provision equivalent to s 29 of the Australian Insurance Contracts Act 1984 has been recommended.

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<sup>189</sup> *HIH Casualty and General Insurance v Chase Manhattan Bank* [2003] Lloyd’s Rep IR 230.

<sup>190</sup> *Drake Insurance Co v Provident Insurance Co* [2004] Lloyd’s Rep IR 277.

<sup>191</sup> Report 87.

**4.66** As seen at various points in this paper, the Australian Treasury Review appeared in 2004. The New Zealand Ministry of Economic Development in May 2005 launched a review of financial services regulation with the specific intention of bringing New Zealand law into line with Australian law. Its review, *Review of Financial Products and Providers*, was published in September 2006. The review is for the most part concerned with regulatory matters but the entire question of the duty of utmost good faith has been reconsidered in the light of the Australian Treasury Review. The MED review<sup>192</sup> has suggested three major variations to the Law Commission's proposals. The first is that they should be extended to misrepresentation, so that earlier legislation would be repealed and a unified system adopted applicable to the duty of utmost good faith in both non-life<sup>193</sup> and life policies. The second is the removal of careless non-disclosure as a ground of avoidance, so that just fraud, or misrepresentation or non-disclosure in the face of express questions, give a right to avoid. The third is an expansion of the remedies available to insurers outside the four cases in which avoidance is possible or where they have chosen not to avoid. The remedies are restitutionary and are designed to put the insurers in the position that they would have been in had there been a fair presentation of the risk. Restitutionary remedies arise: where a reasonable person ought to have known that the undisclosed or misstated fact would have influenced the judgment of a prudent insurer in relation to that insurance contract (ie, negligence cases); or where there has been an incorrect statement of age under a life policy. The remedies are: the right to exclude a particular risk prospectively; the right to cancel the policy prospectively; the right to accept the risk but at a higher premium. In determining the appropriate remedy it is necessary to assess what the response of the insurers would have been had the risk been presented free of misrepresentation and with disclosure of all material facts: the MED was satisfied that the Law Commission's reservations as to the feasibility of this approach were misplaced and that the Australian experience showed that such assessments are not that difficult for insurers to make.

**4.67** In summary, therefore, the present state of the New Zealand proposals is that insurers are to have the right to avoid only:

(a) for fraudulent or reckless non-disclosure or misrepresentation; (b) for misrepresentation or non-disclosure in response to a specific question, as long as the difference between what was said and the truth would have influenced the judgment of a prudent insurer; (c) within 10 days; and (d) in reinsurance cases. In all other cases avoidance is removed and is replaced with restitutionary remedies. Accordingly, insurers may ask detailed questions in order to preserve the right of avoidance, or they may issue short-form proposal forms and thereby accept that they will have a right of avoidance only in cases of fraud. Coupled with this is an obligation on insurers to warn policyholders of the duty of disclosure and of the consequences of non-disclosure and misrepresentation. These proposals are presently out for consultation.

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<sup>192</sup> Part 5.

<sup>193</sup> There is apparently no such proposal with respect to marine insurance: the New Zealand Marine Insurance Act 1908 is the usual Commonwealth replica of the Marine Insurance Act 1906.

## Co-assureds

**4.68** English law draws a distinction between joint assureds (those with indivisible interests in the same subject matter) and composite assureds (those with different interests in the same subject matter whose respective rights and interests are insured in a single document). The former are treated as having just one contract with the insurers, so that in the event of breach of duty by either then both are disqualified from recovery.<sup>194</sup> By contrast, if the policy is composite, the co-assureds are treated as having separate contracts with the insurers so that breach of duty by one does not affect the validity of the policy for the others.<sup>195</sup> The distinction between the two depends upon the nature of the parties' interests and the wording of the policy: spouses, and arguably partners in a commercial partnership, are generally to be treated as joint assureds<sup>196</sup> unless the policy provides otherwise. The 1984 Act is silent on the position of co-assureds, although it was held in *Advance (NSW) Insurance Agencies Pty Ltd v Matthews*<sup>197</sup> that the non-disclosure and misrepresentation provisions of the legislation have removed the distinction and that a breach of duty by one party gives the insurers the same remedies against both.<sup>198</sup> The point was discussed by Treasury Review II, 2004,<sup>199</sup> the conclusion being that further work was required but that there was merit in the court being given a discretion to relieve an innocent co-assured from the consequences of the guilty co-assured's breach of duty. There is nothing on this matter in the draft Insurance Contracts Amendment Bill 2007 other than the proposal that third party beneficiaries – non-parties but who have a right to claim under the policy – are subject to any defences which would have been available against the assured. However, the rights of such persons are clearly derivative and cannot affect the approach which may be appropriate to co-assureds.

**4.69** The ruling in *Advance* is perhaps not as damaging as would have been the case had insurers retained their absolute right of avoidance, but there is a need for the Law Commissions to consider whether joint and composite assureds should be treated in the same way rather than leaving the matter to be resolved by the courts. The English rule has operated for many years, although the author's own experience is that insurers have not always appreciated the principle that an innocent co-assured has a claim in his or her own right and have expressed surprise when faced with the point. The point is one which must not be overlooked in any reform of UK law.

## Group policies and declaration policies

**4.70** Various forms of policy are issued to an employer or other organisation for the benefit of employees or members, as the case may be. Such policies may provide life or accident cover.

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<sup>194</sup> Cf *Direct Line Insurance v Khan* [2002] Lloyd's Rep IR 364

<sup>195</sup> *Woolcott v Sun Alliance* [1978] 1 Lloyd's Rep 629.

<sup>196</sup> The New Zealand courts have rejected the notion of joint insurance as between spouses: *Maulder v National Insurance Co of New Zealand Ltd* [1993] 2 NZLR 351. See also *Holmes v GRE Insurance Ltd* [1988] Tas R 147.

<sup>197</sup> (1989) 166 CLR 606.

<sup>198</sup> The policy may reverse this rule and give protection to innocent co-assureds: *FAI General Insurance Co Ltd v Sherry* [2002] SASC 431. See Sutton, paras 3.147 to 3.160.

<sup>199</sup> Chapter 9.

Some policies apply automatically to shifting membership so that as and when a new employee or member becomes eligible, he is automatically covered. Others require some form of declaration, eg, as to the health of the new employee or member as a condition of coverage. The 1984 Act has a special provision, s 32, which applies only to superannuation schemes. The section assures that a duty of disclosure or a duty to avoid misrepresentation is owed when a declaration is made to the insurers, and that in the event of breach of duty that particular person's coverage is to be treated in the same way as if he was an applicant for a policy in his own right. The point here is that the policy as a whole is unaffected by a subsequent individual declaration.<sup>200</sup> Treasury Review II, 2004 pointed out that s 32 does not deal with the case in which there is non-disclosure or misrepresentation after the person has joined the superannuation scheme but before cover has been effected on his life. It was recommended that the remedies for non-disclosure and misrepresentation should be available regardless of whether a person is a member of the scheme when he applies for the cover.<sup>201</sup> It was also recommended that s 32 be extended to other group schemes not involving superannuation.<sup>202</sup> These recommendations have been taken up by the draft Insurance Contracts Amendment Bill 2007, which amends the relevant definitions in s 11 and repeals the existing version of 32. In its place, the new s 32(1) repeats the earlier principle that each member has an individual contract of insurance with the insurers, while new s 32(2) provides that if the failure to disclose or misrepresentation occurred after the proposed life assured became a member of the relevant superannuation, retirement or other group life scheme but before the insurance cover was provided by the group life contract in respect of the life assured, the failure or misrepresentation is taken to have occurred before the proposed life insured became a life insured under the group life contract.

**4.71** This section opens up an issue which is otherwise not touched by the 1984 Act, namely declaration policies and reinsurance treaties generally: s 32 is concerned only with superannuation.<sup>203</sup> English law on this matter is complex and as yet not fully articulated. The incidence of the disclosure and representation obligations may arise only when the policy is made (which appears to be the case if the policy is obligatory in that the (re)insurers have to accept any risks),<sup>204</sup> or at the stage of each individual declaration (which appears to be the case if the policy is facultative in that the (re)insurers can refuse any individual declaration). The principle in s 32 is inapplicable in the former case, whereas English law adopts the principle of s 32 in the latter case, so that an individual declaration may be avoided under a facultative policy while leaving the rest of the declarations and the policy itself untouched.<sup>205</sup>

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<sup>200</sup> ALRC 20, para 199.

<sup>201</sup> Para 10.31 and recommendation 10.5.

<sup>202</sup> Para 10.32 and recommendation 10.6.

<sup>203</sup> S 32A extends a similar principle to Retirement Savings Accounts.

<sup>204</sup> Attachment of risks may be automatic (as where the contract is obligatory) or dependent upon a decision of the policyholder to make a declaration (as where the contract is facultative-obligatory).

<sup>205</sup> *SAIL v Farex Gie* [1995] LRLR 116.

## Temporary cover<sup>206</sup>

**4.72** English law says very little about temporary cover obtained by an assured pending the issue of full. Three main problems have arisen. The first is, what are the terms of temporary cover? The basic view is that in the absence of any express provision the insurers' standard terms are deemed to apply, although the cases are far from consistent on the point and there is an issue as to whether the terms can be binding on the assured if they have not been notified to him.<sup>207</sup> The second is, can there be a binding contract for temporary cover if the assured does not intend to make an application for full cover to the insurers issuing the temporary cover. English authority indicates that an offer of temporary cover may not be binding in the circumstances, although there seems to be little in law or sense to justify this result.<sup>208</sup> Thirdly, what is the extent of the assured's duty to make a fair presentation of the risk at the interim stage? There is no authority in England on this point, although commentators generally cite the pre-1984 Act decision, *Mayne Nickless Ltd v Pegler*,<sup>209</sup> for the proposition that the duties apply in full effect even to an informal application for temporary cover.

**4.73** The ALRC considered interim cover in some detail.<sup>210</sup> It concluded on these points that: (1) the terms on which a cover note was issued should be made available to the assured, although legislation was not desirable in that it might inhibit the offer of temporary cover; (2) it should not be open to insurers to stipulate that temporary cover was conditional on them receiving a satisfactory proposal form, given that this might not be possible if an accident occurs during the period of temporary cover or that the proposal form might be completed by a third party whose authority is in doubt, and given also that determining whether a proposal was "satisfactory" was a matter for insurers and was capable of arbitrary decision (particularly where a loss had been suffered); and (3) it was necessary to retain the duty of disclosure at the cover note stage. Limited reform on issue (2) is contained in s 38(1) of the Insurance Contracts Act 1984. The section negatives any provision in a temporary insurance cover which renders the liability of the insurers dependent on the submission or acceptance of a proposal for a contract of insurance intended to replace the temporary cover.<sup>211</sup> The section also provides, in s 38(2), that the insurers remain liable under the temporary contract until that contract is replaced by a full policy, is cancelled (plainly not with retroactive effect so that the loss remains covered) or the assured withdraws any proposal for a full policy. That period may be beyond the period specified by the insurers for the grant of temporary cover:<sup>212</sup> in that event it is open to the insurers to cancel the temporary cover under s 60 by giving notice in accordance with s 59. This section works well for both general and life insurance as far as it goes, but it might be thought appropriate to address the other matters raised by temporary cover.

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<sup>206</sup> Sutton, chapter 4.

<sup>207</sup> The most difficult case is *Re Coleman's Depositories Ltd and Life and Health Assurance Association* [1907] 2 KB 798.

<sup>208</sup> *Taylor v Allon* [1966] 1 QB 304.

<sup>209</sup> [1974] 1 NSWLR 228. See also *Marene Knitting Mills Pty Ltd v Greater Pacific General Insurance Ltd* (1976) 11 ALR 167.

<sup>210</sup> ALRC 20, paras 200-214.

<sup>211</sup> It is arguable that this provision would impliedly overrule *Taylor v Allon* [1966] 1 QB 304.

<sup>212</sup> Treasury Review II, 2004, para 11.7, rejected the suggestion that temporary cover should lapse on the date specified by the insurers.

## The subscription market

**4.74** The practice at Lloyd's and in the London subscription market is for the slip to be scratched successively by different underwriters. In principle each of them is required to assess the risk for himself, but in practice it is common for the judgment of the leading underwriter to be taken into account by the following market. A legal problem arises where a false statement is made to the leading underwriter but not repeated to the following market: if the leader is induced, the following market may argue that although nothing has been said to them they are entitled to rely on the presentation to the leader. This argument has little to commend it, particularly since the adoption of the actual inducement test in *Pan Atlantic*, and it was rejected by the Court of Appeal in *General Accident v Tanter, The Zephyr*<sup>213</sup> where it was held that a false statement made to the leader could not be relied on by the following market to deny liability. However, in a series of later first instance decisions<sup>214</sup> the courts have reached the contrary view, the reasoning being variously that it was understood by the market that the followers would rely on the leader or that if a false statement is made to the leader there is an obligation to disclose it to the followers.<sup>215</sup>

**4.75** This point was unsurprisingly not considered by the ALRC in its 1982 Report on general insurance, but was discussed by the ALRC in its 2001 Report on marine insurance, the latter concluding that "following underwriters should be deemed to have been induced to enter into the contract if all the leading underwriters were induced. For this purpose, leading underwriters should be defined to be those underwriters whose earlier acceptance of part of the risk induced the following underwriter to do so as well."<sup>216</sup> There are no reasons given for this conclusion, and it may be that the issue should be fully reviewed in any proposals for reform.

## 5 THE CONTINUING DUTY OF UTMOST GOOD FAITH

### The implied term

**5.1** The Insurance Contracts Act 1984 effectively abolishes the continuing duty of utmost good faith<sup>217</sup> and replaces it with an implied term in s 13 whereby the parties are required to act towards each other, in respect of any matter arising under or in relation to the policy, with the

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<sup>213</sup> [1985] 2 Lloyd's Rep 529.

<sup>214</sup> The two root cases are *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins* [1998] 1 Lloyd's Rep. 565 and *International Lottery Management Ltd v Dumas* [2002] Lloyd's Rep IR 237.

<sup>215</sup> An argument which can be right only if the broker making the false statement was aware that he had done so, given that a broker is not required to disclose what he does not know.

<sup>216</sup> ALRC 91, para 10.130.

<sup>217</sup> *Re Zurich Australia Insurance Ltd* (1999) 10 ANZ Ins Cas 61-429. There remains some doubt as to this proposition, and it is arguable that ALRC 20 had intended to preserve and extend the duty of utmost good faith. The point is probably insignificant given the development of the law since the passing of the Act.

utmost good faith.<sup>218</sup> The remedy is contractual, so that the measure of damages is that for breach of contract,<sup>219</sup> and the ALRC took the view that this approach was preferable to the introduction of a possible tort of bad faith.<sup>220</sup> The phrase “arising under or in relation to” is a wide one, and is potentially capable of encompassing settlements of liability reached under the policy. The duty is expressed by s 12 to be paramount, and will apply irrespective of any express obligations which arise under the terms of the policy. The paramount status of the implied term has given rise to some confusion with regard to the relationship between s 13 and ss 54 (inability of insurers to rely upon policy terms to refuse to pay claims in absence of causal link between breach and loss) and 56 (no obligation to pay fraudulent claims). It is thus possible to argue that the insurers who establish a breach of the duty of utmost good faith by the assured are unable under s 54 to rely upon it to refuse to pay a claim unless the breach has given rise to the loss in respect of which the claim is made.<sup>221</sup> The problem here is that a breach of s 13 is a straightforward breach of contract which gives rise to damages,<sup>222</sup> whereas s 54 is concerned with payment or non-payment of claims. Similarly, a fraudulent claim contrary to s 56 allows the insurers to refuse to pay the claim and to cancel the policy but does not contemplate damages.<sup>223</sup> Any adoption of the implied term approach in the UK should make it clear that good faith, express terms and fraudulent claims are entirely separate concepts. In practice, allegations of breach of the implied term of utmost good faith are more often made by the assured against the insurers than vice versa.

**5.2** There is nothing in s 13 which deals with the duration of the post-contractual duty. In *The Star Sea* the House of Lords held that the duty came to an end once legal proceedings commenced, and it would appear to be sensible to codify this rule.<sup>224</sup>

**5.3** At present s 13 has purely civil consequences as between the parties. However, Treasury Review II was firmly of the view that enforcement of the duty if left in the hands of private assureds might not be fully effective. Accordingly, it recommended<sup>225</sup> that any failure by insurers to act with the utmost good faith should be both a breach of an implied contractual term and a breach of the 1984 Act, thereby attracting the regulatory powers of ASIC, although the breach of the Act should not be an offence and should not attract a penalty. This recommendation was adopted by the Treasury in the draft Insurance Contracts Amendment Bill 2007. The primary concern in this regard was claims handling, and in particular the need to

<sup>218</sup> ALRC 91, paras 10.136-10.150, recommended the same approach for marine insurance, but coupled with the right of the insurers to impose an express contractual duty on the assured dealing with post-contract disclosure.

<sup>219</sup> *Moss v Sun Alliance Aust Ltd* (1990) 55 SASR 145; *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.

<sup>220</sup> ALRC 20, paras 51 and 328. There is some authority in Australia for the proposition that a tort of bad faith may operate in cases to which the 1984 Act does not apply: see the authorities cited by Mann, para 12.30. The possibility of a tort claim based on the 1984 Act has, however, been denied: *Lomsargis v. National Mutual Life Association of Australasia Ltd* [2005] QSC 199. The English courts have, rightly it is submitted, set their faces against the intervention of tort into this area: *La Banque Financière de la Cite SA v Westgate Insurance Co. Ltd* [1990] 2 All ER 947.

<sup>221</sup> See Ipp J in *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 6 WAR 68, 77, favouring the view that the only remedies open to the insurers for breach of s 13 are those stipulated in s 54.

<sup>222</sup> ALRC 20, para 328.

<sup>223</sup> ALRC 20, para 243. See the discussion of fraudulent claims, *infra*.

<sup>224</sup> Cf ALRC 91, para 10.142. See also *Allison Pty Ltd v Lumley General Insurance Ltd* [2004] WASC 98.

<sup>225</sup> Recommendation 1.2.



ensure that: insurers operate procedures under which: claims handling is conducted in a fair, transparent and timely manner; assureds have the opportunity to respond to adverse findings by insurers and receive reasons for the denial of claims; employees and outsourced service providers involved in the claims handling process receive adequate training and supervision; insurers are liable for the conduct of outsourced providers involved in the claims handling process; and experts involved in the claims handling process are independent. The Treasury in its explanatory notes to the 2007 draft Bill felt that this could be achieved by a combination of self-regulation and also enforcement by ASIC. The former in practice operates under the General Insurance Code of Practice adopted by the Insurance Council of Australia in July 2005. The latter is to be achieved by an amendment to s 13 of the 1984 Act. Section 13 becomes s 13(1), and new s 13(2) will provide that “A failure by a party to a contract of insurance to comply with the provision implied in the contract by subsection (1) is a breach of the requirements of this Act.” One significance of treating a breach of the duty of utmost good faith as a breach of the Act is that under s 55A of the Act<sup>226</sup> ASIC may bring a representative action against an insurer if it is satisfied that the assured has or is likely to suffer damage and it is in the public interest to bring the action.<sup>227</sup> The 2007 draft Bill will further strengthen the powers of ASIC by adding new s 11F to the 1984 Act: this states that ASIC may intervene in any proceedings relating to a matter arising under the Act, in which case it is taken to be a party to the proceedings and may appear and be represented. The proposed s 11F procedure is likely to be quicker and easier than a full representative action, given that proceedings are already in existence.

## **The meaning of utmost good faith**

**5.4** The 1984 Act does not define “utmost good faith”. The most detailed analysis is that of Professor Sutton,<sup>228</sup> who has defined the concept in terms that it:

encompasses notions of fairness, reasonableness and community standards of decency and fair dealing. It imposes a market standard of fairness, that is, what is customary and acceptable conduct in the particular commercial activity concerned as established by expert evidence.

Decided cases have referred to honesty,<sup>229</sup> or the absence of “dishonest, unreasonable or capricious conduct”.<sup>230</sup> However, it is to be noted that the word “utmost” indicates that something more than honesty is required,<sup>231</sup> so that while dishonesty prevents a finding of good faith on the basis that a dishonest act is by definition one which is performed for an improper

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<sup>226</sup> Added in 1994.

<sup>227</sup> It is also significant in that ASIC has various remedies under the Corporations Act 2001 in respect of the licensing of insurers, and a breach may lead to the removal or suspension of a licence or the imposition of conditions.

<sup>228</sup> Para 3.7.

<sup>229</sup> *Vermuelen v SIMU Mutual Assurance Association* (1987) 4 ANZ Ins Cas 60-812.

<sup>230</sup> *Kelly v New Zealand Insurance Co Ltd* (1993) 7 ANZ Ins Cas 61-197. See also *CIC Insurance v Barwon Region Water Authority* (1999) 10 ANZ Ins Cas 61-425.

<sup>231</sup> *Sheldon v Sun Alliance* (1989) 53 SASR 97; *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* [2005] FCAFC 185.

purpose,<sup>232</sup> proof of honesty is not of itself enough to establish utmost good faith so that an honest act may nevertheless be one carried out without utmost good faith.<sup>233</sup> How, then, has the implied term operated in practice?

### **The continuing duty of the assured**

**5.5** As noted above, English law does not impose any stand alone continuing duty of utmost good faith on the assured, but retains a continuing duty: (a) where there is an express disclosure obligation, in which case a breach of the obligation other than with the utmost good faith and in a manner which induces the insurers in some way triggers the parallel duty of utmost good faith allowing the insurers either to terminate the policy for repudiation or to avoid the policy; and (b) where the court feels it appropriate to imply a term for disclosure in particular circumstances. The Australian legislation deals with the matter in an entirely different way, by means of the implied term of utmost good faith in s 13 of the Insurance Contracts Act 1984. Where the Act applies there is no continuing duty at common law and obligations to disclose must be express, although where the Act does not apply the common law position prevails and there may be a parallel common law duty to disclose if it is attached to an express contractual obligation to disclose.<sup>234</sup> The remedy for breach is damages, and in addition the insurers may cancel the policy on notice.<sup>235</sup> There is little authority on the scope of the assured's duty, although it seems that the remedy for breach of duty is governed by the provisions of s 54.<sup>236</sup> Fraudulent claims are governed independently by s 56.<sup>237</sup> In practice, s 13 has little or no independent application to policyholders. The assured is also subject to the specific obligation in s 14 not to rely on policy terms other than in accordance with the principles of utmost good faith, although there is no breach of this provision simply because the assured has brought a claim under the policy,<sup>238</sup> has sought to rely upon a waiver of rights by the insurers<sup>239</sup> or has broken a policy term and has sought relief from the consequences of his breach under s 54.<sup>240</sup>

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<sup>232</sup> *Re Zurich Australian Insurance Ltd* (1999) 10 ANZ Ins Cas 61-429.

<sup>233</sup> *Gutteridge v Commonwealth of Australia* 1993, unreported; *Kelly v New Zealand Insurance Co Ltd* (1996) 130 FLR 97; *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* [2005] FCAFC 185.

<sup>234</sup> *New South Wales Medical Defence Union Ltd v Transport Industries Insurance Co Ltd* (1985) 4 NSWLR 107; *GIO Insurance Ltd v Leighton Contractors Ltd Pty Ltd* (1996) 8 ANZ Cas 61-293.

<sup>235</sup> Insurance Contracts Act 1984, s 60(1)(a).

<sup>236</sup> See *infra*.

<sup>237</sup> See *infra*.

<sup>238</sup> *CIC Insurance Ltd v Barrown Region Water Authority* (1999) 10 ANZ Ins Cas 61-425.

<sup>239</sup> *Sherry v FAI General Insurance Co Ltd* (2002) ANZ Ins Cas 61-516.

<sup>240</sup> *Einfeld v HIH Casualty & General Insurance Ltd* (1999) 10 ANZ Ins Cas 61-450.

## The continuing duty of insurers<sup>241</sup>

**5.6** The insurers' continuing duty of good faith is set out in s 13 of the Insurance Contracts Act 1984, and is framed as an implied term. To what does it apply? To date the section has not really been tested. The ALRC's view was that it applies to "all aspects of the relationship between insurer and assured".<sup>242</sup> It is to be remembered that in all cases there has to be proof that the insurers' conduct was not carried out with utmost good faith, but if that is established then the following classes of conduct in principle fall within s 13.

**5.7** First, insurers are required to notify the assured of matters relating to the policy. They are under a statutory duty under s 22 to inform the assured of the consequences of non-disclosure. In addition, s 14 provides that a provision of an insurance policy can be relied upon only in the utmost good faith, a provision which by its terms is one primarily concerned with the conduct of insurers<sup>243</sup> and which works in tandem with s 13. By application of ss 13 and 14 it has been held that insurers must inform the assured of the nature and consequences of any breach of a policy term<sup>244</sup> and may not plead policy defences other than with the utmost good faith.<sup>245</sup> There are also cases which hold that the insurers must draw the assured's attention to the possibility that the policy is not suitable for his needs, eg, that he is underinsured.<sup>246</sup> In applying s 14, the court must – under s 14(3) – have regard to whether the assured received notification of the term: there is in any event an obligation in s 37 for insurers to notify the assured of any unusual term in advance of the policy being made where the policy is not prescribed.<sup>247</sup> Most domestic policies are prescribed and are subject to the special rules on standard cover, discussed above. The obligation to notify unusual terms is thus confined to commercial policies. Treasury Review II, 2004, has suggested that s 14 has greater potential than to date has been realised, and that it could be extended from reliance on policy terms other than with the utmost good faith to all obligations

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<sup>241</sup> Section 15 of the 1984 Act disapplies all other legislation, including Commonwealth, State or Territory legislation which allows for judicial review of unfair contracts. Treasury Review II, 2004, paras 6.4 to 6.14 considered whether s 15 should be repealed. The arguments proved to be finely balanced, but the Review concluded that no change should be made in the short term, although wished the matter to be reopened following a review of unfair terms legislation. The point is only open to a limited extent in England. The Unfair Contract Terms Regulations 1999 apply to consumer insurance contracts, and are required to do so by the Directive on which the Regulations are based, Directive 93/13/EC. The Unfair Contract Terms Act 1977 does not apply to insurance contracts: Law Commission Report 292 on Unfair Contract Terms did not recommend any substantial change to this rule.

<sup>242</sup> ALRC 20, para 328. See: Mannolini "The Uncertain Ambit of Section 54 of the Insurance Contracts Act" (1996) 24 Australian Business Law Review 260; Bremen, "Good Faith and Insurance Contracts — Obligations on Insurers" (1999) 19(1) Australian Bar Review 89; Godfrey, "The duty of utmost good faith — the great unknown of modern insurance law" (2002) 14 Ins LJ 56.

<sup>243</sup> But not exclusively so. See *supra*.

<sup>244</sup> *Australian Associated Motor Insurers Ltd v Ellis* (1990) 54 SASR 61, a decision doubted in *Re Zurich Australian Insurance Ltd* (1999) 10 ANZ Ins Cas 61-429, on the basis that it elevated the duty to act in good faith into a duty to "coddle the insured". The principle is nevertheless established: *Banks v NRMA Insurance Ltd* 1988, unreported, NSW Supreme Court.

<sup>245</sup> *ACN 007 838 584 Pty Ltd v Zurich Australian Insurance Ltd* (1997) 69 SASR 374.

<sup>246</sup> *Kelly v New Zealand Insurance Co Ltd* (1993) 7 ANZ Ins Cas 61-197.

<sup>247</sup> It was held in *Porter v GIO Australia Ltd* [2003] NSWSC 668 that if the assured uses a broker then s 71 dispenses with the need for s 37 notice. It was further held that the insurers do not owe a separate duty of utmost good faith under s 13 to notify the assured in the absence of any duty under s 37.

of the insurers under the policy, under the Insurance Contracts Act 1984 and under any terms implied into the policy under the general law.<sup>248</sup>

**5.8** Secondly, insurers are under a duty to reach a timely decision on a claim.<sup>249</sup> There is a limited specific provision to this effect, in s 41 of the Insurance Contracts Act 1984 which seeks to overcome the problems raised by the decision in *Distillers Co Biochemicals (Aust) Pty Ltd v Ajax Insurance Co Ltd*.<sup>250</sup> There, the insurers of the assured manufacturers of the drug “Thalidomide” refused to confirm or deny coverage in respect of massive claims faced by their assured. The policy stated that the assured was not to make any admission of liability without the written consent of the insurers. In proceedings for declaratory relief brought by the assured, it was held that any settlement by the assured without the insurers’ consent would preclude recovery even if there would otherwise have been liability under the policy. The ALRC’s view was that the assured should be able to put the insurers to election within a reasonable time between confirmation or denial of cover.<sup>251</sup> The recommendation was enacted in s 41, which applies to any clause which prohibits a settlement or an admission of liability without the consent of the insurers.<sup>252</sup> The assured may give notice to the insurers asking for a decision within a reasonable time on coverage and on whether the insurers intend to defend the claim: in the absence of a decision, compliance with the clause is waived. Treasury Review II, the recommendations<sup>253</sup> of which have been adopted by the draft Insurance Contracts Amendment Bill 2007. Under the proposed revised version of s 41 the right to information will be extended to third party beneficiaries, defined as persons with a right to claim under the policy

**5.9** Thirdly, insurers are under a duty to settle claims in good faith. This appears from the ALRC Report itself.<sup>254</sup> Thus insurers must act with the utmost good faith in deciding whether the assured has made out a claim under the policy, eg, for the purposes of an accident policy in determining whether the assured is totally and permanently disabled,<sup>255</sup> or as to the amount due to the assured under the policy.<sup>256</sup> Again, reliance on potential ambiguity in the insuring clause

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<sup>248</sup> Recommendation 6.16. This was thought to be a substitute for the application of unfair terms legislation: see *supra*. The recommendation has been accepted by the draft Insurance Contracts Amendment Bill 2007, which would amend s 14(1) to extend its scope to “reliance ... on a provision of the contract or a provision of this Act ...”

<sup>249</sup> *Gutteridge v Commonwealth of Australia* 1993, unreported, Queensland Supreme Court; *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* [2005] FCAFC 185; *Boulderstone Hornibrook Engineering Pty Ltd v Gordian Runoff Ltd* [2006] NSWSC 223. Treasury Review II, 2004, Recommendation 1.1 was that “Best practice guidelines relating to claims handling processes by insurers should be developed and included in the relevant industry codes.” The Code of Practice now requires a response within 60 days. It could be argued that any failure to comply should automatically lead to a finding of bad faith.

<sup>250</sup> (1973) 130 CLR 1.

<sup>251</sup> ALRC 20, paras 234 and 244.

<sup>252</sup> Sutton, paras 15.41 to 15.44.

<sup>253</sup> In particular Recommendation 10.1

<sup>254</sup> ALRC 20, para 328.

<sup>255</sup> *Dumitrov v SC Johnson & Son Superannuation Pty Ltd* [2006] NSWSC 1372; *McArthur v Mercantile Life Insurance Co Ltd* [2002] 2 Qd R 197.

<sup>256</sup> *Ibrahim v Greater Pacific Life Insurance Co Ltd* (1996) 9 ANZ Ins Cas 61-330. Cf *Dumitrov v S C Johnson & Son Superannuation Pty Ltd* [2006] NSWSC 1372.

may be a breach of the duty.<sup>257</sup> However, there is no breach of duty simply because the insurers assert a defence which is ultimately shown to be unfounded: the insurers' conduct must be in breach of the duty of utmost good faith before s 13 applies.<sup>258</sup> In the same way, insurers who exercise their right to cancel the policy cannot be said to have acted without utmost good faith even if they have taken steps to settle the claim prior to their cancellation.<sup>259</sup> The proposals of Treasury Review II, and the provisions of the draft Insurance Contracts Amendment Bill 2007 to tighten controls over claims handling through self-regulation and ASIC enforcement, were referred to earlier.

**5.10** Fourthly, insurers who make late payment may face liability for damages for breach of duty in respect of consequential loss, as well as interest on the sum payable under s 57.<sup>260</sup>

## Comment

**5.11** The author's discussions in Australia demonstrate that the implied term in s 13 of the 1984 Act has not given rise to particular problems in practice, although it is also apparent that it has provoked a good deal of litigation both with respect to its own meaning and with respect to its interrelationship with other provisions of the 1984 Act. If the UK is to adopt an implied obligation on the parties to act with the utmost good faith, it would be possible to avoid some of the short term dislocation by specifically legislating to remove the legislative drafting matters which have exercised the Australian courts. Is that enough to justify acceptance? As far as the assured's obligations are concerned, the post-contractual duty of utmost good faith adds little to his express obligations and to the duty not to submit fraudulent claims. The efficacy of s 13 is, accordingly, to be assessed from the point of view of insurers.

**5.12** Some of the decisions may be criticised in holding insurers liable for breach of contract simply because they chose to take policy defences, even if those defences ultimately proved unsustainable. That aside, the main problem is uncertainty. It is necessary for there to be clear guidance as to the meaning of utmost good faith, particularly if it is to operate in the commercial insurance and reinsurance markets. By definition the duty of utmost good faith operates both on express terms, and may also imply obligations where there are no express terms. Given the width of the concept it may be preferable for any UK legislation to provide an exhaustive or, if greater flexibility is preferred, non-exhaustive illustrative list of obligations rather than leaving the scope of the concept unarticulated.

**5.13** Disclosure of unusual policy terms is one area where English law could usefully be changed. The concept is recognised by the common law,<sup>261</sup> but has never been applied to insurance.

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<sup>257</sup> *Hammer Waste Pty Ltd v QBE Mercantile Mutual Ltd* [2002] NSWSC 1006 (affirmed [2003] NSWCA 356) where it was said that reliance on an ambiguous clause would lead to summary judgment and an indemnity costs order.

<sup>258</sup> *Komorowski v Australian Associated Motor Insurers* (1996) 9 ANZ Ins Cas 61-303.

<sup>259</sup> *Massoud v NRMA Insurance Ltd* (1995) 8 ANZ Ins Cas 61-257.

<sup>260</sup> See *supra*.

<sup>261</sup> *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433.

**5.14** A second obvious possibility is an obligation on insurers to process and pay claims within a reasonable time failing which they face liability for consequential loss. Utmost good faith could, therefore, be the basis on which insurers are liable for consequential loss arising from late or non-payment. The question of late payment is considered in more detail below.

**5.15** A third is that insurers faced with an option under the policy should be placed under an obligation to define their position within a reasonable time. This could apply to decisions to affirm or to deny cover, to decide whether or not to pay defence costs and to decide whether or not to defend a claim. At present English law imposes limited duties in these contexts, which at their highest allow the courts to intervene on a judicial review basis by requiring insurers to reach their decisions only by taking into account considerations relevant to the policy in question and not by reference to extraneous considerations such as a desire to exercise leverage in other dealings or disputes between the parties. Imposing an obligation to act with the utmost good faith might not, however, produce a dramatic change: a decision which is based on extraneous considerations is plainly not one made in accordance with the principle of utmost good faith, whereas a decision reached using the proper criteria but which the court or other insurers would not have reached cannot for that reason alone be classified as having been made with an absence of utmost good faith. A codification of English law to this effect would encompass the specific principle in s 41, which is confined to timely confirmation or denial of coverage under liability policies, and would also confirm the existence of a remedy of damages for breach of contract, a step presently beyond the English courts.

**5.16** A fourth possibility is that insurers should be liable for failing to pay a claim to which they know they have no valid defence: this is more or less equivalent to s 14 of the 1984 Act. This is, unfortunately, a tactic commonly encountered, particularly in the commercial market. It might also be sensible to codify the rule that liability insurers must avoid conflicts of interest and must take into account the interests of their assured in negotiating with third parties. All of these points have been held to fall within s 13 of the 1984 Act.

## 6 FRAUDULENT CLAIMS

**6.1** This topic is dealt with here because of its historical links with the assured's continuing duty of utmost good faith. In both England<sup>262</sup> and Australia<sup>263</sup> fraudulent claims have now been

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<sup>262</sup> *K/S Merc Skandia XXXXII v Certain Lloyd's Underwriters* [2001] Lloyd's Rep IR 802; *Agapitos v Agnew* [2002] Lloyd's Rep IR 573.

<sup>263</sup> The authorities favour the proposition that the rules which govern fraudulent claims are distinct from the assured's duty to act with the utmost good faith in s 13 (even though a fraudulent claim is possibly the paradigm example of bad faith, as where the assured gives a false answer to a question in a claim form), and also from the rules which preclude insurers from relying on policy defences in s 54: *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 6 WAR 68; *Gugliotti v Commercial Union Assurance Co of Australia* (1992) 7 ANZ Ins Cas 61-104; *Tiep Thi To v AAMI Ltd* (2001) 161 FLR 61; *Walton v The Colonial Mutual Life Assurance Society Ltd* [2004] NSWSC 616.

severed from utmost good faith and the duty not to make a fraudulent claim is a stand-alone concept. A series of issues concerning fraudulent claims have arisen in both jurisdictions, and some of these would merit being addressed by legislation.

### The meaning of fraud<sup>264</sup>

**6.2** In *Agapitos v Agnew*<sup>265</sup> Mance LJ identified five types of fraudulent claim:

- (1) The assured had not suffered loss from an insured peril but rather by his own hand.
- (2) The assured's loss was less than had been claimed. Substantial exaggeration is fraudulent.
- (3) The assured believed at the time of his claim that he had suffered a loss, but, having subsequently discovered that he had suffered no loss at all or a loss smaller than that claimed for, failed to correct the claimed loss.
- (4) The assured had suffered a genuine loss but had suppressed a defence known to him which might be available to insurers.
- (5) The assured had furthered a genuine claim by the use of fraudulent means or devices. This category encompasses false statements made by the assured in pressing his claim<sup>266</sup> insofar as they are directly related to the claim, designed to improve the assured's prospects of recovery and objectively capable of having that effect,<sup>267</sup> although it is uncertain whether it catches a failure by the assured to disclose all material facts relating to the claim.<sup>268</sup>

Case (1) involves fraud at the outset. Cases (2)—(5) all involve a genuine loss which has become tainted by the subsequent conduct of the assured, although once the claim has reached the point of legal proceedings any subsequent fraud by the assured is a matter for the court and not for the insurers.<sup>269</sup> It is irrelevant to a finding of the use of fraudulent means or devices that the assured's lie has unravelled before any settlement or during the course of the trial,<sup>270</sup> although it

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<sup>264</sup> Sutton, paras 15.75 to 15.78 and 15.84 to 15.85. Fraud now has a statutory definition in England, under the Fraud Act 2006. The definition adds nothing to the common law on insurance claims.

<sup>265</sup> [2002] Lloyd's Rep IR 573.

<sup>266</sup> Of the numerous examples, see: *Eagle Star Insurance Co Ltd v Games Video Co (GVC) SA, The Game Boy* [2004] Lloyd's Rep IR 867; *Interpart Comercio e Gestao SA v Lexington Insurance Co* [2004] Lloyd's Rep IR 690.

<sup>267</sup> The criteria laid down in *Agapitos v Agnew* [2002] Lloyd's Rep IR 573.

<sup>268</sup> A point left open in *Marc Rich Agriculture Trading SA v Fortis Corporate Insurance NV* [2005] Lloyd's Rep IR 396.

<sup>269</sup> This brings fraudulent claims into line with the continuing duty of utmost good faith which, insofar as it exists, terminates once proceedings have commenced: *Manifest Shipping Co v Uni-Polaris Co Ltd, The Star Sea* [2001] Lloyd's Rep IR 247. Earlier cases in which the courts have treated fraud in the proceedings as a fraudulent claim are to that extent no longer correct: *Transthene Packaging v. Royal Insurance* [1996] LRLR 32; *Insurance Corporation of the Channel Islands v. Royal Hotel (No. 1)* [1998] LRLR 94; *Baghbadrani v Commercial Union Assurance Co.* [2000] Lloyd's Rep. IR. 94. See also *The Ainikolas I* (1996) Lloyd's List, April 5. The point was seemingly overlooked in *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC).

<sup>270</sup> *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30.

has been held – perhaps inconsistently with this principle – that a statement by the assured which is plainly untrue and which does not induce the insurers in any way is not to be regarded as a fraudulent claim.<sup>271</sup>

**6.3** The Insurance Contracts Act 1984 does not seek to define “fraud”, so that the common law remains applicable. Australian courts have adopted much the same approach to fraud as their English counterparts.<sup>272</sup> The only controversial matter is point (5), as the courts originally objected to the notion that a perfectly valid claim could be lost by the assured’s subsequent conduct in pressing the claim.<sup>273</sup> That view has now been discredited in both Australia and New Zealand,<sup>274</sup> so that submission of fraudulent stock sheets<sup>275</sup> or a false statement as to the circumstances in which a motor vehicle had been damaged<sup>276</sup> will constitute fraud.

### **There must be a claim**

**6.4** Fraud by the assured is only relevant if it relates to a claim. The assured must have made a claim before it can be said that he has made a fraudulent claim. This obvious point causes some difficulty in liability insurance. In *K/S Merc Skandia XXXXII v. Certain Lloyd’s Underwriters*<sup>277</sup> the Court of Appeal was of the view that the assured under a liability policy cannot make a claim until he has suffered a loss, which occurs when the assured’s liability to a third party is established and quantified by judgment, arbitration award or binding settlement. Most liability policies impose an obligation on the assured to notify any third party claim and thereafter co-operate with the insurers in handling the claim by the third party. If *K/S* is correctly decided, any deliberate flouting of these obligations by the assured – eg by deliberately providing false information to the insurers – is a breach of contract, the consequences of which depend upon the nature of the term broken, but it is not a fraudulent claim. Given, however, that the notification of a third party claim to insurers may trigger their obligation to pay defence costs, it seems curious to argue that the assured has not himself made a claim at this stage, although here it may be noted that defence costs are generally a separate undertaking in the policy and it has recently been said that the tail of defence costs are not to wag the dog of indemnity.<sup>278</sup>

### **The effects of a fraudulent claim**

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<sup>271</sup> *Danepoint Ltd v Underwriting Insurance Ltd* [2005] EWHC 2318 (TCC). Inducement has been rejected as a relevant consideration in Australia: *Tiep Thi To v AAMI Ltd* (2001) 161 FLR 61.

<sup>272</sup> Mann, para 56.10.3; Sutton, paras 15.75 to 15.85.

<sup>273</sup> *GRE Insurance Ltd v Ormsby* [1982] 29 SASR 498, where the assured suffered a genuine burglary but sought to put the matter beyond doubt by causing additional damage to the door and lock that had been forced.

<sup>274</sup> *Vermeulen v SIMU Mutual Insurance Association* (1987) 4 ANZ Insurance Cases 60-812; *New Zealand Insurance Co Ltd v Forbes* [1988] 5 ANZ Insurance Cases 60-871; *Back v National Insurance Co of New Zealand Ltd* [1996] 3 NZLR 363; *Mourad v NRMA Insurance Ltd* [2003] 12 ANZ Insurance Cases 61-560.

<sup>275</sup> *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 6 WAR 68.

<sup>276</sup> *Tiep Thi To v AAMI Ltd* (2001) 161 FLR 61. Contrast *Insurance Manufacturers of Australia Pty Ltd v Heron* [2005] VSC 482 where the court found that no fraudulent statements had been made.

<sup>277</sup> [2001] 1 Lloyd’s Rep 802.

<sup>278</sup> *Travelers Casualty and Surety Co of Canada v Sun Life Assurance Co of Canada (UK) Ltd* [2006] EWHC 2716 (Comm).



**6.5** The common law position, which reflects the standard fraud wording used in the London market, that in the event of a fraudulent claim the assured is to forfeit all benefit under the policy,<sup>279</sup> is that a fraudulent claim does not amount to a breach of the duty of utmost good faith<sup>280</sup> but rather is a breach of contract so that the remedy of the insurers is not to avoid the contract: the remedy is contractual only.<sup>281</sup> This principle is now statutory in Australia, s 56(1) of the Insurance Contracts Act 1984 stating that the insurer may not avoid the policy.<sup>282</sup> It is settled law in England that the insurers have the right to refuse to pay a fraudulent claim, and s 56(1) of the 1984 Act similarly provides that the insurers may refuse payment of the claim. From that point onwards there are three uncertainties in English law which have been resolved in Australia.

**6.6** Fraud by one co-assured is in principle not fatal to the rights of another co assured,<sup>283</sup> in the absence of agency,<sup>284</sup> although in the case of joint insurance fraud by one joint assured affects the rights of all.<sup>285</sup>

#### *Effects on the policy and on other policies*

**6.7** The first is whether the insurers have the right, in addition to refusing to pay the claim, to treat the policy as repudiated and accordingly to terminate the contract for breach. This matter was carefully left open by the Court of Appeal in *Axa General Insurance v Gottlieb*.<sup>286</sup> If the insurers are limited to refusing to pay the claim, the fraud is necessarily backdated to the loss itself, so that fraud subsequent to the loss itself means that there was never a point at which the insurers were liable to pay the claim. The point has been addressed in the Australian legislation, s 60(1)(e) of the 1984 Act stating that where the assured under a general policy has made a fraudulent claim the insurers are entitled to cancel both the policy itself and also any other policy between the parties on the basis that the insurers cannot be expected to maintain a contractual relationship with a fraudster.<sup>287</sup> The notion that insurers can cancel other insurance contracts as well is not one which has arisen in England, and there is certainly room to argue that the sanction

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<sup>279</sup> *Britton v. Royal Insurance Co* (1866) 4 F. & F. 905, 909.

<sup>280</sup> A line of authority, starting with *The Litsion Pride* [1985] 1 Lloyd's Rep 437, and continued in *Continental Illinois National Bank of Chicago v Alliance Assurance Co Ltd*, *The Captain Panagos* [1986] 2 Lloyd's Rep 470 and by Sir Roger Parker in *Orakpo v Barclays Insurance Services Ltd* [1995] LRLR 433, adopted the utmost good faith approach.

<sup>281</sup> *The Star Sea* [2001] Lloyd's Rep IR 247; *K/S Merc Skandia XXXXII v Certain Lloyd's Underwriters* [2001] Lloyd's Rep IR 802; *Agapitos v Agnew* [2002] Lloyd's Rep IR 573; *Marc Rich Agriculture Trading SA v Fortis Corporate Insurance NV* [2005] Lloyd's Rep IR 396.

<sup>282</sup> Based on ALRC 20, para 243. See *Walton v The Colonial Mutual Life Assurance Society Ltd* [2004] NSWSC 616. The relationship between good faith and fraudulent claims is discussed in Sutton, paras 15.71 to 15.73 and 15.82 to 15.83.

<sup>283</sup> *VL Credits Pty Ltd v Switzerland Insurance Co* [1990] VR 938.

<sup>284</sup> *Direct Line v Khan* [2002] Lloyd's Rep IR 151, in which the Court of Appeal was prepared to accept that a husband-wife policy was composite and not joint, but that the husband acted as agent for the wife in making a fraudulent claim. If there is agency, then s 56(1) of the 1984 Act reaches the same result: it expressly provides that a fraudulent claim made by a person who is not the assured is itself a fraudulent claim.

<sup>285</sup> *MMI General Insurance v Baktoo* [2000] NSWCA 70.

<sup>286</sup> [2005] Lloyd's Rep IR 369.

<sup>287</sup> ALRC 20, paras 243 and 251.

is unduly harsh. Whatever the effect on the policy and on other policies, there needs to be express provision in any UK legislation as to the effect of cancellation on the rights of an innocent co-assured. It is implicit in the legislation that, unless steps are taken to cancel the policy, it remains in full force other than in respect of the claim itself.<sup>288</sup>

### *Effect of fraud on later claims*

**6.8** If, it is the case that the contract itself is to be treated as repudiated, then the second uncertainty is whether the right to terminate dates back to the loss which gave rise to the fraudulent claim or whether it takes effect from the date of the fraud. The assured may suffer genuine loss A and then genuine loss B, followed by a fraudulent claim in relation to loss A. Plainly, as stated above, the fraud taints loss A itself, but if the insurers have the right to terminate the policy does that mean that loss B also disappears, or is it the case that at the time that loss B occurred the policy was valid and in existence so that the termination of the policy cannot affect the assured's accrued rights in respect of loss B? The Insurance Contracts Act 1984 does not directly address this problem, although it would seem that cancellation is possible only by the insurer giving fourteen days' notice of cancellation in accordance with s 59 of the 1984 Act. If that is right, then the Australian solution is that the claim itself is lost, but that losses which occur up to the date on which cancellation takes effect are payable by the insurers. Again, the solution is not an obvious one and it might be argued that if it is right that insurers have the right to refuse to deal with the assured in the light of his fraud then the fraud – albeit backdated to the loss which gave rise to the fraud – should preclude future claims.

### *Relief from fraud*

**6.9** The final issue is whether fraud should disentitle the assured from making any claim against the insurers. The point is particularly acute where fraud relates only to part of a claim, typically in the case of an exaggerated claim where the amount of the assured's loss is less than the sum claimed. The approach of English law is to treat an exaggeration as fraudulent when it both goes beyond a mere "bargaining" claim<sup>289</sup> designed to ensure that any offer by the insurers does not undervalue the actual loss and where the amount of the exaggeration is substantial. English law has rejected any possibility of apportionment<sup>290</sup> and has held that exaggeration which is substantial taints the entire claim. The legal policy behind this is to discourage fraudulent claims. One uncertainty here is that some cases take the view that the extent of exaggeration is to be measured both in absolute and in proportional terms, so that exaggeration by a significant sum is always fraud but a small exaggeration may also be fraud if the claim itself is small.<sup>291</sup> Other

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<sup>288</sup> *Barroora Pty Ltd v Provincial Insurance (Australia) Ltd* (1992) 7 ANZ Ins Cas 61-103; *C E Heath Casualty and General Insurance Ltd v Grey* (1993) 32 NSWLR 25.

<sup>289</sup> See: *London Assurance v Clare* (1937) 57 Ll LR 254; *Nsubuga v Commercial Union Assurance Co plc* [1998] 2 Lloyd's Rep 682; *Horne v Norwich Union Insurance Ltd* July 2005, unreported.

<sup>290</sup> Despite the views of Staughton LJ in *Orakpo v Barclays Insurance Services Ltd* [1995] LRLR 433, followed in *Transthene Packaging Co Ltd v Royal Insurance (UK) Ltd* [1996] LRLR 32.

<sup>291</sup> The authorities on the extent of exaggeration are too numerous to be mentioned here. The most important recent cases are: *Orakpo v Barclays Insurance Services Ltd* [1995] LRLR 443; *Transthene Packaging Co Ltd v Royal Insurance (UK) Ltd* [1996] LRLR 32; *Insurance Corporation of the Channel Islands Ltd v McHugh (No.1)* [1997]

cases suggest that the matter is to be looked at purely in proportional terms, so that, for example, exaggeration by £2000 is not fraud where the total loss is 300 times greater.<sup>292</sup> The English cases also seem to accept the concept that if the assured has suffered two entirely separate losses from the same event fraud in relation to one will not taint the other,<sup>293</sup> although the point is unclear.<sup>294</sup>

**6.10** Sections 56(2) and 56(3) of the 1984 Act, by contrast, adopt a proportionality approach. Section 56(2) states that the court may, “if only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair, order the insurer to pay, in relation to the claim, such amount (if any) as is just and equitable in the circumstances”. This is subject to s 56(3), under which in making an order under s 56(2) the court must “have regard to the need to deter fraudulent conduct in relation to insurance but may also have regard to any other relevant matter.”<sup>295</sup> The discretion is thus a broad one, with the relevant factors for the grant of partial relief being the degree of the fraud, the need to deter fraud and any other circumstances. In recommending this approach, the ALRC noted that insurers would not in practice reject an entire claim where there was a small and insignificant fraud affecting part of it, and gave as an illustration of the circumstances in which its recommendation for partial recovery would operate a baggage claim for A\$3000 which included a fraudulent claim for a camera worth A\$200.<sup>296</sup> However, a subsequent example given by the ALRC in its notes to its draft Bill referred to fraud of A\$100 in a claim of A\$10,000, and the Explanatory Memorandum leading to the Act referred to fraud of A\$50 in a claim of \$100,000. It is unlikely that the Australian position is in practice any different to that prevailing in England. The examples given by the ALRC and in the Explanatory Memorandum would not be treated as fraud at all in England, whereas in Australia they would be treated as fraud but which was nevertheless capable of being excused under s 56(2).

**6.11** Should s 56(2) be adopted in this jurisdiction? Surprisingly underwriters appear to have no objection to the subsection, as indeed the ALRC had predicted. It has been tested in three contexts. The first is where the assured has made a false statement in the course of his claim as regards the circumstances of the loss or the events leading up to it: the view taken here is that a false statement which relates to the entirety of the claim is not one which can be described as relating “only [to] a minimal or insignificant part” of it.<sup>297</sup> The second is where the assured has exaggerated his claim. The third is where the assured has suffered a number of divisible losses and there is fraud in respect of some of them. It is notable that the ALRC’s examples were of the third type, and it has been doubted whether partial fraud in relation to a single loss falls within s

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LRLR 94; *Nsubuga v Commercial Union Assurance Co plc* [1998] 2 Lloyd’s Rep. 682; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] LRLR 209; *Baghadrani v Commercial Union Assurance Co plc* [2000] Lloyd’s Rep IR 94; *Direct Line v Khan* [2002] Lloyd’s Rep IR 151; *Micro Design Group Ltd v Norwich Union Insurance Ltd* [2005] EWHC 3093 (TCC); *Axa Insurance Ltd v Gottlieb* [2005] Lloyd’s Rep IR 369; *Danepoint Ltd v Underwriting Insurance Ltd* [2005] EWHC 2318 (TCC).

<sup>292</sup> *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC).

<sup>293</sup> *Danepoint Ltd v Underwriting Insurance Ltd* [2005] EWHC 2318 (Comm), an argument not made out on the facts.

<sup>294</sup> Cf the facts of *Direct Line v Khan* [2002] Lloyd’s Rep IR 151.

<sup>295</sup> See Sutton, paras 15.86 to 15.88.

<sup>296</sup> ALRC 20, para 243.

<sup>297</sup> *Gugliotti v Commercial Union Assurance Co of Australia* (1992) 7 ANZ Ins Cas 61-104; *Tiep Thi To v AAMI Ltd* (2001) 161 FLR 61.

56(2),<sup>298</sup> and that what is required is severable loss. Assuming that what is required is a severable loss, the question then becomes, when is a severable loss a minimal or insignificant part of the total loss. In *Entwells Pty Ltd v National and General Insurance Co Ltd*<sup>299</sup> it was held that the exaggeration of a claim of between A\$222,589 and A\$528,000 by A\$27,000 was not sufficiently large to taint the entirety of the claim, a decision which has not been welcomed. The author's own view is that there is a clear need to deter fraud and that this should be the paramount consideration, but that it should continue to be recognised that not every exaggerated claim is fraudulent. On balance the discretion conferred upon the courts by s 56(2)-(3) is likely to give the wrong message, and that the English approach remains correct.

## 7 WARRANTIES

### The common law

**7.1** Warranties in their origin were designed to describe and delimit the risk that insurers were prepared to run. If the risk as described to insurers was not that which they actually faced, it seemed right for them to treat themselves as discharged from future liability. However, the original conception has been abused, and by the middle of the twentieth century it had become common practice for insurers to demand warranties of all manner of matters, many of which would have had no or little impact on the underwriting decision, such as the marine premium payment warranty which guaranteed payment of premium instalments on given days. The defects with the law of warranties are too well known to be rehearsed at any length. It suffices to say that a warranty as now understood is a guarantee of the truth of a particular statement whether or not that statement is material to the risk or affected the underwriter's judgment, or in the case of a future warranty that a given state of affairs will prevail whether or not that state of affairs was relevant to the risk.<sup>300</sup> The use of the word "warranty" is not essential, and it suffices that the intention of the parties to create a warranty is clear:<sup>301</sup> relevant considerations include whether the term goes to the heart of the risk and whether damages would be an adequate remedy in the event of breach.<sup>302</sup> All non-marine warranties must be express, although there are implied warranties of seaworthiness and legality in marine law.<sup>303</sup> If the warranty is broken the risk terminates automatically,<sup>304</sup> so that in the case of a present warranty the risk never attaches (and the premium is never earned) whereas in the case of a future warranty the risk terminates from the date of breach (leaving the premium irrecoverable because the risk has attached) and the risk

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<sup>298</sup> *Riccardi v Suncorp Metway Insurance Ltd* (2001) 11 ANZ Ins Cas 61-493. The market in Australia has this view of the section.

<sup>299</sup> *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 6 WAR 68.

<sup>300</sup> Marine Insurance Act 1906, s 33(1).

<sup>301</sup> Marine Insurance Act 1906, s 35.

<sup>302</sup> *HIH Casualty and General Insurance v New Hampshire Insurance* [2001] Lloyd's Rep IR 596.

<sup>303</sup> Marine Insurance Act 1906, ss 33(2), 39 and 41 respectively.

<sup>304</sup> Marine Insurance Act 1906, s 33(3), as construed by *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd, The Good Luck* [1991] 3 All ER 1.

is not reinstated when the assured's breach of the warranty is remedied. It follows that any loss arising after breach of warranty is uninsured, and this in turn means that there is no need for any causal connection between the breach of warranty and the loss.<sup>305</sup> One particular curiosity of the law is that because the insurers are automatically discharged, they cannot waive the breach other than by putting themselves in a position whereby they are estopped from reliance on the breach.<sup>306</sup> There is also a doctrine of strict compliance with warranties, so that any breach other than one which is minuscule is fatal to the risk.<sup>307</sup> A long-standing device for creating warranties is the basis of the contract clause, which appears in the proposal and which purports to incorporate all of the assured's answers into the policy as warranties.<sup>308</sup> The advantage to insurers of the warranty is any immaterial and non-inducing false statement which has been warranted can be relied upon, whereas the policy cannot be avoided for misrepresentation in the absence of a material false statement. Any failure to disclose cannot amount to a breach of warranty: a positive false statement is required. The defects in the law of warranties have been recognised regularly by the courts, from which there has emanated a series of disparaging comments<sup>309</sup> and the adoption of a number of devices to mitigate the harshness of warranties, including narrow construction,<sup>310</sup> confining the warranty to a specific part of the policy<sup>311</sup> and treating what would otherwise be a continuing warranty as merely suspending the risk so that once the breach has been repaired the risk reinstates.<sup>312</sup>

**7.2** The Law Commission in its 1980 Report recognised that the law of warranties was unsatisfactory, in four respects: cover could be lost for failure to comply with a term immaterial to the risk; there was no need for a causal link between the breach and any later loss; warranties, despite their significance, were not readily accessible to the assured; and basis of the contract clauses were a particular problem because they deemed all statements to be warranties, whether or not they were material to the risk and without drawing the assured's attention to them. The Law Commission's solution was to: (a) abolish basis clauses and require insurers to give assureds a written statement of any warranties as soon as practicable after the contract was made, possibly by providing the assured with a copy of the proposal form; and (b) require insurers to pay despite a breach of warranty unless the assured could show that the breach of warranty was immaterial to the risk, that the type of loss fell within the commercial purpose of the warranty and that there was no causal connection between the breach and the loss. It was also of the view that whether or not the insurers were required to pay, they could give notice terminating the policy for the future.

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<sup>305</sup> *Forsakrings Vesta v Butcher* [1989] 1 Lloyd's Rep 331.

<sup>306</sup> *HIH Casualty and General Insurance v Axa Corporate Solutions* [2003] Lloyd's Rep IR 1.

<sup>307</sup> Marine Insurance Act 1906, s 33(3).

<sup>308</sup> *Yorkshire Insurance v Campbell* [1917] AC 218.

<sup>309</sup> Notably by Lord Griffiths in *Forsakrings Vesta v Butcher* [1989] 1 Lloyd's Rep 331, bemoaning the absence of any causal link between the breach and the loss.

<sup>310</sup> *Hide v Bruce* (1783) 3 Doug 213.

<sup>311</sup> *Printpak v AGF Insurance* [1999] Lloyd's Rep IR 502.

<sup>312</sup> As exemplified by *Provincial Insurance v Morgan* [1933] AC 240 and *Kler Knitwear Ltd v Lombard General Insurance Co Ltd* [2000] Lloyd's Rep IR 47.

## Warranties of fact

**7.3** Warranties of fact are dealt with very simply by s 24 of the Insurance Contracts Act 1984.<sup>313</sup>

“A statement made in or in connection with a contract of insurance, being a statement made by or attributable to the insured, with respect to the existence of a state of affairs does not have effect as a warranty but has effect as though it were a statement made to the insurer by the insured during the negotiations for the contract but before it was entered into.”

In short, and following the recommendations of the ALRC,<sup>314</sup> statements may no longer be warranted by basis clauses or by any other means, and all statements are to be treated as representations.<sup>315</sup> They are, accordingly, subject to the rules on misrepresentation discussed above. No distinction is drawn between consumer and commercial policies, and the view of those involved in operating the section in Australia emphasised its effectiveness.

## Continuing obligations: future warranties, coverage terms and conditions

### Outline

**7.4** Future warranties are encompassed by perhaps the most difficult section in the entire Insurance Contracts Act 1984, namely s 54, which was the result of lengthy deliberation by the ALRC.<sup>316</sup> The overriding considerations on which s 54 is based are the need for a causal link between the assured's breach of contract and the loss and, if there is such a link, reduction of the claim on a proportionate rather than absolute basis. The section is concerned with the assured's acts or omissions, including his obligation of continuing good faith under s 13. Section 54 is wide-ranging, extending to any contractual obligation which has “the effect” of entitling insurers to refuse to pay a claim, including provisions governing the assured's conduct during the currency of the policy (encompassing risk definition insofar as it is based on an act or omission of the assured,<sup>317</sup> continuing warranties and other obligations such as reasonable care clauses)<sup>318</sup> and provisions which regulate the assured's conduct in the claims process (notifying claims, co-operating with insurers and, in the case of a liability policy, not admitting liability or settling

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<sup>313</sup> Sutton, paras 3.319 to 3.122.

<sup>314</sup> ALRC 20, para 195.

<sup>315</sup> A similar recommendation has been made by the New Zealand Law Commission, *Some Problems of Insurance Law*, Report 46, 1998, Chapter 1. Sections 4-7 of the Insurance Law Reform Act 1977 presently prevent avoidance of a policy for misrepresentation unless it is material.

<sup>316</sup> ALRC 20, paras 215-244.

<sup>317</sup> Thus a claims made policy which attaches only if a claim is made against the assured during the currency of the policy cannot operate to allow the assured to seek indemnity for a claim made against the assured after the policy has expired: *Gosford City Council v GIO General Ltd* [2003] NSWCA 34. In such a case there is no relevant act or omission on the part of the assured.

<sup>318</sup> ALRC 20, paras 224-230.

without consent should the policy so specify).<sup>319</sup> The result is to treat all policy obligations or restrictions affecting the assured's conduct, whether in the form of risk definition, continuing warranties, conditions or otherwise, in exactly the same way, because they can all have the effect of entitling the insurers to refuse to pay a claim.<sup>320</sup> English law, by contrast, maintains a distinction between risk description, exclusions, continuing warranties whose breach is fatal to the risk irrespective of materiality or causation, suspensory conditions whose breach only precludes a claim during the period of breach, conditions precedent whose breach is fatal to the attachment of the risk or to any claim (as the case may be) and bare conditions whose breach is almost certain not to give rise to any right in the insurers to refuse to pay the claim or to recover damages for breach. English law in effect turns on the classification of the policy provision as defining the risk, or as a warranty or condition. If it is a condition then there is a further need to determine whether it is a condition precedent to any recovery or to the operation of the risk in given circumstances, or a bare condition. English law has been criticised for conferring all or nothing rights on insurers based on the drafting of the relevant provision rather than on its causal connection to the loss. Something along the lines of s 54 is clearly called for, and was indeed the very situation which prompted the ARLC to act.<sup>321</sup>

**7.5** The provisions of the section<sup>322</sup> may be summarised as follows.

- (1) In a case where the act or omission of the assured could not reasonably be regarded as being capable of causing or contributing to a loss, then under s 54(1) the insurers are not able to refuse to pay the claim by reason only of the act or omission but they are entitled to damages and any liability is to be reduced by the amount that fairly represents the extent to which the insurers' interests were prejudiced by the act or omission.
- (2) Where an act or omission of the assured could reasonably be regarded as being capable of causing or contributing to a loss covered by the policy, then on the face of things under s 54(2) the insurers may refuse to pay the claim.
- (3) Where an act or omission could reasonably be regarded as being capable of causing or contributing to a loss covered by the policy, but the assured proves that no part of the loss was caused by the assured's act or omission, the insurers may not, under s 54(3), refuse to pay the claim by reason only of the act or omission.
- (4) Where an act or omission could reasonably be regarded as being capable of causing or contributing to a loss covered by the policy, and the assured proves that some part of the loss was not caused by that act or omission, then under s 54(4) the insurers may not refuse to pay that part of the claim by reason only of the act or omission.
- (5) Where the act or omission was necessary to protect the safety of a person or to preserve property, or it was not reasonably possible for the assured or some other

<sup>319</sup> ALRC 20, paras 231-233 and 238-242.

<sup>320</sup> *East End Real Estate Pty Ltd v C E Heath Casualty and General Insurance Ltd* (1992) 25 NSWLR 400; *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652; *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) 204 CLR 641.

<sup>321</sup> ALRC 20, paras 216-220.

<sup>322</sup> As amended.

- person not to do the act or to avoid the omission, under s 54(5) the insurers may not refuse to pay the claim by reason only of the act or omission.
- (6) Whatever the nature of the breach, insurers have the right to give notice of cancellation under ss 59 and 60.

### *Act or omissions*

**7.6 General meaning.** The initial question is to decide whether the act or omission specified by the policy, and whatever its form,<sup>323</sup> is capable of causing or contributing to a loss.<sup>324</sup> If it is not so capable, s 54(1) applies; if it is so capable, s 54(2)-(4) apply. An act or omission will not be capable of causing or contributing to a loss if it is one of two types.

**7.7** First, claims provisions will generally fall within s 54(1), because by the time a claim is made the loss will already have occurred and the assured's conduct cannot contribute to it let alone cause it.<sup>325</sup> Failure by the assured to obtain the consent of the insurers for the incurring of defence costs falls within s 54(1).<sup>326</sup>

**7.8** Secondly, procedural obligations arising from the assured's use of the insured subject matter will normally be within s 54(1). It was held in *Ferrcom Pty Ltd v Commercial Union Assurance Co of Aust Ltd*<sup>327</sup> that the assured's failure to notify the registration of a mobile crane as a motor vehicle, contrary to a term requiring notice of change of use, could not have contributed to any loss. It was similarly held in *Gibbs Holdings Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd*<sup>328</sup> that failure to notify the insurers of an increase of risk by change of use did not affect the prospects of loss. The notes to the Draft Bill 1982 provide the illustration of a motor policy which requires the assured to have a driving licence: this is regarded as a s 54(1) case. It has also been held that a compromise agreement under which the assured surrenders subrogation rights is not an act capable of causing or contributing to a loss.<sup>329</sup>

**7.9** By contrast, provisions which relate to the risk itself are within s 54(2). Thus it was recognised in *Gibbs* that the act of increasing the risk would have been capable of causing a loss

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<sup>323</sup> But see *Stapleton v ATI Ltd* [2002] QDC 204 where it was held that risk definition was outside s 54. The policy excluded liability for damage to the assured's vehicle while it was engaged on a journey that would take it more than 450 kms from the assured's home base. It was damaged while on such a journey, albeit it was within the 450 km limit at the time. The court held that s 54 was inapplicable. A better analysis would be that the limit was one which was capable of causing or contributing to a loss, and that the loss had been caused by the fact that the vehicle was on the prohibited journey so that s 54(3) denied recovery. Were it otherwise, it would be possible to sidestep s 54 by drafting obligations as situations in which there was no cover.

<sup>324</sup> Sutton has suggested that this is a "reasonable insurer" test: Sutton, para 8.28.

<sup>325</sup> *Jones v Vero Insurance Ltd & Gibbs (Home Building)* [2005] NSWCTTT 534. There may be an exception in the case of liability insurance (and reinsurance), where a failure to allow (re)insurers to participate in the settlement process following a third party claim may affect their ultimate liability and thus the "loss" under the policy. See *infra*,

<sup>326</sup> *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652; *Manufacturers Mutual Insurance Ltd v Murray River North Pty Ltd* [2004] WASCA 276.

<sup>327</sup> (1993) 176 CLR 332.

<sup>328</sup> [2002] 1 Qd R 17.

<sup>329</sup> *Yeoh v Vero Insurance Ltd & Tannous (Home Building)* [2005] NSWCTTT 74.



had that been the conduct prohibited by the policy.<sup>330</sup> Equally, s 54(2) is engaged where the assured drives an insured vehicle while under the influence of alcohol,<sup>331</sup> where the assured modifies the insured vehicle without requesting the permission required of the insurers<sup>332</sup> or where the assured fails to set an alarm as required by the policy.<sup>333</sup>

**7.10 Omissions and inactions.** Perhaps the key issue which has arisen under s 54 is whether the assured's failure to exercise an option that would entitle him to cover had he exercised it can be classified as an "omission" and thus subject to the saving provisions of s 54, or whether there is simply "inaction" not amounting to omission. The main context of the question is the right of the assured under a liability policy to give notice to the insurers of circumstances likely to give rise to a claim so that he is thereby entitled to treat any subsequent claims made against him after the policy has expired as backdated to the notification of those circumstances. As will be seen below in the discussion of liability insurance, it is now settled, after a good deal of confusion, that an assured who fails to exercise a contractual option can be said to have been guilty of an omission which triggers s 54,<sup>334</sup> although this particular rule is likely to be reversed by legislation in due course.<sup>335</sup> In the same way, an assured who fails to seek the permission of liability insurers to incur defence costs falls within s 54, given that an omission includes a failure to exercise a right or choice.<sup>336</sup> The distinction between an option and an obligation at first sight appears to be an obvious one, but further reflection – as is demonstrated by the case law – indicates that any provision can be framed in either way. A condition precedent providing for a claim to be made as soon as reasonably practicable could equally be drafted as a clause which permits the assured to make a claim if he notifies the insurers as soon as is reasonably practicable; in the same way, the option to notify circumstances likely to give rise to a loss could be an obligation to notify circumstances which may (the more common form of wording) or are likely to give rise to a loss in order to trigger coverage. The Australian courts have, it is suggested, been correct in rejecting form and focusing on substance. There is a wider question as to whether a typical London market claims made policy should be treated in some special way, so that failure to notify circumstances is not something which can be disregarded. This is considered below.

**7.11 Extension of cover.** An additional situation in which the distinction between option and obligation comes to the fore is under a declaration policy or other form of cover under which the risk may be extended if the assured so wishes. If the policy is obligatory in that any risk accepted by the assured is automatically binding on the insurers, then any obligation on the assured to notify would under the Australian system fall within s 54(1) because it cannot have any effect on

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<sup>330</sup> See also *Austcan Investments Pty Ltd v Sun Alliance Insurance Ltd* (1992) 7 ANZ Ins Cas 61-116.

<sup>331</sup> *Bunting v Australian Associated Motor Insurers Ltd* February 1994, unreported, Tas Sup Ct.

<sup>332</sup> *Australian Associated Motor Insurers Ltd v Ellis* (1990) 54 SASR 61.

<sup>333</sup> *McNeill v O'Kane* [2004] QSC 144.

<sup>334</sup> The leading case affirming this distinction, *FAI General Insurance Co Ltd v Perry* (1993) 30 NSWLR 89, held that it was justified by reference to the considerations that: (a) the assured had a choice but failed to exercise it; and (b) the assured, by failing to exercise his option, did not lose any pre-existing rights. The counter arguments, which subsequently prevailed, were that: (a) the distinction gives effect to form over substance; and (b) if there is a distinction between a failure to act and a decision not to act, the law would be introducing subjective intention as the relevant test.

<sup>335</sup> See *infra*.

<sup>336</sup> *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652.

the risk and is purely administrative: there is no reason to deny the assured coverage for breach in such circumstances.<sup>337</sup> If the policy is facultative, so that a risk must be both offered by the assured and accepted by the insurers, failure by the assured to notify is in effect failure by the assured to make an offer to the insurers so that no contract in respect of the risk in question could ever have come into existence. This cannot be an omission at all: if it were, the law would be saying that an assured is entitled to recover from insurers to whom he failed to put a proposal. The difficult case is that of the facultative obligatory contract under which the assured has the option but not the obligation to notify a risk, and if he does so then the insurers are bound by it. Failure to notify in such a case is probably to be construed as an omission so that a later notification is permitted. The English courts have held that the cut off date for a notification is the date on which the assured became aware of the loss,<sup>338</sup> as the assured would otherwise be betting on the race after it had been run. This outcome is obviously right, and could be implemented by a statutory provision which stated that an option to create an insurance cannot be exercised once the loss has occurred or is known by the assured to have occurred.<sup>339</sup> It may be that the 1984 Act is as things stand to be construed in this way. In *Kelly v New Zealand Insurance Co Ltd*<sup>340</sup> the assured had an option to extend their cover by declaring specified items to the insurers: their failure to do so was held to be outside s 54 because it was “inaction” rather than “omission”. That reasoning clearly can no longer stand in the light of the abolition of that distinction in *Antico v Heath Fielding Australia Pty Ltd*<sup>341</sup> and *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd*<sup>342</sup> but it must surely be right that an assured cannot choose to opt into cover by paying additional premium after a loss has occurred.

**7.12 The liability insurance tangle.** The confusing case law on this matter has gradually settled down.<sup>343</sup> The majority of the High Court of Australia in *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd*<sup>344</sup> confirmed that an omission for the purposes of s 54 includes a failure by the assured to exercise a right, choice or liberty which he enjoys under a contract of insurance and is not restricted to obligations. The position is now as follows.<sup>345</sup>

- (1) If the policy permits the assured to notify circumstances which may give rise to a loss during the currency of the policy, and the assured fails to do so, this is an omission falling within s 54(1) which is capable of being excused to the extent

<sup>337</sup> Cf *Glencore International AG v Ryan, The Beursgracht* [2002] Lloyd’s Rep IR 335, which shows that English law can reach this conclusion as long as the obligation to notify is not a condition precedent.

<sup>338</sup> Cf *Glencore International AG v Alpina* [2003] 1 Lloyd’s Rep 1, which raises the possibility that the relevant date is the date of the loss whether or not the assured is aware of it.

<sup>339</sup> A deliberate decision not to notify in advance of the loss, coupled with an actual notification after the loss, would doubtless be regarded as breach by the assured of his duty of utmost good faith as set out in s 13 of the 1984 Act.

<sup>340</sup> (1996) 9 ANZ Ins Cas 61-317

<sup>341</sup> (1997) 188 CLR 652.

<sup>342</sup> (2001) 204 CLR 641.

<sup>343</sup> *CA & MEC McNally Nominees Ptd Ltd v HTW Valuers (Brisbane) Pty Ltd* (2001) 11 ANZ Ins Cas 61-507; *Gosford City Council v GIO General Ltd* (2002) 12 ANZ Ins Cas 61-527.

<sup>344</sup> [2001] HCA 38.

<sup>345</sup> Claims made and notified policies are not used in England, so the ruling in *East End Real Estate Pty Ltd v C E Heath Casualty & General Insurance Ltd* (1992) 25 NSWLR 400 that a failure to notify within the policy period could be excused by s 54 is of no relevance.

that there is no prejudice to the insurers.<sup>346</sup> In the absence of any such provision, the assured cannot argue that he was entitled by s 40(3) to give notice of circumstances which may give rise to a claim and then seek to be excused for not taking advantage of that statutory concession.<sup>347</sup>

- (2) If the policy requires the assured to notify a loss or claim as soon as he becomes aware of it, or within some time period thereafter, then his failure to do so is an omission which falls within s 54(1) which is capable of being excused to the extent that there is no prejudice to the insurers.
- (3) If the third party has, unknown to the assured, suffered a loss, but has not made a claim against the assured during the currency of the policy, the third party's failure to do so is outside s 54(1) even though the subsection refers to acts of "some other person".<sup>348</sup>
- (4) If the assured has notified circumstances or a claim against him, his subsequent failure to comply with claims co-operation obligations is a matter falling within s 54(1) which can be excused under s 54(1).
- (5) If the policy requires the assured to obtain the consent of the insurers before incurring defence costs or settling a claim, and the assured fails to do so, s 54(1) is applicable and the assured's failure to seek consent may be excused.<sup>349</sup> That does not of course mean that the insurers are liable: if the criteria set out in the policy for giving consent are not fulfilled, or if there are no criteria if the insurers have acted in good faith in refusing consent, there will still not be any recovery.

**7.13** To the extent that the Australian cases indicate that a failure to notify circumstances or any claim, and any failure to co-operate thereafter, are omissions which are not capable of causing or contributing to the loss in respect of which cover is provided, they appear to proceed on the assumption that a loss is the loss suffered by the claimant<sup>350</sup> against the assured rather than the loss by the assured himself. It may nevertheless be thought that the "loss" referred to in the legislation is the amount payable by the assured under the judgment, award or settlement secured by the third party. If that is right, then the omission is one which is capable of causing or contributing to the loss, and the matter is to be judged under s 54(3) so that the insurers are liable if the assured can prove that the assured did not cause his own loss. The outcome is the same whether the matter is dealt with under s 54(1) or under s 54(3), but to avoid pointless litigation it might make sense for the position of liability insurance to be the subject of specific provision on the point.

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<sup>346</sup> *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) CLR 641, overruling *FAI General Insurance Co Ltd v Perry* (1993) 30 NSWLR 89 and also the reasoning in *Greentree v FAI General Insurance Co Ltd* (1998) 158 ALR 592 and *Permanent Trustee v FAI General Insurance Co Ltd* (1998) 44 NSWLR 186.

<sup>347</sup> *Gosford City Council v GIO General Ltd* (2003) 56 NSWLR 542.

<sup>348</sup> *Greentree v FAI General Insurance Co Ltd* (1998) 158 ALR 592.

<sup>349</sup> *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652.

<sup>350</sup> For which proposition there is English authority: *Royal and Sun Alliance Insurance plc v Dornoch Ltd* [2005] Lloyd's Rep IR 544; *AIG Europe (Ireland) Ltd v Faraday Capital Ltd* [2006] EWHC 2707 (Comm),

**7.14** The position in Australia has been subject to heavy criticism<sup>351</sup> and was discussed at length by Treasury Review I, 2003. There was a general consensus that s 54 should no longer be utilised to condone late notification of circumstances likely to give rise to a claim after the policy had expired, and the Review duly recommended that notification by an assured to the insurers, of facts or circumstances which might give rise to a claim outside the period of cover, should be excluded from the relief provided under s 54.<sup>352</sup> The Review went on to reject the further suggestion that s 54 should be modified to deny relief in respect of a claim made against the assured while the policy remained current but not notified until after the policy had expired. A distinction is, therefore, to be drawn between contractual options in general and the option to bring coverage back into the year of a claims made policy by notifying circumstances which may give rise to a later claim.

**7.15** These proposals have been incorporated into the draft Insurance Contracts Amendment Bill 2007. The Bill maintains the distinction between policies which do not permit the assured to notify circumstances which may give rise to a claim and those which do. The former situation is governed by a revised s 40, under which the principle that the assured has a statutory right to notify circumstances which may give rise to a claim, so that any later claim is brought within the policy, is maintained, and indeed the assured has an additional 28 days after termination to notify circumstances which may give rise to a claim, coupled with the right to receive a statutory warning of the consequences of his failure to notify. The assured does not, however, have any right to rely on s 54 to excuse his failure to notify circumstances within the policy or the 28-day extended period. By contrast, where the policy does give the assured the right to notify circumstances likely to give rise to a claim (so that reliance on s 40 is unnecessary) and the assured fails to do so, the rule developed by the courts that the assured can seek to have his omission excused by s 54 is to be removed. New draft s 54A(2) provides that:

*(2) Despite subsection 54(1), the insurer may refuse to pay a claim against the insured or any third party beneficiary under the contract if:*

- (a) the insured or third party beneficiary became aware, during the period in which insurance cover was provided by the contract, of facts that might give rise to such a claim; and*
- (b) the insured or third party beneficiary did not give notice in writing to the insurer of those facts:*
  - (i) during the period in which insurance cover was provided by the contract; or*

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<sup>351</sup> Schoombee “*Antico's Case and Other Recent Decisions on Notification of Claims and Circumstances: Sections 54 and 40 of the Insurance Contracts Act*” (1997) 8 Ins LJ 167; Mead “*The Effect of Section 54 of the Insurance Contracts Act 1984 and Proposals for Reform*” (1997) 9 Ins LJ 1; J Clarke “*After the Dust Settles on Antico: FIA v Perry Lives*” (1997) 9 Ins LJ 29; Sutton “*The High Court Widens the "Reach" of the Insurance Contracts Act*” (1998) 26 *Australian Business Law Review* 57; Masel “*Taking Liberties with Claims Made Policies*” (2000) 11(2) Ins LJ 104.

<sup>352</sup> A similar problem has arisen in New Zealand under s 9 of the Insurance Law Reform Act 1977: see *Sinclair Horder O'Malley & Co v National Insurance Co of NZ Ltd* [1995] 2 NZLR 257; *Bradley West Clarke List v Keeman* (1997) 9 ANZ Ins Cas 76,742, and remedial legislation has been proposed by the New Zealand Law Commission, Report 46, 1998, chapter 3.

(ii) *within 28 days after that cover had expired.*<sup>353</sup>

Accordingly, if there is a contractual right to notify, any failure to exercise it either within the policy period or within a new extended 28-day period removes the possibility of the courts giving relief under s 54.

*Act or omission not capable of causing or contributing to a loss: prejudice*

**7.16** Once it is established that the assured's act or omission was not capable of causing or contributing to a loss, the insurers have to pay the claim. They are, however, entitled to damages which fairly represent the prejudice suffered to their interests. It is not possible to calculate damages by reference to common law authorities, for the simple reason that at common law breaches of conditions precedent and continuing warranties do not give rise to damages, so that common law rules have to be applied by analogy.<sup>354</sup> Damages will generally take the form of deduction from the sum payable under the policy, and the cases are consistent that, as in cases under s 28, in appropriate circumstances deduction can reduce the sum payable to nil. The authorities establish that there is a two-step test to determining prejudice: the insurers have to prove that they would have relied upon the assured's act or omission in order to defeat the claim; and they have to prove that their inability to do so means that they have suffered monetary prejudice.<sup>355</sup> In circumstances where the assured has broken a term which would have given the insurers a complete defence, then on the face of things the insurers have lost their opportunity to deny liability and the prejudice suffered by them is the full amount of the claim. Equally, if the assured has not sought the insurers' consent for a variation of the risk – whether it be the addition of a named driver of a motor vehicle<sup>356</sup> or the incurring of defence costs<sup>357</sup> – and the insurers can show that consent would have been refused or that they would have come off risk, their prejudice is *prima facie* 100% of the assured's claim. However, recovery is possible if the insurers cannot show that they would have taken that opportunity. The general view taken by the courts is that if the assured's breach is not one which would have produced any different result then there is no prejudice. Thus in the case of a liability policy, failure by the assured to give the insurers due notice of a claim against him and which prevents them from defending the claim properly only gives rise to prejudice if the insurers can show that their defence would have made a difference to the outcome,<sup>358</sup> in the case of a property policy the insurers have not suffered any prejudice if they cannot show that they would have refused their consent to a change of risk<sup>359</sup> and in a

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<sup>353</sup> The drafting is not perfect. Draft s 54A(1) states that the section applies only to policies within s 40, but this reference appears to be erroneous, as the whole point is that s 40 applies only to policies which do not permit notification of circumstances.

<sup>354</sup> *Ferrcom Pty Ltd v Commercial Union Assurance Co of Aust Ltd* (1993) 176 CLR 332.

<sup>355</sup> *Ferrcom Pty Ltd v Commercial Union Assurance Co of Aust Ltd* (1993) 176 CLR 332; *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149. See also *Yeoh v Vero Insurance Ltd & Tannous (Home Building)* [2005] NSWCTTT 74 (loss of subrogation rights).

<sup>356</sup> *Australian Associated Motor Insurers Ltd v Ellis* (1990) 54 SASR 61. See also *Gibbs Holdings Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* [2002] 1 Qd R 17.

<sup>357</sup> *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652.

<sup>358</sup> *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652 (no prejudice); *FAI General Insurance Ltd v Jarvis* (1999) 19 ANZ Ins Cas 61-426 (prejudice).

<sup>359</sup> *Ferrcom Pty Ltd v Commercial Union Assurance Co of Aust Ltd* (1993) 176 CLR 332.

personal injury claim failure by the assured to inform the insurers in due time will only be regarded as having caused prejudice if the insurers can show that they would have undertaken an examination of the assured and that this might have affected the outcome of the claim.<sup>360</sup> By contrast, if the insurers have been denied an opportunity to investigate a claim properly and they would otherwise have been able to recover from a third party, the claim may be reduced by that amount.<sup>361</sup>

*Act or omission capable of causing or contributing to a loss: causation*

**7.17** The starting point is that an act or omission of the assured in breach of policy terms which is capable of causing or contributing to a loss gives the insurers a defence (s 54(2)). However, this is subject to a causation test. Under s 54(3), if the assured can prove that no part of the loss was caused by the act or omission and that the loss arose from a completely separate source even though the assured was in breach of his policy obligations at the time, the insurers are liable for the full amount of the claim. It is to be noted that s 54(3) is concerned with the loss itself and not with the potential for a loss: if the act or omission does not have the potential to give rise to a loss, then the matter is dealt with under s 54(1), whereas if it does have that potential then the question under s 54(3) is whether the act or omission actually caused the loss. Thus if a vehicle is warranted to be roadworthy, and is stolen while parked and not in use, the roadworthiness provision attracts s 54(2) because its breach is capable of causing a loss, but the assured will recover under s 54(3) because his breach did not cause the loss. The fact that it may have contributed to the loss does not prevent the operation of s 54(3). The test under s 54(3) is “caused”, so that the assured can recover if the proximate cause of the loss was something other than the act or event and he cannot recover if the loss was proximately caused by the act or event. If there are two causes of the loss, one the assured’s act or omission and one a cause beyond the assured’s control, ordinary causation principles would indicate that the exclusion takes priority and that there is no recovery at all.<sup>362</sup> It would seem, however, that even if the assured can prove that his conduct did not cause the loss so as to bring himself within s 54(3), the insurers are still entitled to damages under s 54(1) based on the prejudice that they have suffered by reason of the assured’s conduct.<sup>363</sup> Sutton has explained the point in the following way. If the act is capable of causing or contributing to a loss, s 54(2) applies and the insurers may refuse to pay the claim, although the assured is entitled to recover under s 54(3) if he can prove that his conduct did not cause the loss. The effect of the assured establishing that the loss was not caused by his conduct is, however, to disapply s 54(2), because the operation of s 54(2) is expressly stated to be subject to s 54(3) – that means that s 54(2) ceases to be relevant and the matter is to be dealt with under s 54(1), where the insurers are entitled to damages for any prejudice suffered by them by reason of the assured’s act or omission (ie, causation).<sup>364</sup> Whatever the correct explanation of apportionment might be, it is plainly right – as commented by Sutton – that “the

<sup>360</sup> *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) ANZ Ins Cas 61-468.

<sup>361</sup> *Jones v Vero Insurance Ltd & Gibbs (Home Building)* [2005] NSWCTTT 534.

<sup>362</sup> *Wayne Tank & Pump Co v Employers’ Liability Assurance Corp Ltd* [1973] 2 Lloyd’s Rep 237

<sup>363</sup> The notes to the Draft Bill give the example of an assured who warrants that his vehicle will be maintained in a roadworthy condition, and it is damaged in a collision for which a third party is 50% responsible: the assured is entitled to recover 50% of the policy moneys.

<sup>364</sup> Sutton, para 8.30, citing *Australian Associated Motor Insurers Ltd v Ellis and Ellis* (1990) 54 SASR 61.

legislation could hardly have intended the result that, where the act of the assured could not have caused the loss, the prejudice suffered by the insurer could thereby be taken into account in assessing liability, but that such prejudice could not be considered where the act was one which was capable of causing or contributing to the loss, but was found not to have done so.”<sup>365</sup> The Law Commissions are also suggesting that the causation test should not provide an absolute defence to insurers and that some measure of apportionment should be applied where the loss was in part the result of the assured’s act or omission.

**7.18** Section 56(4) states that if the assured proves that some part of his loss which gave rise to the claim was not caused by his own act or omission, the insurers are liable for that part of the loss. The subsection is apparently not concerned with apportionment of blame for a single loss, but is concerned with different insured losses. This provision has been anticipated by English law<sup>366</sup> but it is worthy of codification.

### *Comment*

**7.19** It is important that insurers should remain able to define the risks that they are willing to insure and that they should not face liability for any other form of risk. Section 54 achieves this by allowing insurers to define the limits of cover so that if the assured exceeds the limits of cover, eg, by using a motor vehicle in a prohibited way, the insurers can argue that but for the prohibited use the loss would not have occurred and there is no recovery. In addition to immunity from the claim, they can then give notice to cancel the policy. Warranties as originally conceived were promises taken by insurers to guarantee that the risk had been accurately described to them. If the risk was not as described – particularly in respect of a vessel moored overseas or a cargo which the insurers had no way of inspecting – then it would never attach. The notion that a warranty could extend to matters unconnected with underwriting the risk, in particular through a basis clause, was a later innovation. The concept of a “premium warranty” is even more bizarre. It is plainly right that insurers should be permitted to treat themselves as discharged where underwriting has been undermined. Accordingly it is necessary to find a mechanism which distinguishes between terms which define the very risk that is covered by the policy and terms which remove liability in particular circumstances. The Australian legislation attempts to achieve just that. It does not preclude a delimitation of cover based on external considerations, and it allows the court to limit or refuse recovery if the assured has failed to comply with contract provisions which are designed to prevent or minimise the risk of losses. The section probably does not interfere with the common law principle that a fundamental alteration in the nature of the risk discharges the insurers automatically,<sup>367</sup> at least where the alteration is beyond the control of the assured. If the alteration is the result of the assured’s actions, then it is almost certain that the insurers would be discharged from liability under s 54(2).

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<sup>365</sup> Sutton, para 8.77.

<sup>366</sup> *Printpak v AGF Insurance Ltd* [1999] Lloyd’s Rep IR 452.

<sup>367</sup> *Swiss Reinsurance Co v United India Insurance Co Ltd* [2005] Lloyd’s Rep IR 341.

**7.20** Treasury Review I, 2003, found that s 54 was generally welcomed and that there were no calls for its general abolition or modification, despite its overcautious rejection by ALRC for marine insurance purposes. The beauty of the Australian non-marine approach is that it removes all distinctions between classes of terms and is concerned only with the relationship between the operation of the provision and the loss suffered by the assured. The initial classification of terms into those whose breach are capable of causing or contributing to a loss and those which are not so capable is not without its difficulties, many of which do not arise in England because of the use of “claims made” rather than “claims made and notified” policies in this jurisdiction, but the section operates logically thereafter, subject to the possible need to modify the section so that it no longer condones notification of circumstances under a claims made policy where the policy has expired. Notice and other provisions which are not capable of causing or contributing to loss are analysed purely in terms of the prejudice suffered by the insurers following their “breach”,<sup>368</sup> a process familiar to the English courts in the case of innominate terms. The English courts have been very slow to find that insurers have suffered prejudice sufficient to remove some or all of their liability, but in fairness insurers in England have rarely claimed damages for breach of policy terms. The damages test seems to work well. In late notification cases the English courts have doubted whether insurers have suffered any prejudice at all,<sup>369</sup> whereas in a case where the assured failed to notify insurers of an increase of risk, the assured was held to have caused prejudice to the insurers in that they had been denied the opportunity to insist upon increased security measures so that the assured’s damages were reduced by 50%.<sup>370</sup> Had these cases arisen in Australia, the result under s 54(1) of the Insurance Contracts Act 1984 would in all probability have been the same in each of them.

**7.21** The causation test under s 54(2)-(4) for acts or omissions capable of giving rise to losses is again something which English law could readily endorse. The need for a causation test was mooted by Lord Griffiths in *Forsakrings Vesta v Butcher*<sup>371</sup> in 1989, and the Australian approach – with some essential tidying up of the wording to confirm that apportionment is involved rather than a strict all or nothing causation test – is logical. However, one matter which domestic legislation must address is exactly how apportionment is to work where the assured is shown to have caused his own loss in part. Thus, if the assured is using the insured subject matter in a manner which is prohibited by the policy, and suffers a loss from an independent source, exactly what proportion of the policy proceeds should be deducted? Australian law does not give a clear answer. If a vehicle is only to be used for social, domestic or pleasure purposes, and suffers an accident while being used for business purposes, then the assured’s act is one which is capable of causing or contributing to a loss so that s 54(3)-(4) are engaged. The assured would then, in order to recover, be required to show that no part of the loss was caused by the breach. If he could do that, then the insurers would be entitled to damages under s 54(1) representing the prejudice caused to them by reason of the assured’s act or omission. This permits the court to effect an apportionment based on causation, and it is arguable that their liability could be anything from

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<sup>368</sup> Not the correct word for a clause framed as a part of the risk or as an exclusion, but it will suffice as shorthand for present purposes.

<sup>369</sup> *K/S Merc-Skandia XXXXII v Lloyd’s Underwriters* [2001] Lloyd’s Rep IR 802; *Friends Provident v Sirius* [2006] Lloyd’s Rep IR 45.

<sup>370</sup> *Hussain v Brown (No 2)* 1996, unreported.

<sup>371</sup> [1989] AC 852.



100% (on the basis that the insurers would have refused to insure) to nil.<sup>372</sup> The problem here is that the prejudice contemplated by s 54(1) is not related to the degree to which the assured's conduct contributed to the loss, but rather to the insurers' loss of opportunity to refuse cover. It should be made clear in any English legislation that apportionment is to be on causation grounds.

**7.22** The point was considered by the New Zealand Law Reform Commission in its 1998 Report. The Law Commission considered and rejected the adoption of s 54. Under New Zealand law as it stands, s 11 of the Insurance Law Reform Act 1977 prohibits reliance on a term excluding or limiting liability in circumstances where there is an increased risk of loss "if the insured proves on the balance of probability that the loss in respect of which the insured seeks to be indemnified was not caused or contributed to by the happening of such events or the existence of such circumstances." This creates the requirement for a causal link between the assured's act or omission and the loss suffered by the assured. The Law Commission expressed dissatisfaction with its own provision on the ground that it had been interpreted in a fashion which imposed liability on insurers where the assured was in blatant breach of a term delimiting the risk but the loss had not been caused by such breach.<sup>373</sup> Although s 54 would give rise to proportional recovery rather than to an all or nothing approach in such cases, the New Zealand Law Commission felt that the Australian approach gave rise to an unacceptable degree of uncertainty<sup>374</sup> and also allowed an assured to recover something in circumstances when he ought to have recovered nothing. Its solution was to recommend the retention of s 11, but with the addition of a new subsection which takes particular risk-defining terms found to have given rise to difficulties outside the scope of the indulgence granted by s 11:

- (3) A provision is not an increased risk exclusion for the purposes of this section that
  - (a) defines the age, identity, qualifications or experience of a driver of a vehicle, a pilot of an aircraft, or an operator of a chattel; or
  - (b) defines the geographical area in which a loss must occur if the insurer is to be liable to indemnify the insured; or
  - (c) excludes loss that occurs while a vehicle, aircraft, or other chattel is being used for commercial purposes other than those permitted by the contract of insurance.

**7.23** Finally, it should be noted that there is nothing in s 54 which touches upon the rights of co-assureds.<sup>375</sup> Domestic legislation should deal with this matter expressly, presumably by confirming the accepted rule that a composite assured is not tainted by the wrongdoing of other policyholders. Whether the same rule should continue for joint assureds is a matter to be resolved.

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<sup>372</sup> Sutton, para 8.78.

<sup>373</sup> *New Zealand Insurance Co Ltd v Harris* [1990] 1 NZLR 10; *State Insurance Ltd v Lam* 1996, unreported.

<sup>374</sup> "Sweeping and unfocused".

<sup>375</sup> Sutton, para 8.34.

## Continuing obligations in marine insurance

### *Express marine warranties*

**7.24** The ALRC in its 2001 report on marine insurance<sup>376</sup> discussed whether the provisions of the 1984 Act should be extended to the marine market. The ALRC rehearsed the familiar objections to warranties and then considered whether s 54 of the Insurance Contracts Act 1984 could operate in the marine context. The ALRC had reservations, noting the problems which had been caused by professional indemnity policies, and also commenting that s 54 was “more consumer oriented than one would expect in legislation dealing with marine insurance which operates in the vast majority of cases in a wholly commercial context”, that adopting s 54 would be a sweeping reform which rewrote the terms of the cover and which had the potential to increase room for dispute as to whether a claim was payable, and that the proportionality test gave rise to uncertainty.<sup>377</sup> The ALRC thus recommended a more limited reform, based on causation, as follows:<sup>378</sup>

- (1) The existing law on express warranties should be abolished.
- (2) Insurers should be able to include a term that they are discharged from liability, but only for loss proximately caused by the breach of an express policy term. If a loss is proximately caused by breach of a term, the policy remains on foot but the insurers have the right of cancellation on notice, as is the case under ss 59 to 60 of the Insurance Contracts Act 1984.
- (3) If there is a breach which proximately causes the loss, the principle that the insurers are automatically discharged from liability should be retained, so that there is no argument about waiver or estoppel by reason of failure to notify a decision not to pay.
- (4) If there is a breach of a continuing obligation, that obligation is to be construed as suspensory only, so that if the breach is remedied before any loss has occurred the assured is entitled to recover.

**7.25** The question is whether the adoption of different approaches in non-marine and marine law is justified. It is a common theme that the “warranty” should be excised from the law, and indeed it should be pointed out that as far as the London Market is concerned the Institute Hulls Clauses 2003, with one specific exception (which is apparently oversight), no longer refer to warranties. If warranties are to go, the question is, how are insurers likely to react? Matters covered by warranties will be dealt with in some other way. However, the marine proposals are not comprehensive. They are concerned only with warranties, and do not address the problems of classification of duties – warranty, condition, condition precedent, policy exclusion – which are expressly covered by s 54 of the 1984 Act. It may thus be possible for insurers to achieve the effects of warranties by appropriate drafting. The argument that the 1984 Act is consumer

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<sup>376</sup> ALRC 91, chapter 9.

<sup>377</sup> ALRC 91, paras 9.117 to 9.1.21..

<sup>378</sup> ALRC 91, para 9.129.

oriented is not fully convincing: while marine and reinsurance are excluded from the 1984 Act, that was more to do with the nature of the markets on which those risks were typically written rather than anything intrinsic in the policies themselves. Although there are issues which remain to be resolved under s 54 of the 1984 Act, most of the core points have now been resolved and the argument that its adoption in marine insurance would give rise to uncertainty is not persuasive. The Institute Time Clauses 2003 illustrate that the market is perfectly happy to remove technical defences and to replace them with clear principles as to what is to happen when a particular obligation is broken.

### *Implied marine warranties*

**7.26** The Marine Insurance Act 1906 contains two implied warranties: the seaworthiness warranty in s 39, and the warranty of legality in s 41. The latter warranty is uncertain as to its effect, although it probably adds little to the general law on legality of risks and the effects of illegal conduct on the recoverability of claims. The former is in principle of greater significance, although in practice seaworthiness has been governed by express terms for many years. Where s 39 is applicable, a distinction is drawn between seaworthiness in voyage policies, which operates as a full warranty (s 39(1)-(4)), and seaworthiness in time policies, which operates as a rule of causation precluding recovery if the loss is attributable to seaworthiness of which the assured was aware (s 39(5)). The ALRC reviewed each of these warranties and proposed that the use of the word “warranty” be abandoned and replaced with more limited provisions.<sup>379</sup>

**7.27** As far as the seaworthiness warranty is concerned, the ALRC preferred the abolition so that the matter could be dealt with by express term. As a fallback, the ALRC recommended that the distinction between time and voyage policies should be abandoned<sup>380</sup> and that the causation principle should be adopted<sup>381</sup> although modified to catch an assured who knew or ought to have known that the vessel was unseaworthy rather than – as under the present law – assured who actually knew of the unseaworthiness.<sup>382</sup> The ALRC also thought that the obligation should be a continuing one, so that if a vessel became unseaworthy after the voyage had commenced the insurers would be discharged if the vessel was lost by reason of the assured’s failure to take remedial action.

**7.28** As far as the warranty of legality is concerned, the ALRC’s view was that the law should continue to provide that a marine adventure should have a lawful purpose but to modify the assured’s continuing warranty that the adventure is to be carried out in a lawful manner. In its place there should be a provision allowing recovery only where the loss was not caused or

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<sup>379</sup> The ALRC also recommended the repeal of the old rules on nationality, neutrality, good safety in ss 36 to 38 of the 1906 Act, all of which are in any event predicated on an express warranty: ALRC 91, paras 9.217 to 9.219.

<sup>380</sup> The difficulty of the distinction is demonstrated by the recent decision of the Supreme Court of Singapore in *Marine Offshore Pte Ltd v China Insurance Co (Singapore) Pte Ltd* [2006] SGCA 28,

<sup>381</sup> ALRC 91, paras 9.142 to 9.176.

<sup>382</sup> *Compania Maritima San Basilio SA v Oceanus Mutual Underwriting Association (Bermuda) Ltd, The Eurysthenes* [1976] 2 Lloyd’s Rep 171; *The Star Sea* [2001] Lloyd’s Rep IR 247.

contributed to by the illegality and the assured did not know and could not have known about the illegality.<sup>383</sup>

**7.29** All of this may be thought to be over-elaborate. If marine warranties were to be brought within the equivalent of s 54 of the Insurance Contracts Act 1984, the seaworthiness warranty would be replaced with a test based on whether the seaworthiness caused the loss. The legality warranty would disappear entirely, and recovery following an illegal act would depend upon ordinary common law principles, namely, whether the assured had to rely upon his own illegality to establish his claim and, if so, whether the illegality was of a nature which demanded denial of indemnity on public policy grounds.<sup>384</sup>

#### *Other implied terms affecting marine policies*

**7.30** Sections 42 to 49 of the Marine Insurance Act 1906 set out a series of grounds on which the risk under a voyage policy will determine automatically or may be determined. These are: if the adventure is not commenced within a reasonable time, the insurers may terminate the policy (s 42); if the place of departure is specified by the policy and is altered, the risk does not attach (s 43); if the destination is specified but the vessel sails for some other destination, the risk does not attach (s 44); if the destination is changed after the commencement of the voyage, the risk automatically determines (s 45); if there is deviation from the specified or usual route the risk automatically determines (ss 46 and 47), subject to the defences in s 49; delay, which is historically a form of deviation, automatically determines the risk (s 48) subject to the defences in s 49. These principles are of little modern relevance. There is scarcely a modern reported case involving any of them, mainly for the reason that voyage policies contain their own rules on these matters. The most important recent authority is *Nima SARL v Deves Insurance plc*,<sup>385</sup> which pointed out the inconsistency between the rule in s 44 that a change of destination before the voyage commences discharges the insurers and the long-established warehouse to warehouse clause under which the risk attaches as soon as the goods leave the warehouse at the port of origin. In *Nima* the Court of Appeal was forced to conclude that the risk attached to goods as soon as they left the warehouse, but terminated once they were loaded on board a vessel destined for a different destination. The sections are also problematic in their drafting. Insurers are discharged where there is an anticipated change of voyage which has not been put into effect, but they are only discharged by deviation once the deviation has commenced. There are no statutory defences to change of voyage, but there are a number of such defences to deviation and delay. In practice these matters are often regulated by a held covered clause under which the assured remains covered, albeit at a higher premium.

**7.31** It is almost inevitable that if the concept of a warranty automatically determining the risk is abolished, these sections cannot survive unscathed. The ALRC recognised this, and recommended that the rules relating to change of voyage, delay and deviation should be treated in the same way as other breaches of contract, namely that insurers are not discharged

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<sup>383</sup> ALRC 91, paras 9.177 to 9.188.

<sup>384</sup> The law on illegality in respect of insurance claims is unduly complex and requires clarification. See *Effect of Illegality on Contracts and Trusts*, Law Commission Report 154, 1999.

<sup>385</sup> [2002] Lloyd's Rep IR 752.

automatically and that it is up to the insurers to insert their own policy terms on the matter. Any breach is, however, to be operative only if it is the proximate cause of the loss.<sup>386</sup> The ALRC was, however, happy to retain ss 42 to 44 as they stand. It may be that such terms are necessary, but they could be dealt with by express provision and not by implied term which conflicts with standard London market wording.<sup>387</sup>

## 8 OTHER ISSUES RAISED BY THE AUSTRALIAN LEGISLATION

### Matters within the Law Commissions' scoping document

**8.1** Matters not dealt with in any detail in this paper but which are within the scope of the Law Commissions' future review include the following.

#### *Definition of insurance and scope of legislation: marine insurance*

**8.2** The Law Commissions have indicated that a definition is desirable, but that different definitions may be required for different purposes. There is a general and not particularly helpful definition in the Insurance Contracts Act 1984, s 10, which treats a contract as one of insurance even though it contains additional terms.<sup>388</sup>

**8.2** One important aspect of the ALRC's 2001 recommendations was that there should be no significant changes to the scope of the Marine Insurance Act 1909. The ALRC considered whether all marine, aviation and transport insurance should be governed by a single regime based on the marine insurance legislation, with all other policies falling within the Insurance Contracts Act 1984. The ALRC recognised that much aviation business is conducted on marine terms, that it was not always easy to tell whether a policy was marine or non-marine in nature,<sup>389</sup> that open covers often encompassed both marine and non-marine risks so that different declarations could be governed by different legal principles, that liability policies could cover both marine and non-marine risks,<sup>390</sup> that it was not always easy to distinguish sea from inland

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<sup>386</sup> ALRC 91, paras 9.214 to 9.216.

<sup>387</sup> *Nima v Deves* was of course decided after the publication of ALRC 91, so the problem raised by that case had not been anticipated.

<sup>388</sup> Extended warranties fall outside the legislation, Treasury Review II, 2004, para 1.52, considered but rejected the suggestion that the law should be changed in this regard

<sup>389</sup> Which arises where cargo is insured against mixed land and marine risks. Australian law follows English law in adopting the "dominant purpose" test: *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur (Australia) Ltd* (1986) 160 CLR 226.

<sup>390</sup> See *Hansen Development P/L v MMI Ltd* [1999] NSWCA 186, which appears to deny that a liability policy can ever be a marine policy, although in that case the coverage related to a lake and not to a sea voyage. Given that collision liability and P&I Club cover for cargo and personal injury liabilities is all liability insurance, it is difficult to see how this view can hold good. The ruling cannot stand in the light of *Gibbs v Mercantile Mutual Insurance (Australia) Ltd* [2003] HCA 39.

waters,<sup>391</sup> that the classification of offshore platforms was uncertain<sup>392</sup> and that the increasing use of multimodal transport rendered the distinction between marine and other transport policies artificial. Its ultimate conclusion was that this change would involve extensive amendment of both the 1909 and 1984 Acts and fell outside its terms of reference, but that the idea should not be ruled out for the future.<sup>393</sup> The ALRC summarily dismissed the fusion of all forms of insurance into a single legal regime:<sup>394</sup> its concern was merely whether particular risks should be transferred from the general insurance to the marine insurance regime by way of clarification.<sup>395</sup>

**8.3** The ALRC did make a number of recommendations for the improvement of the marine insurance legislation, although these were based on the assumption that the 1909 Act retained an existence separate from the Insurance Contracts Act 1984. The most important of the recommendations include the following. (1) It should be permissible to hear an action on a marine contract without the policy being produced, so that s 22 of the 1906 Act should be repealed. The recommendation is largely irrelevant given that the London Market Principles and Contract Certainty principles adopted in England in recent years require a timely issue of a policy, and s 22 has all but been sidestepped by the decision of the Court of Appeal in *Eide UK Ltd v Lowndes Lambert Group Ltd, The Sun Tender*.<sup>396</sup> (2) The statutory formalities required of marine policies – specifying the name of the assured and the signature by the insurers (ss 23 and 24 of the 1906 Act) – should no longer go to validity. (3) The Rules of Construction set out in schedule to the 1906 Act should be repealed and re-enacted in a new definitions section in the 1906 Act: no change of substance was involved here. Other provisions which might have been expected to come under scrutiny, in particular the anomalous (and for the most part now inapplicable) rule in s 16 of the 1906 Act that the measure of indemnity under an unvalued policy is based on value at the date of inception rather than value immediately prior to the loss,

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<sup>391</sup> *Raptis & Son v South Australia* (1977) 138 CLR 356.

<sup>392</sup> In England these are insured under marine policies. ALRC 91, para 8.96, recommended that they should not be covered by the Marine Insurance Act 1906.

<sup>393</sup> ALRC 91, paras 3.24-3.34.

<sup>394</sup> ALRC 91, paras 3.12-3.23 and 8.50. But note the use of the word “regrettably” in para 8.97 with respect to the continuation of a dual regime.

<sup>395</sup> The differences between the two systems are noted in ALRC 2001, chapter 8. ALRC 91 ultimately recommended that: (1) all contracts of insurance for the transportation by water of goods other than those being transported for the purposes of a business, trade, profession or occupation carried on or engaged in by the assured should be covered by the 1984 Act, consistently with that Act having been amended by the insertion of s 9A to cover pleasure craft – this recommendation was subsequently adopted in Treasury Review II, 2004, recommendation 1.5; (2) the 1909 Act should be amended to cover air risks incidental to a marine voyage; (3) the 1909 Act should be amended to refer to losses arising from the repair of a vessel; and (4) the 1909 Act should be extended to inland waterways, a recommendation which anticipated the decision in *Gibbs v Mercantile Mutual Insurance (Australia) Ltd* [2003] HCA 39 – Treasury Review II, 2004, para 1.33 felt that there was no need to change the law in the light of this ruling and the ALRC’s recommendation. The ALRC found no support for the transfer of cover for small fishing vessels to the 1984 Act. Treasury Review II’s recommendations have found their way into the draft Insurance Contracts Amendment Bill 2007. Proposed new s 9A(1A) states that the Marine Insurance Act 1909 does not apply to a contract of marine insurance which covers water transportation of property that is wholly or substantially used for personal, domestic or household purposes by the insured, a relative of the insured or any person with whom the insured resides, thereby bringing such policies within the 1984 Act.

<sup>396</sup> [1998] 1 Lloyd’s Rep 389.

was not considered. There remain differences as to the payment of the premium,<sup>397</sup> definition of contribution,<sup>398</sup> as to suing and labouring<sup>399</sup> and also as to return of premium.<sup>400</sup>

**8.4** It is also to be remembered that the Marine Insurance legislation is not a comprehensive code but deals only with particular issues. If different rules continued to apply to marine and non-marine, then the common law would continue to apply to marine insurance. There would, for example be variations between the effects of breaches of claims conditions in the two regimes.

**8.5** The ALRC's conservatism should not necessarily be regarded as a constraint to the approach to reform in England, where the Law Commissions have tentatively proposed a single regime. The issues raised by the ALRC, as well as the consideration that the differences in the rules governing marine and non-marine brokers could equally be taken to make a good case for the conclusion opposite to that which it ultimately reached.

### *Insurable interest*

**8.6** English law on insurable interest is a confusing and illogical mess. The Life Assurance Act 1774 requires a person obtaining a life policy to possess an insurable interest in the life of the named assured at inception, and also demands the naming in the policy of the persons interested in the life assured. Once the policy has incepted, the need for insurable interest disappears, leaving the assured free to assign or otherwise deal with the policy as he thinks fit: this is justified by the twin considerations that a policy of life insurance is not one of indemnity, and that the contract is an investment which should be capable of trade. As far as marine insurance is concerned, a policy effected by way of wagering or gaming is void, and the principle of indemnity requires the assured to possess insurable interest at the date of the loss.<sup>401</sup> The Marine Insurance Act 1788 requires the assured to be identified in the policy. The Marine Insurance (Gambling Policies) Act 1909 even creates criminal offences for those responsible for issuing policies without interest, although there is no record of any prosecution under the legislation. There is no specific insurable interest requirement for non-life insurance, although a policy taken out without interest is a wagering policy and void under s 18 of the Gaming Act 1845 and the principle of indemnity holds the assured to recovering his actual loss on the happening of the insured peril. English law will change when s 335 of the Gambling Act 2005 comes into force: by repealing s 18 of the Gaming Act 1845 and other anti-gambling legislation, general non-marine policies will be freed from the requirement of initial insurable interest and will be governed only by the indemnity rule, and it is at least arguable that the provisions of the Marine Insurance Act 1906 requiring insurable interest at inception will be impliedly repealed. It would seem that the 2005 Act does not affect the Life Assurance Act 1774. The result is uncertainty as to when insurable interest is required, and there is great uncertainty as to what insurable interest actually means: the definition has changed dramatically over the years to keep up with the

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<sup>397</sup> See *infra*.

<sup>398</sup> See *O'Kane v Jones* [2005] Lloyd's Rep IR 174, *infra*.

<sup>399</sup> *Yorkshire Water v Sun Alliance and London Insurance plc* [1997] 2 Lloyd's Rep 21.

<sup>400</sup> It is unclear whether s 84 of the 1906 Act (England) applies fully to non-marine insurance.

<sup>401</sup> Marine Insurance Act 1906, ss 4-15.

changing market, and the Court of Appeal in the most recent authority has considerably relaxed the definition.<sup>402</sup>

**8.7** The Australian approach has been robust.<sup>403</sup> The Insurance Contracts Act 1984, s 16, abolished the need for insurable interest at the date of the policy for non-life and non-marine covers. The ALRC in its 1982 Report had recommended this step,<sup>404</sup> but the ALRC by a majority recommended that the requirement be retained for life assurance. However, life insurance was subsequently brought into line by the insertion of a revised version of s 18 of the 1984 Act<sup>405</sup> once it had become apparent that the anti-wagering laws served no useful purpose.<sup>406</sup> The author has been informed that the insurable interest sections have not given rise to any difficulties in Australia, although Mann has commented that in the life market the existence or otherwise of an insurable interest at the outset is now an underwriting matter.<sup>407</sup> The Australian legislation has thus repealed the Marine Insurance Act 1788 and the Life Assurance Act 1774 so far as they applied in that jurisdiction. Section 20 of the Insurance Contracts Act 1984 confirms that the pre-existing technical requirement for the beneficiary to be named in the policy is no longer part of the law.

**8.8** The 1984 Act has also removed any argument that there is a need for insurable interest strictly defined at the date of the loss. Section 17 provides that the assured is able to recover if he has suffered a pecuniary or economic loss, and it is irrelevant that he does not possess a legal or equitable interest – previously the manner in which insurable interest had been defined – in the insured subject matter. The need for a definition of insurable interest is thus replaced by the question of whether the assured has suffered any loss by the occurrence of the insured peril.<sup>408</sup> This section does not apply to life assurance, and it remains the case that there is no indemnity or insurable interest requirement for a life policy.

**8.9** The Australian Marine Insurance Act 1909 is unaffected by the 1984 changes.<sup>409</sup> The ALRC in its investigation into marine insurance considered the question at length, and its 2001 Report recommended wholesale changes to the legislation. A particular focus of its recommendations was the decision in *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd*<sup>410</sup> in which it was held that the purchaser of goods on FOB terms had no insurable interest in goods stolen before loading as at that time neither property nor risk had passed, although he was ultimately able to recover on the ground that the goods had been insured on a “lost or not lost” basis and that the

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<sup>402</sup> *Feasey v Sun Life Assurance of Canada* [2003] Lloyd’s Rep IR 637.

<sup>403</sup> Sutton, chapter 6; Mann, paras 16.10 to 18.20.

<sup>404</sup> ALRC 20, Chapter 5.

<sup>405</sup> By the Life Insurance Act 1995 and the Life Insurance (Consequential Amendments and Repeals) Act 1995.

<sup>406</sup> This had been the dissenting view of Kirby J in the ALRC Report. See paras 145-146.

<sup>407</sup> Mann, para 18.20.

<sup>408</sup> See ALRC 20, para 120 for this recommendation. The width of the test was noted in *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1998) 12 NSWLR 250. It is inherent in the section that the insurers will not be liable to the assured and others for more than the full insured amount arising out of the same loss.

<sup>409</sup> Galbraith “An Unmeritorious Defence – The Requirement of Insurable Interest in the Law of Marine Insurance and Related Matters” (1993) 5(3) Ins LJ 177; Taylor “Is the Requirement of an Insurable Interest in the Marine Insurance Act Still Valid?” (2000) 11 Ins LJ 147.

<sup>410</sup> (1991) 25 NSWLR 699 (NSWCA).



assured had suffered a loss.<sup>411</sup> More generally, the ALRC recommended the adoption of ss 16 and 17 of the Insurance Contracts Act 1984 for the marine market, thereby abolishing the requirement for insurable interest at the outset and allowing the assured to recover if he could prove that he had suffered loss (whether or not he possessed insurable interest).<sup>412</sup> As a necessary consequence of this new approach, it was also recommended that the rule in s 51 of the Marine Insurance Act 1906 (s 57 of the Australian 1909) Act prohibiting assignment of a marine policy by an assured who had lost insurable interest, be repealed.

**8.10** In the light of the Australian experience, it is suggested that the UK should move to a similar approach. This is perhaps particularly urgent given the uncertainties created by the Gambling Act 2005, s 335.

### *Policies covering other interests*

**8.11** Section 49 of the 1984 Act attempts to lay down clear rules for recovery under policies which cover the interests of persons other than the assured and who are not named or identified beneficiaries under the policy.<sup>413</sup> The approach adopted,<sup>414</sup> is that, in the event that the sum insured exceeds the named assured's actual interest, the insurers are required to pay the assured to the value of his own interest<sup>415</sup> and must also pay any third party to the value of his interest (subject of course to policy limits) as long as the third party has served written notice on the insurers within three months of the loss. Insurers are free to negative the effect of s 49 by specifying in the policy the interests which are covered, in which case the holder of any uninsured interest will have no remedy. It is unclear from s 49 whether, in the case of fraudulent destruction by one or other of the named assured or the third party, the rights of the other are unaffected.<sup>416</sup> However, it is uncertain whether express provision on this matter is necessary in English law, which has moved on significantly since 1984. The concept of "pervasive insurable interest", which allows an insured person to recover the full sum insured and to hold the balance for the third party interests, is now well entrenched in English law,<sup>417</sup> although there are

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<sup>411</sup> ALRC 91, paras 11.36-11.40 notes the criticism of this outcome, in that a "lost or not lost" clause was not designed for this purpose but dealt with the specific problem that in the days of poor communications the assured might at the date of the policy be unaware of the condition or fate of goods purchased by him and located abroad. However, paras 11.40-11.64 go on to highlight the difficulties faced by a CIF or FOB buyer where the goods are damaged prior to shipment and suggest various alternative means whereby insurance cover can be effected.

<sup>412</sup> There was significant opposition to these proposals from the cargo insurance market, the main argument being that the law at the moment allows the policy to be assigned with the goods so that the owner at any one time is the insured person: by giving insurable interest to other persons could undermine international sales contracts and relieve the seller from his obligations to the buyer. The ALRC regarded the argument as flawed, but felt it necessary to make alternative and less extensive recommendations under which (ALRC 91, paras 11.91-11.103 under which: a purchaser of goods would have insurable interest as long as he ultimately paid for them and the redundant provisions relating to bottomry and respondentia would be repealed)

<sup>413</sup> Named and identified beneficiaries have direct enforcement rights under ss 48, 48AA and 48A of the 1984 Act: see *infra*.

<sup>414</sup> Following ALRC 20, paras 124-127.

<sup>415</sup> This is not specified in the section, but is a necessary implication.

<sup>416</sup> That was the common law rule in *British Traders' Insurance Co Ltd v Monson* (1964) 111 CLR 86.

<sup>417</sup> *Waters v Monarch Fire and Life Assurance Co* (1856) 5 E & B 870; *Petrofina (UK) Ltd v Magnaload* [1984] QB 127.

unresolved issues as to whether the assured holds the balance as a trustee or as a mere debtor,<sup>418</sup> and it is not always easy to ascertain whether an assured in possession of property belonging to a third party is insuring against his own liability for the goods or for their full value.<sup>419</sup> The English courts do, however, seem to have reached the conclusion that if the third party has been guilty of fraud leading to the loss the named assured will be held to recovering an amount equal to his own interest and will not be entitled to the balance representing the third party's interest.<sup>420</sup> The policy question is whether the third party's rights should be directly enforceable against the insurers or whether the pervasive insurable interest rules suffice. The Australian approach has the merit of relative simplicity and there have been no adverse comments as to the operation of s 49.

### *Late payment of policy proceeds*

**8.12** The English courts do not permit damages for late payment of policy moneys. The theory here is that the insurers are under an immediate obligation, arising when the insured loss occurs, to hold the assured harmless, so that the indemnity must be provided at that time. By failing to provide an indemnity on the date of the loss the insurers render themselves liable in damages, but as it is well established that English law does not permit the award of damages for late payment of damages<sup>421</sup> it follows that in principle the assured's only remedy is interest. That point is statutory under the Marine Insurance Act 1906, which does not countenance any award other than for loss as defined by the legislation,<sup>422</sup> and although it has been suggested that there is an implied term in a policy requiring timely payment there is no case in which it has been found that the insurers are in breach of that term.<sup>423</sup> It may be that insurers have not simply refused to pay, but have repudiated the entire policy: in that situation they are plainly in breach of contract,<sup>424</sup> but the assumption has been that the damages for which they are liable are simply the sums due under the policy. English law has thus adopted the position that an assured who is paid late, and who in the meantime loses his business for want of funds to reinstate his premises, has no additional remedy against the insurers. The assured is held to interest under the provisions of section 35A of the Supreme Court Act 1981, which typically runs from the date of the loss subject to possible rests to allow the insurers to consider the claim and to take account of the extent to which the assured was himself liable for the delay, and also subject to possible

<sup>418</sup> *Re Dibbens & Sons Ltd* [1990] BCLC 577.

<sup>419</sup> *Tomlinson (Hauliers) v Hepburn* [1966] AC 451; *Ramco (UK) Ltd v International Insurance Co of Hannover Ltd* [2004] Lloyd's Rep IR 606.

<sup>420</sup> *State of Netherlands v Youell* [1998] 1 Lloyd's Rep 236.

<sup>421</sup> *President of India v Lips Maritime Corporation, The Lips* [1988] AC 395.

<sup>422</sup> *Ventouris v Mountain, The Italia Express* [1992] 2 Lloyd's Rep 281; *Bank of America v Christmas, The Kyriaki* [1993] 1 Lloyd's Rep 137.

<sup>423</sup> See: *Insurance Corporation of the Channel Islands v McHugh (No 1)* [1997] LRLR 94; *Sprung v Royal Insurance* [1999] Lloyd's Rep IR 111; *Pride Valley Foods Ltd v Independent Insurance Co Ltd* [1999] Lloyd's Rep IR 120; *Normhurst v Dornoch* [2005] Lloyd's Rep IR 27; *Tonkin v UK Insurance Ltd* [2006] EWCH 1120 (TCC). But see the comments of Rix LJ in *Mandrake Holdings Ltd v Countrywide Assurance Group plc* May 2005, unreported.

<sup>424</sup> *Lefevre v White* [1990] 1 Lloyd's Rep 569; *Transthene Packaging v Royal Insurance* [1996] LRLR 32. Cf *Diab v Regent Insurance Co Ltd* [2006] UKPC 29. However, a plea of fraud is not a repudiation: *Super Chem Products Ltd v American Life & General Insurance Co Ltd* [2004] Lloyd's Rep IR 446.

increases in the standard rate of 1% above base where the insurers' conduct merits such increase.<sup>425</sup> Late payment is known to be a matter of concern for the Law Commissions.

**8.13** The Australian response to this is only partially formulated. The ALRC,<sup>426</sup> having noted that the English Law Commission had recommended only the payment of interest in respect of a late claim,<sup>427</sup> adopted an interest approach: "An obligation should be imposed on an insurer to pay interest from the date on which a claim should reasonably have been paid. The rate of interest should be prescribed by regulation and should reflect commercial rates".<sup>428</sup> By this recommendation the ALRC sought to produce equivalence between those cases in which the assured took his case to court (where he would generally be awarded interest) and those cases in which he accepted payment (in which case there would be no interest payable). It was not suggested that damages would be awardable for late payment, and the award of interest at commercial rates was itself thought to be an innovation given that State law at the time did not require payment at commercial rates. The ALRC recommendation was duly implemented by s 57 of the Insurance Contracts Act 1984.<sup>429</sup> Simple interest<sup>430</sup> is payable at a specified rate for the period commencing on the day from which it was unreasonable for the insurer to have withheld payment<sup>431</sup> and ending on the earlier of the day of actual payment or the day on which payment was sent by post. The current rate is 3% above Treasury Bond yield.<sup>432</sup> The provision overrides other legislation on the payment of interest generally.<sup>433</sup> In applying s 57, the question of what is unreasonable is to be determined on an objective basis, and although there is a presumption that interest will run from an early date taking into account the period for reasonable consideration and investigation of the claim,<sup>434</sup> the conduct of the assured may justify a later start date where, for example, there is a reasonable suspicion of fraud and investigation is required<sup>435</sup> or where the assured has himself been guilty of delay.<sup>436</sup>

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<sup>425</sup> See: *Kuwait Airways Corporation v Kuwait Insurance Co SAK (No 3)* [2000] Lloyd's Rep IR 678; *Adcock v Co-operative Insurance Society Ltd* [2000] Lloyd's Rep IR 657; *Hellenic Industrial Development Bank v Atkin, The Julia* [2002] EWHC 1405 (Comm); *Quorum AS v Schramm (No 2)* [2002] Lloyd's Rep IR 315.

<sup>426</sup> Paras 319-324.

<sup>427</sup> *Payment of Interest*, Law Commission Report No 88 (1978).

<sup>428</sup> ALRC 20, paras 323 and 324.

<sup>429</sup> As amended. See Sutton, paras 15.123 to 15.130.

<sup>430</sup> It is unclear whether compound interest can be awarded: Treasury Review II, 2004, para 6.24. The 2007 proposals for legislative reform do not pick up this issue.

<sup>431</sup> See: *Einfeld v HIH Casualty* [1999] NSWSC 867; *Max Hams v CGU Insurance Ltd* [2002] NSWSC 843; *Suncorp Metway Insurance Ltd v Scarf* [2003] NSWCA 185; *HIH Casualty & General Insurance Ltd v Insurance Australia Ltd (No 2)* [2006] VSC 128.

<sup>432</sup> Insurance Contracts Regulations 1995, reg 32.

<sup>433</sup> Mann, para 57.10.1, Sutton, para 15.124, discuss the history of the relationship between s 57 and State legislation on interest.

<sup>434</sup> *Zurich Aust Insurance Ltd v Fruehauf Finance Corp Pty Ltd* (1993) 7 Anz Ins Cas 61-177; *Bankstown Football Club Ltd v CIC Insurance Ltd* (1997) 187 CLR 384.

<sup>435</sup> *Settlement Wine Co Pty Ltd v National & General Insurance Co Ltd* (1994) 62 SASR 40

<sup>436</sup> *Sun Alliance & Royal Insurance Australia Ltd v Switzerland Australia Ltd* (1996) 9 ANZ Cas 61-353. Treasury Review II, 2004, para 6.28, rejected a fixed period after which interest should be payable, preferring the trigger date for interest to be determined on the facts of each case.

**8.14** Although the point is not finally resolved,<sup>437</sup> there is authority for the proposition that s 57 does not preclude an award of damages in addition to interest in an appropriate case. The basis for damages here is the statutorily implied term of good faith in s 13: an insurer who failed to make payment while aware of his obligation to do so would arguably be acting other than with the utmost good faith and would thereby expose itself to an action for damages for breach of the implied term.<sup>438</sup> There also appears to be recognition that a repudiation of the policy by the insurers can, independently of the legislation, give rise to an action for damages for breach of implied term,<sup>439</sup> a step refused in England. The argument that there is liability in tort for failing to make a timely payment, based on the notion that the duty to act with the utmost good faith has a common law tortious counterpart, has been rejected.<sup>440</sup> Treasury Review II, 2004, left open the question whether there should be additional bad faith damages, but was of the view that interest would be an adequate remedy in most cases,<sup>441</sup> and to that end recommended, in recommendation 6.2, an increase in the rate of interest to 5% above 10-year Treasury Bond yield: that recommendation has been picked up by the proposals for reform published by the Treasury in February 2007.<sup>442</sup>

**8.15** What can English law learn from this? There are two separate issues here. The first is whether interest should be payable as a matter of principle on all claims where insurers have not made payment within a reasonable time, and not simply on those where the assured has successfully brought proceedings against insurers for non-payment. This is the Australian position. The second is whether the law should authorise payment of damages for consequential loss caused by an insurer by late payment of the proceeds over and above the loss of the use of money and, if so, whether damages should be payable only where the insurers are not acting in good faith (seemingly the position under statute in Australia), whether they should be awardable on the ordinary principles in *Hadley v Baxendale*<sup>443</sup> in the case of repudiation by the insurers so that foreseeable loss to the assured (including loss of business) should be recoverable (apparently the common law position in Australia) or whether damages should simply be available in all cases of late payment leading to consequential loss. An issue may arise here as to whether what was contemplated by the insurers should be tested at the date of the policy (as in *Hadley v*

<sup>437</sup> Those questioned by the author had no doubt that damages are awardable.

<sup>438</sup> *Moss v Sun Alliance Aust Ltd* (1990) 55 SASR 145; *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* [2005] FCAFC 185. See also: *Hungerfords v Walker* (1989) 171 CLR 125; *Walker v FAI Insurance Ltd* (1991) 6 ANZ Ins Cas 61-081; *Hobartville Stud Pty Ltd v Union Insurance Co Ltd* (1991) 25 NSWLR 358. This approach was subsequently doubted in *Re Zurich Australian Insurance Ltd* (1999) 10 ANZ Ins Cas 61-429, where the view was expressed that there could be liability for damages only if there was breach of an implied term requiring payment on a given date. It has been accepted in other cases that insurers are under an implied obligation to consider a claim fairly and in good faith (*Wylie v National Mutual Life Association of Australasia Ltd* 1997, unreported; *Beverley v Tyndall Life Insurance Co Ltd* (1999) 10 ANZ Ins Cas 61-453, *McArthur v Mercantile Mutual Life Insurance Co Ltd* [2002] Qd R 197). This view has also been accepted in England (*Napier v UNUM Ltd* [1996] 2 Lloyd's Rep 950) but as far as English law is concerned this does not give rise to an action for damages but merely a right to have a claim accepted.

<sup>439</sup> *Tropicus Orchids Flowers & Foliage Pty Ltd v Territory Insurance Office* [1999] NTSC 16, a case falling outside the 1984 Act as the insurer was a state body. See Sutton, para 15.122.

<sup>440</sup> *Lomsargis v. National Mutual Life Association of Australasia Ltd* [2005] QSC 199, although the possibility of exemplary damages was there left open.

<sup>441</sup> Paras 6.27 and 6.31.

<sup>442</sup> In the draft Insurance Contracts Amendment Regulations 2007, reg 4.

<sup>443</sup> (1854) 9 Ex 341.

*Baxendale*) at the date of the claim or at the date on which payment was refused. The difference could be crucial for a small business which acquired a lucrative contract after the inception of the policy but is unable to fulfil it by reason of late payment of the proceeds. There is certainly an argument that in the special case of insurance, where the obligation is to hold the assured harmless, insurers should face liability for consequential loss which has been brought to their attention once a claim has been made.

### *Subrogation*

**8.16** Subrogation is a major issue which is referred to in the Law Commissions' Scoping Paper as an area to be investigated in due course. The ALRC considered in principle whether subrogation ought to be retained, and ultimately accepted that subrogation could be justified in that it prevented the assured from obtaining a double indemnity.<sup>444</sup> One particular possibility discussed by the ALRC was whether subrogation rights should be confined to proceeding against persons who deliberately or recklessly caused the insured loss, although this was ultimately rejected on the grounds that: (a) the effect would be to confer the benefit of insurance on a third party who had no contract with the insurers;<sup>445</sup> (b) the standard of care might be reduced if third parties were immune from suit by the fortuity of the victim having insurance cover;<sup>446</sup> and (c) there might be adverse effects for reinsurance cover.<sup>447</sup> The ALRC also scrutinised the most common situations in which subrogation issues arose, namely vendor and purchaser, mortgagor and mortgagee and landlord and tenant were scrutinised, the ALRC concluding<sup>448</sup> that although there was a risk of hardship in that the loss would be transferred to an uninsured party, the first could be dealt with by transferring the benefit of the policy to the purchaser in the period between exchange and completion,<sup>449</sup> the second was resolved by the near universal practice of the parties becoming co-assureds and the third was an issue of landlord and tenant law. In fact, scrutiny of cases decided in the last two decades shows the construction industry has generated more subrogation disputes than any other sector, the question often being whether the contract between the insured employer or contractor required them to take out insurance and thereby to retain for themselves as against any sub-contractor the risk of any loss. The cases have all turned on the proper construction of the risk allocation provisions, and it might be thought that it is now perfectly possible for contracting parties to enter into suitable risk allocation arrangements under

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<sup>444</sup> ALRC 20, paras 309-313

<sup>445</sup> The very argument used by the House of Lords to justify subrogation in *Caledonia North Sea Ltd v British Telecommunications plc* [2002] Lloyd's Rep IR 261

<sup>446</sup> An argument which misses the point that a third party will rarely be worth suing unless he has insurance, in which case the effect on the third party will be confined to any applicable deductible and his ability to obtain favourable renewal, arguably insufficient deterrents against negligent behaviour.

<sup>447</sup> It is certainly the case that excess of loss treaties calculate the trigger point of the reinsurers' liability as the reinsured's ultimate net loss taking into account subrogation recoveries, so that cover is based on the concept that the reinsured will exercise subrogation rights. It would also seem that in other situations reinsurers themselves have subrogation rights, in that they are subrogated to the subrogated rights of the reinsured. The author has heard the argument that the reinsured is under an implied obligation to exercise subrogation rights so that any recovery from reinsurers is net of actual or potential subrogation recoveries, although is of the view that this does not represent the law.

<sup>448</sup> ALRC 20, paras 299-304.

<sup>449</sup> Effected by s 50 of the 1984 Act: see *infra*.

which the need for each of the parties to take out insurance to guard against a subrogation action can be eliminated. In practice, therefore, many instances of subrogation can be resolved by proper contractual arrangements which make it clear who bears the risk. Subrogation thus raises an issue of principle where the loss is caused by a third party who has no prior arrangements with the assured. In practice the exercise of subrogation rights is likely to depend upon whether the third party has his own insurance,<sup>450</sup> in which case subrogation operates as a mechanism to switch losses between first and third party insurers. There are also issues, which post-date the ALRC's report, concerning the allocation of policy proceeds, particularly where there is a shortfall in recovery from the third party and the assured has to bear a hefty deductible.<sup>451</sup> There also remain questions to be asked about the use of subrogation, not to preclude a double indemnity but to strip the assured of any benefits at all when he has – perhaps unwisely – compromised his potential claim against a third party.<sup>452</sup> These points do cast doubt as to the need for subrogation, although this is a matter which cannot readily be resolved other than by a detailed investigation into its operation in practice.

**8.17** Various aspects of the law of subrogation were nevertheless regarded as worthy of reform by the ALRC, and the necessary changes were implemented by ss 65 to 68 of the Insurance Contracts Act 1984. Four changes were made.

**8.18** First, s 65 removes the right of insurers to exercise subrogation against a third person<sup>453</sup> in circumstances where the assured would not reasonably have been expected to have exercised any cause of action either by reason of a family or other personal relationship or by reason of the fact that the assured had consented to the third party's use of a motor vehicle covered by the insurance.<sup>454</sup> Even if this requirement is not met, or if the third party has been guilty of wilful or serious misconduct<sup>455</sup> or was an employee of the assured, a subrogation action cannot go ahead if the third party was not himself uninsured. The section goes on to prevent its avoidance, by outlawing any attempt by the insurers to take an assignment of the assured's rights. The extent to which this is a problem in the UK is uncertain, although a subrogation action against a friend or family member would almost certainly have the effect of requiring that third party to bear a deductible under his own policy and a possible penalty on renewal.

**8.19** Secondly, s 66<sup>456</sup> applies much the same exclusion to a third party who is an employee of the assured and the conduct giving rise to the loss was not serious<sup>457</sup> or wilful. The section reverses the notorious decision of the House of Lords in *Lister v Romford Ice and Cold Storage*

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<sup>450</sup> See, for a recent example, *Ronson International Ltd v Patrick* [2006] EWCA Civ 421

<sup>451</sup> See *Napier and Ettrick Ltd v Kershaw* [1993] AC 713, which adopts a “recover down” approach and thereby denies the assured recovery of his deductible in the event of a shortfall.

<sup>452</sup> *Commercial Union Assurance Co v Lister* (1874) LR Ch App 483; *West of England Fire Insurance Co v Isaacs* [1897] 1 QB 226; *Phoenix Assurance Co v Spooner* [1905] 2 KB 753.

<sup>453</sup> ALRC 20, para 305.

<sup>454</sup> Sutton, paras 16.25 to 16.28.

<sup>455</sup> This must relate to the event itself and not to the subsequent investigation of it: *Lennox Motors Pty Ltd v Pastrello* (1991) 6 ANZ Ins Cas 61-033.

<sup>456</sup> Sutton, paras 16.20 to 16.24.

<sup>457</sup> Drunkenness is serious misconduct: *Boral Resources (Qld) Ltd v Pyke* [1992] 2 Qd R 25; *Ingham v Vita Pacific Ltd* (1995) 8 ANZ Ins Cas 61-272.

*Co*,<sup>458</sup> in which an employer's insurers exercised subrogation rights against an employee responsible for the injuries of a fellow employee (who happened to be his father). The ALRC regarded this type of action as inconsistent with sound practice in the field of industrial relations,<sup>459</sup> and as far as the UK is concerned insurers agreed with the Government immediately after the decision that they would not rely upon their rights in this regard.

**8.20** Thirdly, s 67 is concerned with the allocation of third party recoveries as between insurers and assured. The common law operates on a recover down basis, the assumption being that the insurance is to be treated as having been placed in layers so that the highest layer insurer bears the lowest risk and thus benefits from the subrogation recovery first.<sup>460</sup> Accordingly, if the assured obtains a policy for £1000 in excess of a deductible of £100, and suffers a loss of £1500 only £800 of which is recoverable from the third party, the £800 is allocated first to the assured for his uninsured loss as the notional top layer insurer (£400), then to the insurers (£400), with the deductible being borne by the assured himself.<sup>461</sup> The 1984 Act is most curious. Under s 67, the assured is entitled to claim from the subrogation recovery no more than one of two amounts: (a) an amount greater than the amount by which the amount recovered by the insurers exceeds the amount paid to the assured; or (b) an amount that, together with the amount paid to the assured by the insurers, is greater than the amount of the assured's loss. Suppose, therefore, that (disregarding any deductible) the assured has suffered a loss of £1000 and has received £600 from the insurers. The insurers then exercise subrogation rights and recover £800. Under (a), the assured may not recover more than £200, the amount by which the sum recovered by the insurers exceeds the amount paid to the assured. The assured thus recovers a total of £800 while the insurers retain their full payment of £600. Under (b), the assured obtains his full loss of £1000, as he receives the £600 paid by the insurers plus the amount necessary to make good his loss, £400. In determining the amount recovered by the insurers, they are entitled to deduct administrative and legal costs incurred in effecting the recovery. It is unclear whether the assured recovers the greater or the lesser of amounts provided for by these alternative methods of calculation.<sup>462</sup> Whichever is correct, the principles are subject to contrary agreement after the loss has occurred,<sup>463</sup> so that it is open to the assured to agree to allow insurers to exercise subrogation rights even though he has not been paid a full indemnity but on condition that the insurers can retain a proportion of the sum received: presumably the assured can refuse to agree to this and remains entitled to pursue the third party for his uninsured loss.<sup>464</sup> The notion that the insurers can benefit from subrogation recoveries before the assured has recovered a full indemnity (net of deductible) is alien to the common law and has little justification. The approach adopted in the 1984 Act was rejected by the ALRC in its review of marine insurance law. The ALRC there recommended a codification of the recover down principle.<sup>465</sup> This was accepted by Treasury

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<sup>458</sup> [1957] AC 555.

<sup>459</sup> ALRC 20, para 306.

<sup>460</sup> *Napier and Ettrick Ltd v Kershaw* [1993] AC 713.

<sup>461</sup> This rule becomes more complex when the policy is valued or is subject to average, or both. For the permutations, see *Colinvaux's Law of Insurance*, 8th ed 2006, para 11-19.

<sup>462</sup> Sutton, para 16.64.

<sup>463</sup> So that the agreement cannot be a policy term.

<sup>464</sup> See ALRC 20, paras 300-302.

<sup>465</sup> ALRC 91, para 12.17.

Review II, 2004, as an appropriate reform of s 67,<sup>466</sup> a recommendation accepted in the draft Insurance Contracts Amendment Act 2007 which repeals and replaces s 67 with an entirely new provision. The principles in the redrafted s 67 are as follows:

- (1) The party taking the recovery action should be entitled to reimbursement for the administrative and legal costs of that action from any moneys recovered. If both parties contribute, they should be reimbursed, or share the reimbursement pro rata if there is insufficient recovered money to reimburse both in full.
- (2) There are three possibilities depending on who has funded the recovery action.
  - (a) If the insurer funds the recovery action pursuant to its rights of subrogation, it is entitled to an amount equal to the amount that it has paid to the insured under the insurance contract. The insured is then entitled to any further amount that may be required so that it ultimately recovers from the insurer under the insurance contract or the third party in the recovery action, or both in combination, the full amount of its loss (not just the measure of indemnity under the policy).<sup>467</sup> This entitlement does not diminish the insured's right to receive payment promptly under the policy in accordance with its terms and the insurer's obligation to pay promptly, subject to any contrary agreement between the parties.
  - (b) If the insured funds the recovery action, the order in the preceding paragraph is reversed. The insured is entitled to retain an amount so that the total that it receives from the recovery action and under the policy is equal to its total loss. The insurer is entitled at this point to an amount equal to the amount that it has paid to the insured under the insurance contract.
  - (c) If the action is funded jointly by both insurer and insured, they are entitled to the same amounts as those referred to in (a) and (b) above, pro rata if there are insufficient funds to reimburse them in full.
- (3) Any excess or windfall recovery is then distributed to both parties in the same proportions as they contributed to the administrative and legal costs of the recovery action.<sup>468</sup> Thus the party (or parties) shouldering the cost and risk of the recovery action for the benefit of all concerned receives the benefit of the windfall. Most commonly this would be the insurer — but the insurer only gets the benefit after the insured has received full recovery for all its losses as the insured would have been entitled to these losses as damages from the third party as a matter of principle, whether or not there was any insurance in place.
- (4) Any separate or identifiable component in respect of interest should be paid to the parties in such proportions as fairly reflects the amounts that they have each

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<sup>466</sup> Recommendation 11.1.

<sup>467</sup> So that if the policy is valued, the assured recovers the actual rather than the agreed amount of his loss : this is seemingly a departure from the common law, and in the author's view a sensible one.

<sup>468</sup> The common law rule is that the assured benefits exclusively from any windfall: *Yorkshire Insurance Co v Nisbet Shipping* [1962] 2 QB 330



recovered and the periods of time for which they have each lost the use of their money.<sup>469</sup>

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<sup>469</sup> The full text of the revised s 67 is as follows:

- (1) *This section applies if:*
- (a) *an insurer is liable to an insured under a contract of general insurance in respect of a loss; and*
  - (b) *the insurer has a right of subrogation in respect of the loss; and*
  - (c) *an amount is recovered (whether by the insurer or the insured) from another person in respect of the loss.*
- (2) *If the amount is recovered by the insurer in exercising the insurer's right of subrogation in respect of the loss:*
- (a) *the insurer is entitled under this paragraph to so much of the amount as does not exceed the sum of the following:*
    - (i) *the amount paid by the insurer to the insured in respect of the loss;*
    - (ii) *the amount paid by the insurer for administrative and legal costs incurred in connection with the recovery; and*
  - (b) *if the amount recovered exceeds the amount to which the insurer is entitled under paragraph (a)—the insured is entitled under this paragraph to so much of the excess as does not exceed the insured's overall loss; and*
  - (c) *if the amount recovered exceeds the sum of the amounts to which the insurer and the insured are entitled under paragraphs (a) and (b)—the insurer is entitled to the excess.*
- (3) *If the amount is recovered by the insured:*
- (a) *the insured is entitled under this paragraph to so much of the amount as does not exceed the sum of the following:*
    - (i) *the insured's overall loss;*
    - (ii) *the amount paid by the insured for administrative and legal costs incurred in connection with the recovery; and*
  - (b) *if the amount recovered exceeds the amount to which the insured is entitled under paragraph (a)—the insurer is entitled to so much of the excess as does not exceed the amount paid by the insurer to the insured in respect of the loss; and*
  - (c) *if the amount recovered exceeds the sum of the amounts to which the insured and the insurer are entitled under paragraphs (a) and (b)—the insured is entitled to the excess.*
- (4) *If the amount is recovered by the insurer and the insured jointly:*
- (a) *the insurer is entitled to the amount referred to in paragraph (2)(a); and*
  - (b) *the insured is entitled to the amount referred to in paragraph (3)(a).*
- (5) *If:*
- (a) *the amount is recovered by the insurer and the insured jointly; and*
  - (b) *the amount recovered exceeds, or is less than, the sum of the amounts to which the insurer and the insured are entitled under paragraphs (4)(a) and (b);*
- the entitlements of the insurer and the insured under those paragraphs are to be calculated on a pro rata basis in proportion to the amounts paid by the insurer and the insured for the administrative and legal costs incurred in connection with the recovery.*
- (6) *If an amount by way of interest is awarded in respect of the amount recovered (the principal amount), the following apply:*
- (a) *if the principal amount was recovered by the insurer, the insurer is entitled to the amount by way of interest;*
  - (b) *if the principal amount was recovered by the insured, the insured is entitled to the amount by way of interest;*
  - (c) *if the principal amount was recovered by the insurer and the insured jointly, the amount by way of interest is to be divided fairly between the insurer and the insured, having regard to:*
    - (i) *the amounts to which the insurer and the insured are entitled under subsection (4) or (5), as the case requires; and*
    - (ii) *the periods of time for which the insurer and the insured have lost the use of their money.*
- (7) *The rights of the insurer and the insured under this section are subject to:*

**8.21** Finally, s 68 seeks to protect the assured in the event that he has entered into an agreement with a third party which excludes or limits his liability to the assured and thus prejudices the rights of the insurers.<sup>470</sup> Section 68(2) reverses the rule that the existence of such a contract is a material fact,<sup>471</sup> and s 68(1) provides that a policy term which removes cover in the event that the assured enters into such a contract after the risk has incepted is of no effect unless he has been informed of it in writing.<sup>472</sup> The latter measure is unarguably right, and reflects the common law position that the courts will not imply a term prohibiting the assured from entering into such contracts.<sup>473</sup> As to s 68(2), it is only in exceptional circumstances that an absence of subrogation rights is material even under the present definition of materiality, and any change in the law of materiality is likely to render this type of contract immaterial. That point aside, s 68(2) seems eminently sensible.<sup>474</sup>

### *Brokers*

**8.22** As brokers play a central role in the placing of insurance in England, particularly in the placement of commercial, marine and reinsurance risks, a few words on their role are appropriate at this stage. Both Australia and England treat a broker as the agent of the assured as a starting point, although the jurisdictions recognise that there are many situations in which a broker may operate both as an agent for the insurers or as a “common agent”. These conflicts are largely tolerated or explained away in the cases, although on occasion the English courts at least have pointed out to brokers that if they choose to act in a fashion which gives rise to conflicts of interest then the courts will not bail them out.<sup>475</sup> There is little relevant legislation in either jurisdiction on the substantive duties of brokers, each system having adopted an administrative approach more concerned with qualifications and the holding of professional indemnity cover.<sup>476</sup>

**8.23** The most important aspect of a broker’s duties is that of placement, and the use of brokers was discussed above. Here it suffices to note that there are some key differences between marine and non-marine broking, the most important being that marine brokers are required to pay the premium.<sup>477</sup> The marine rule is based on the curious fiction that the broker has paid the premium

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(a) *the relevant contract of insurance; and*

(b) *any agreement made between the insurer and the insured after the loss has occurred.*

(8) *In this section:insured’s overall loss, in relation to a loss incurred by an insured to which this section applies, means the amount of the loss reduced by any amount paid to the insured by the insurer in respect of the loss.*

<sup>470</sup> ALRC 20, paras 307-308.

<sup>471</sup> See: *Tate & Sons v Hyslop* (1884-1885) 15 QBD 368; *Talbot Underwriting Ltd v Nausch Hogan & Murray, The Jascon 5* [2006] Lloyd’s Rep IR 531. For the operation of s 68(2), see Sutton, paras 16.44 to 16.46.

<sup>472</sup> Sutton, para 16.47.

<sup>473</sup> *State Government Insurance Office (Qld) v Brisbane Stevedoring Pty Ltd* (1969) 123 CLR 228.

<sup>474</sup> ALRC 91, paras 12.19-12.28, have recommended the adoption of s 68 for marine insurance.

<sup>475</sup> The authorities on conflicts of interest are numerous. The cases are discussed in the author’s *Colinvaux’s Law of Insurance*, 8th ed, paras 15-27 and 15-28.

<sup>476</sup> Statutory in England under the Financial Services and Markets Act 2000; self-regulatory in Australia following the repeal of the Insurance Brokers and Agents Act 1984.

<sup>477</sup> Marine Insurance Act 1906, s 53 (England); Marine Insurance Act 1909, s 59 (Australia).

but that it has been loaned back to him thereby rendering him personally liable to the underwriters,<sup>478</sup> and there have been problems in reconciling the statutory rule with contractual provisions relating to the payment of the premium.<sup>479</sup> The ALRC in its 1991 Report recommended the abolition of this anomalous rule,<sup>480</sup> a recommendation which would surely be welcomed by many marine brokers operating in the London market.

### *Notification obligations*

**8.24** Various provisions of the 1984 Act require notice to be given by the insurers to the assured. The relevant provisions for the purposes of this paper are: notification of the duty of disclosure (s 22); notification of variation from standard cover (s 35); notification of unusual terms in policies not subject to standard cover (s 37); forfeiture of policy for non-payment of instalment of premium (ss 39 and 62); inclusion of average clauses (s 44); notification of expiry of non-life policy (s 58); notice of cancellation (s 59); inclusion of subrogation clause preventing settlement by assured with third party (s 68); and supply of policy documents (s 74<sup>481</sup>). The general rule is that notice must be giving in writing, although s 69 permits oral notification where written notice was not reasonably practicable as long as written notification is given subsequently. Written notice must be given personally or by post (s 77). Notice must be legible and must comply with the Regulations (s 72). Notice directly to the assured is waived where the insurance was arranged by a broker acting for the assured (s 71): Treasury Review II, 2004, felt that this rule should be maintained and that brokers should be under a duty to communicate the notice to the assured.

**8.25** A particular issue arises with regard to electronic notification. The Electronic Transactions Act 1999 permits written communications to be given electronically. However, insurance contracts within the 1984 Act are excluded from this provision, so that all notices have to be given non-electronically. Treasury Review II, 2004,<sup>482</sup> recommended that provision should be made for electronic notices, and the reforms announced in February 2007 have taken the point up. Section 72 is to be repealed and replaced with a revised version under which notices may be given in the form prescribed by the Regulations, and the draft implementing regulation,<sup>483</sup> allows electronic communications but subject to safeguards. A notification: (a) must not incorporate any image, message, advertisement or other feature that (i) distracts, or is reasonably likely to distract, the recipient, or (ii) otherwise reduces or interferes, or is reasonably likely to reduce or interfere, with the recipient's ability to understand the notice or document; and (b) must be presented in a way that clearly identifies the information that is part of the notice or document; and (c) must be presented in a way that would reasonably be expected to enable the recipient to readily be able to scroll through the whole of the notice or document. An electronic notice must

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<sup>478</sup> Of the many authorities, see *Universo Insurance Co of Milan v Merchants Marine Insurance Co* [1897] 2 QB 93.

<sup>479</sup> *Prentis Donegan & Partners v Leeds & Leeds Co Inc* [1998] 2 Lloyd's Rep 326; *J A Chapman & Co Ltd v Kadirga Denizcilik Ve Ticaret* [1998] Lloyd's Rep IR 377; *Heath Lambert Ltd v Sociedad de Corretaje de Seguros* [2004] Lloyd's Rep IR 905.

<sup>480</sup> ALRC 91, para 13.8.

<sup>481</sup> Under the proposals contained in the draft Insurance Contracts Amendment Bill 2007, rights under s 74 are to be extended to third party beneficiaries with a right to claim under the policy

<sup>482</sup> Chapter 2, recommendations 2.1 and 2.2.

<sup>483</sup> Draft Insurance Contracts Amendment Regulations 2007, reg 34.

also include an address and telephone number where the insurers may be contacted. There are also consequential amendments to s 77 which allows the sending of notices to electronic addresses but in a form which allows the recipient to keep a copy of the notice so that he has ready access to it in the future.

## **Other matters governed by the 1984 Act**

**8.26** There are a number of other aspects of the Australian legislation which are apparently not under consideration in the UK. Some of these are quite useful and innovative, while others are probably redundant in the modern market. They are nevertheless worthy of brief mention.

### *Choice of law and jurisdiction*

**8.27** The United Kingdom is bound by international conventions and EU rules in matters of jurisdiction and choice of law. Jurisdictional rules are governed by EU Council Regulation 44/2001 if the defendant is domiciled within the EU,<sup>484</sup> and by common law principles as enshrined in CPR Parts 6.19 and 6.20. Choice of law is governed by the Rome Convention 1980<sup>485</sup> if the risk is situated outside the EU, and by European rules if the risk is situated inside the EU.<sup>486</sup> These frequently unsatisfactory<sup>487</sup> principles have generated more insurance and reinsurance litigation than any other topic in the past two decades. Sections 8 and 52 of the Insurance Contracts Act 1984, as construed in *Akai Pty Ltd v People's Insurance Co Ltd*<sup>488</sup> override both choice of law and exclusive jurisdiction clauses in favour of the law and jurisdiction of any other place.<sup>489</sup> It is open to the United Kingdom under EU rules to modify choice of law rules for risks situated in the United Kingdom, so as to prevent choice of law of any other jurisdiction or at least to require any choice of law to be subject to the mandatory

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<sup>484</sup> There are specific rules for insurance, whereas reinsurance falls within the general jurisdiction rules.

<sup>485</sup> Implemented into English law by the Contracts (Applicable Law) Act 1991).

<sup>486</sup> Financial Services and Markets Act 2000 (Law Applicable to Insurance Contracts) Regulations 2001, SI 2001 No 2635.

<sup>487</sup> The choice of law rules are predicated on the notion that a policy covers a single policyholder for a single risk, and is issued by a single insurer. As this is rarely the case in commercial insurance, the choice of law rules are often all but impossible to apply. For the most recent illustration, see *Travelers Casualty and Surety Co of Canada v Sun Life Assurance Co of Canada (UK) Ltd* [2006] EWHC 2716 (Comm).

<sup>488</sup> (1996) 188 CLR 418. But see the English sequel, *Akai Pty Ltd v People's Insurance Co Ltd* [1998] 1 Lloyd's Rep 90, in which the High Court thought it appropriate to grant an anti-suit injunction to prevent the claimant in the Australian proceedings from continuing his action even though the Australian courts had asserted jurisdiction.

<sup>489</sup> Treasury Review II, 2005, recommendation 1.6, recommended that it should be made clear, to remove any doubts, that policies issued by direct offshore foreign insurers to Australian policyholders or in respect of risks situated in Australia should be subject to the 1984 Act. This recommendation has been adopted by the draft Insurance Contracts Amendment Bill 2007, which adds a new provision, s 8(1A) to the effect that the 1984 Act applies if either the contract is entered into by a person domiciled in a State or Territory to which the Act applies or has been extended, or if the policy provides cover against the risk of loss or damage occurring in a State, or in a Territory in which the Act applies or has been extended. This is the case irrespective of the chosen proper law.

provisions of any insurance law which might be adopted. Whether this should be done has yet to be considered, and would doubtless depend on the exact shape of any future legislation.

## *Standard cover*

**8.28** Standard cover has been adopted for the most important classes of, primarily, domestic policies.<sup>490</sup> Sections 34 to 36 of the 1984 Act require insurers either to offer standard cover as laid down in regulations or to draw to the attention of a reasonable person in the assured's position by clearly informing him of variations from that cover by providing the assured with a document containing the terms of the proposed contract or otherwise,<sup>491</sup> failing which they cannot rely on those variations for certain classes of claims.<sup>492</sup> As regards contracts not prescribed under these sections, there is a general prohibition, in s 37, preventing insurers from relying on a provision of a kind not normally included in a contract of insurance unless the assured (or his broker<sup>493</sup>) was clearly informed<sup>494</sup> in writing of the effect of the provision.<sup>495</sup> This rule is replicated in, and arguably subsumed by, the good faith provisions of the 1984 Act, in particular s 14(3), which requires insurers to act in good faith when relying on policy terms. The Law Commissions do not at present seem to be proposing the equivalent of ss 34 to 36, although s 37 may be adopted indirectly in relation to the continuing duty of good faith, discussed below. The Unfair Terms in Consumer Contracts Regulations 1999 and also the Financial Services Authority's Contract Certainty initiative achieve something akin to all of this, albeit by placing more faith on disclosure and market forces rather than by a starting point of standard terms. The adoption of standard terms is probably not an option for the UK, as the notification and approval of policy terms and premiums is prohibited under the European Union's single insurance market regime. In Australia the main objection to notification has been that policy holders pay very little attention to the various standard form documents that are given to them, in particular because notification mainly takes place via the policy document itself, and that the provisions achieve very little. If there is to be disclosure, it should be in a separate document, as suggested by the ALRC. Nobody had a supportive word for them. The future of these provisions is uncertain, given the product disclosure rules which operate under the financial services legislation operative in Australia, and it may be that the two sets of provisions will ultimately merge. Treasury Review II, 2004, recommendations 5.3, 5.4 and 5.5 were on this basis concerned with bringing ss 34 to 37 in line with product disclosure requirements, in particular by allowing the sections to be complied with by use of a product disclosure statement.

**8.29** The legislative proposals for the reform of the standard cover rules, published in February 2007, have, in line with the recommendations of Treasury Review II, modified the obligation in s

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<sup>490</sup> Motor, home buildings and contents, sickness and accident, consumer credit and travel: Insurance Contracts Regulation 1985, SI 1985 No 162, regs 5-29. Treasury Review II, 2004, recommendation 5.2, proposed a thorough review of the standard cover provisions to ensure that they accorded with current market practice.

<sup>491</sup> Provision of the policy document itself may not be sufficient to "clearly inform" the assured if its words are unclear: *Hams v CGU Insurance Ltd* (2002) 12 ANZ Ins Cas 61-525; *Marsh v CGU Insurance Ltd* [2004] NTCA 1. Treasury Review II, 2004, recommendation 5.1, has suggested the replacement of "clearly inform" with a new specific test of communication in a "clear, concise and effective manner".

<sup>492</sup> See ALRC 20, paras 43, 45, 69-80.

<sup>493</sup> Insurance Contracts Act 1984, s 71.

<sup>494</sup> See n 120, *supra*.

<sup>495</sup> The Act varies the ALRC's recommendations in that the ALRC was of the view that the assured should receive a separate document setting out deviation from standard cover whereas s 37 provides that this can be done in the policy itself. Treasury Review II, 2004, para 5.13, was against any change in the law on this point, preferring the flexibility granted to insurers by s 37.

35 on insurers to notify the assured “clearly” of any deviation from standard cover. This is to be replaced by a new formulation in s 35(2A) of communication in a “clear, concise and effective” manner. The same formulation is adopted in respect of notifications under s 37 (new s 37(2)) in respect of non-prescribed policies. The suggestion in Treasury Review II that amending ss 35 to 37 to allow compliance with product disclosure requirements under the Corporations Regulations to suffice has not, however, been adopted: changes to the Corporations Regulations which take effect from 20 June 2007 are to require non-life insurers to disclose non-standard or unusual policy terms in their product disclosure statements, so that changes to the 1984 Act are not necessary.<sup>496</sup>

### *Late payment of premiums*

**8.30** Sections 39 and 62 of the 1984 Act grant relief to an assured who is behind with instalments of his premium.<sup>497</sup> Under s 39, where a policy contains a provision which removes the liability of the insurers to meet a claim for non-payment of a premium, the insurers may invoke the term only if it had been drawn to the assured’s attention at the outset and the instalment is 14 days’ late. If the policy goes further and confers upon the insurers the right to cancel the policy for non-payment of the premium, that right can, in accordance with s 62, be exercised only if the term had been drawn to the assured’s attention at the outset and that at least one instalment of the premium has remained unpaid for at least one month. In the last 20 years it has become standard practice for instalments to be generated automatically by direct debit or standing order arrangements, so that if anything goes wrong there is likely to have been some error either at the assured’s bank or in the insurer’s own accounting department. As a result, these measures are probably no longer necessary,<sup>498</sup> although it would be a useful reform to reverse any rule of law which treats the bank<sup>499</sup> as the agent of the assured for the purpose of paying instalments.

### *Claims made and notified liability policies*

**8.31** Section 40 of the 1984 Act addresses a problem which has not arisen in England. In recent years it has become the practice to issue liability policies covering professional negligence risks on a “claims made” basis: these types of policy have become increasingly popular, and in the UK in the last decade they have even been used in employers’ liability covers, albeit with doubtful legality given the possibility of a conflict with the requirements of the Employers Liability (Compulsory Insurance) Act 1969. The essence of a claims made policy as the concept is understood in the UK is that the insurers are liable for any claims first made against the assured by a third party during the currency of the policy, subject to the obligation of the assured to notify the insurers of any claim either within a given period or as soon as is reasonably practicable: it is not essential for the assured’s notification to have taken place inside the policy

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<sup>496</sup> The question whether the same obligation should be extended to life insurers is out for consultation.

<sup>497</sup> ALRC 20, paras 253-254.

<sup>498</sup> The one context in which they might be useful is marine, where the broker rather than the assured pays the premium. However, the 1984 Act does not apply to marine insurance.

<sup>499</sup> Or, in marine, the broker.

period. In addition, such policies generally permit the assured to give the insurers notice of any circumstances which may or are likely to give rise to a claim, and providing the notification is made within the policy period then any subsequent claim against the assured arising from those circumstances is deemed to have been made within the currency of the policy even though it was subsequently made after the policy had expired. Claims made policies are not without their difficulties: there may be room for doubt as to whether a claim has been made against the assured;<sup>500</sup> the question of whether a notification of a specific claim also takes in future claims of the same type arises regularly;<sup>501</sup> there is some dispute as to whether a notification encompasses the assured's continuing conduct; and the right of the assured to notify "circumstances" depends upon the wording of the clause, in particular whether it refers to circumstances which "may" or which are "likely to" give rise to a claim – the present tendency is to use the wider wording, so that assureds are often able to make "laundry list" notifications which pin the entire liability arising from a series of related acts onto one insurer. A particular feature of London market policies as they relate to the notification of circumstances is, as noted above, that there is no need for the claim itself to be made against the assured during the currency of the policy.

**8.32** The position in Australia is, however, somewhat different, in that policies have been written on a "claims made and notified basis", so that the insurers are stated only to be liable for a subsequent claim arising from circumstances notified to the insurers during the currency of the policy if the claim against the assured is itself made during the currency of the policy. The latter requirement will in many circumstances render the right of notification of circumstances nugatory, because it is often the case that the claim itself will not materialise for months or years after circumstances which may give rise to a claim have come to light. For this reason, s 40 of the Insurance Contracts Act 1984<sup>502</sup> gives additional rights to the holder of a policy under which a claim against the assured must be notified during its currency (the definition in s 40(1)). Section 40(3) provides that the insurer is not relieved from liability simply because the claim is made in a later year as long as the assured has given notice of the circumstances to the insurers as soon as is reasonably practicable during the currency of the policy. This provision does not operate as an implied term as such, but rather is a statutory right. There is probably no need for such legislation in the UK, given that liability policies written in this jurisdiction do not operate on this basis.

**8.33** A further reason for shunning s 40 is that it has, in combination with s 54, given rise to more litigation than almost any other provision of the 1984 Act. A number of points have been raised under the section. First, the courts have held that s 40 applies to a policy which makes no provision for the notification of circumstances which may or are likely to give rise to a claim but which only applies to claims made against the assured during the currency of the policy (a pure "claims made" policy): accordingly, and irrespective of the wording of the policy, the assured has a statutory right during the currency of the policy to notify circumstances likely to give rise

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<sup>500</sup> Although the present trend is to define the term "claim" with some precision, generally encompassing the issue of proceedings against the assured or the receipt by him of a letter before action. It has been held that an assured who has been required to undertake a product review to identify possible mis-selling to clients has been subjected to a claim: *Rothschild Assurance Ltd v Collyear* [1999] Lloyd's Rep IR 6

<sup>501</sup> *Hamptons Residential Ltd v Field* [1998] 2 Lloyd's Rep 248.

<sup>502</sup> Based on ALRC 20, para 265.



to a claim and then to recover from the insurers in respect of a claim made after expiration.<sup>503</sup> Secondly, there has been major difficulty in applying ss 40 and 54 of the 1984 Act to a “claims made and notified” policy of the type described above.<sup>504</sup> As seen earlier, section 54 provides that an insurer may not refuse to pay a claim in reliance on an act or omission of the assured which did not cause the loss. The section operates in an unexceptional fashion where a claim has been made against the assured within the policy period but he has failed to inform the insurers of the claim within the currency of the policy as required by its terms: the policy attaches by virtue of the claim being made against the assured, and his omission can be excused under s 54, section s 40 not being engaged.<sup>505</sup> More problematic is the situation in which the assured has during the currency of the policy failed to notify the insurers of circumstances likely to give rise to a claim as specified by the policy, and a claim is then made against the assured in a later year: the Australian courts have here concluded that the failure of the assured is one falling within s 54 and accordingly the assured’s breach is waived by s 54 and the insurers face liability.<sup>506</sup> The courts have, however, refused to hold that a failure by the third party to make a claim against the assured within the currency of the policy is not capable of being excused under s 54.<sup>507</sup> Further, a policy which does not make provision for notification of circumstances likely to give rise to a claim does not respond where the assured has not given due notification in the policy period: this is because s 54 does not apply to the assured’s failure to avail himself of the statutory right under s 40(3) but only to a failure to avail himself of the benefits of the policy.<sup>508</sup> The effect of the authorities is that if the policy allows the assured to notify circumstances likely to give rise to a claim and thereby treat a later claim as within the policy, his failure to notify can be excused under s 54: if, however, the policy does not contain such a clause, although the assured has a statutory right to notify circumstances under s 40(3) his failure to do so cannot be excused by s 40(3). This has led to insurers either increasing premiums or removing from their policies the contractual right to notify circumstances.

**8.34** As see earlier, the draft Insurance Contracts Amendment Bill 2007 inserts a new s 54A which removes claims made and notified policies from s 54 by providing that if the assured is entitled under contract to notify circumstances but fails to do so, s 54 cannot excuse his omission unless the claim is made within 28 days of the expiry of the policy. As far as s 40 itself is concerned, the 2007 Bill makes a number of changes. First, there is an extended definition in new draft s 40(1) of the types of policy covered by the section: it is to cover any contract of liability insurance which satisfies one of three criteria: (a) the insurer’s liability is excluded or limited if a claim against the assured or any third party beneficiary in respect of a loss suffered by some other person is not made before the insurance cover provided by the contract expires

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<sup>503</sup> *Newcastle City Council v GIO General Ltd* (1997) 191 CLR 85. The *Newcastle* decision, it is submitted, cannot be supported, although as far as the UK is concerned the case produces a result which is consistent with the way that claims made liability policies are normally framed.

<sup>504</sup> Mann, paras 40.30, 40.35, 54.10.7, 54.10.14, 54.10.15 and 54.60; Sutton, paras 8.46-8.76.

<sup>505</sup> *East End Real Estate Pty Ltd v CE Heath Casualty & General Insurance Ltd* (1991) 25 NSWLR 400.

<sup>506</sup> *FAI v Australian Hospital Care Pty Ltd* [2001] HCA 38, overruling *FAI General Insurance Co Ltd v Perry* (1993) 30 NSWLR 89 and also the reasoning in *Greentree v FAI General Insurance Co Ltd* (1998) 158 ALR 592 and *Permanent Trustee v FAI General Insurance Co Ltd* (1998) 44 NSWLR 186, in each of which a failure to notify was held not to amount to an omission.

<sup>507</sup> *CA & MEC McNally Nominees Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2001) 11 ANZ Ins Cas 61-507.

<sup>508</sup> *Gosford City Council v GIO General Ltd* (2003) 56 NSWLR 52.

(the existing s 40(1)); or (b) the insurer's liability is excluded or limited if a claim against the assured or any third party beneficiary in respect of a loss suffered by some other person is not made before the insurance cover provided by the contract expires; or (c) the insurer's liability is excluded or limited if a claim against the assured or any third party beneficiary in respect of a loss suffered by some other person is made before the insurance cover provided by the contract expires, but notice of the claim is not given to the insurer before the insurance cover expires. The common theme here is that the assured has no contractual right to notify circumstances likely to give rise to a claim, so that reliance on s 54 is not possible. Secondly, the draft revised version of s 40(3) maintains the principle that the assured (or a third party beneficiary) has a statutory right within the policy period to give notice of circumstances that may give rise to a claim at some future date, but gives the assured an additional 28 day period after expiry of the policy to give such notice: this is partial compensation for the fact that s 54 relief is unavailable if the statutory right to notify circumstances is not exercised. Thirdly, a new draft s 40(4) requires the insurers to notify the assured of the consequences of a failure to notify under s 40(3), by written notice given not later than 14 days before the cover expires: by this means the assured is to be alerted of the fact that, unless he notifies circumstances within 28 days following expiry, he will lose cover if a claim is made thereafter. Finally, new draft s 40(5) extends the s 40(4) notice obligation to the case in which the assured cancels the policy before its due date of termination: the insurers are required to give the statutory warning under s 40(4) as soon as reasonably practicable but no later than 14 days after the date on which the contract was cancelled.

#### *Maximum cover obtained for premium*

**8.35** Section 42 of the 1984 Act states that, irrespective of express policy limits, the assured is entitled to the maximum amount of cover that the insurers would have been prepared to offer at the same premium. This is designed to cover the situation in which the assured believes that he can only afford a limited amount of cover, which he specifies to the insurers, where the insurers would have been willing to provide a higher limit of indemnity for the same premium.<sup>509</sup> It is unclear whether this provision has any practical effect.

#### *Average clauses*

**8.36** Section 44 of the 1984 Act imposes a prohibition on the use of average clauses unless specifically drawn to the assured's attention.<sup>510</sup> An average clause bites where the assured is underinsured and suffers a partial loss, average having the effect of reducing pro rata the amount of recovery by reference to the ratio between the actual value of the insured subject matter and the insured value. Although average is used in the commercial property and marine markets, its use in the consumer market is frequently little more than a trap for the assured. The ALRC had been pressed to abolish average, but chose instead to recommend its retention coupled with appropriate warnings.<sup>511</sup> Section 44, as amended in 1997, does make two important concessions towards the holders of domestic buildings and contents policies: if the sum insured is at least

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<sup>509</sup> ALRC 20, para 275. See Sutton, para 15.197.

<sup>510</sup> Sutton, paras 15.191 to 15.195.

<sup>511</sup> ALRC 20, paras 271-274, with Kirby J dissenting and favouring abolition.

80% of the market value at the date of the policy then the average clause is ineffective; and if the sum insured is less than 80% of the market value at the date of the policy then the insurers are entitled to reduce the amount payable by reference to the ratio which 80% of actual value bears to the sum insured. The compromise adopted here is an interesting one, although at least in the domestic and small business markets there is much to be said for the solution rejected by the ALRC, given that the effects of average would probably not be appreciated even with an explanation.

### *Double insurance and contribution*

**8.37** Section 45 deals with the familiar problem of “double insurance” terms in policies. Such terms are designed to cast any loss onto other insurers should they exist. Double insurance clauses may operate absolutely or they may require the policy to be treated as an excess layer cover only, and they may take a number of different forms, including rendering the policy void, requiring the assured to warrant that no other insurance exists or will be taken out or simply transferring liability. The English courts have refused to allow the assured to be prejudiced by these clauses, and any attempt by two insurers to cast the burden of loss onto each other will be ineffective.<sup>512</sup> The solution adopted by s 45(1)<sup>513</sup> is to outlaw such clauses, although there is necessarily a saving for an excess of loss policy specifically drafted as such.<sup>514</sup>

**8.38** Section 76 of the Insurance Contracts Act 1984, misleadingly headed “Contribution between insurers” is in essence a restatement of the common law rule that the assured who has double insurance may recover from the insurers in such order as he thinks fit up to the limit of indemnity.<sup>515</sup> The section goes on to preserve the insurers’ rights of contribution *inter se*.<sup>516</sup> The section does not appear to change the common law in any respect.<sup>517</sup> The ALRC in its 1982 Report had addressed the problem of contribution and, having considered the various forms of contribution which could be applied, recommended that the law adopt the independent liability rather than the maximum liability approach.<sup>518</sup> This means that if there are two insurers liable for the same loss, apportionment is based on their respective liabilities for the actual loss suffered by the assured rather than on the notional limits of indemnity set out in the policy. The recommendation did not find its way into the 1984 Act. The position in England is uncertain. Insurers in practice do apply the independent liability approach,<sup>519</sup> although there do remain

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<sup>512</sup> *Weddell v Road Transport and General Insurance Co Ltd* [1932] 2 KB 563.

<sup>513</sup> Adopting ALRC 20, Chapter 11; Sutton, chapter 12.

<sup>514</sup> S 45(2). See *HIH Casualty & General Insurance Ltd v Plum Constructions Pty Ltd* [2000] NSWCA 281.

<sup>515</sup> Codified in the Marine Insurance Act 1906, s 32.

<sup>516</sup> See Marine Insurance Act 1906, s 80.

<sup>517</sup> It may render inapplicable the rule in s 32(2)(b) of the Marine Insurance Act 1906 which applies where the assured has both a valued and an unvalued policy: if he claims under the unvalued policy first and fails to recover a full indemnity, any claim that he has against the insurers under the valued policy is reduced by the sum that he has received. Accordingly, if the valuation is less than the actual loss, the assured will suffer a shortfall. It is unclear whether this rule applies in non-marine insurance, and it is noteworthy that ALRC 91 recommended no change to the marine rule. The problem can in practice be sidestepped by claiming against the valued insurers first, so that if there is a shortfall it can be recovered under the unvalued policy (subject to policy limits).

<sup>518</sup> See paras 291 to 298.

<sup>519</sup> *Commercial Union Assurance v Hayden* [1977] QB 804.

disputes as to whether the correct approach is either of these or indeed a third possibility, common liability, under which the insurers bear equally any loss up to the maximum amount of cover provided by the lowest value policy, with the balance being borne by the other policy.<sup>520</sup> Clarification in this jurisdiction would be useful, and independent liability appears to be the fairest measure as it disregards limits of indemnity which in practice are most unlikely to be reached. Other uncertainties affecting the operation of contribution remain untouched by the legislation: that which has given rise to the most judicial conflict of opinion is whether a contingent right of contribution which arises when the insured peril occurs is lost if the assured fails to comply with policy terms and conditions so that by the date of payment the insurers from whom contribution is sought no longer face liability to the assured.<sup>521</sup>

### *Sale of insured property*

**8.39** At common law the sale of property does not transfer with it any insurance which relates to the property,<sup>522</sup> and the policy becomes worthless in the hands of the vendor because he no longer has any insurable interest.<sup>523</sup> That rule is quite properly left untouched by the Insurance Contracts Act 1984, as it must be a matter for the insurers to decide whether they wish to insure an entirely different assured who may represent an enhanced risk. However, one particular problem with this rule is in relation to the sale of land (and, less commonly, goods) where the risk in the subject matter passes to the purchaser before the transfer of title: once again, the purchaser cannot derive any benefit from the policy even though, in the event of a casualty, he remains under an obligation to pay the purchase price.<sup>524</sup> The problem is addressed by s 50 of the Insurance Contracts Act 1984,<sup>525</sup> which operates to transfer the benefit of the policy to a purchaser in the period between the passing of the risk (contract) and the passing of property (conveyance). In this jurisdiction, section 47 of the Law of Property Act did purport to achieve a similar outcome, but the provision has proved to be of little or no value. The matter is in practice

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<sup>520</sup> Common liability was rejected as a possible measure in marine cases in *O’Kane v Jones* [2005] Lloyd’s Rep IR 174, on the ground that it was not an apportionment at all, as required by s 80 of the Marine Insurance Act 1906. ALRC 91 recommended no change to the equivalent provisions of the Australian Marine Insurance Act 1909 on this point.

<sup>521</sup> The conflicting authorities are considered by Longmore LJ in *Bolton Metropolitan Borough Council v Municipal Mutual Insurance* [2006] Lloyd’s Rep IR 15. Quaere, however, whether this should be the case if the assured has made a fraudulent claim against insurer B, and then turns to insurer A for indemnification. In principle there is no difference between this situation and that in which the assured has simply failed to claim against insurer B, given that what is at stake is the right of insurer A to obtain a restitutionary remedy. There is no reported case in which this has occurred: the usual scenario is a straightforward failure to claim from insurer B. The point does not arise in Australia, as any breach of condition is likely to be cured under s 54 of the 1984 Act, leaving the contribution claim intact.

<sup>522</sup> *North of England Pure Oil Cake Co v Archangel Marine Insurance Co* (1875) LR 10 QB 249; Marine Insurance Act 1906, s 15.

<sup>523</sup> *Powles v Innes* (1843) 11 M & W 10; *Ecclesiastical Commissioners v Royal Exchange Assurance* (1895) 11 TLR 476. Contrast the sale of a motor vehicle, as the assured may retain an insurable interest in his liability while driving other vehicles: *Dodson v Peter H Dodson Insurance Services* [2001] Lloyd’s Rep IR 278.

<sup>524</sup> So that if the insurers do indemnify the vendor, they have subrogation rights against the purchaser. See: *Rayner v Preston* (1881) LR 18 Ch D 1, *Castellain v Preston* (1883) LR 11 QBD 380.

<sup>525</sup> Based on ALRC 20, paras 130-132.

dealt with by contractual provisions which require the vendor to retain the risk, but the adoption of something along the lines of s 50 of the 1984 Act would be helpful.

### *Third party rights under liability policies*

**8.40** Section 51 of the Insurance Contracts Act 1984<sup>526</sup> confers upon the victim of a person insured under a liability policy the right to proceed directly against the insurers in the event that the assured “has died or cannot, after reasonable enquiry, be found”.<sup>527</sup> The third party is given no better rights against the insurers than were possessed by the assured. The UK’s Third Parties (Rights against Insurers) Act 1930 – as yet unreformed despite the Law Commissions’ best efforts<sup>528</sup> – confers a direct action against insurers, but only in the case of insolvency and not in the case of death: English law otherwise requires the third party to proceed against the assured’s estate. It is perhaps worthwhile for the Law Commissions to make inquiry to determine whether, in practice, proceeding against a deceased’s estate gives rise to practical problems. Certainly, as regards a company, there is a statutory procedure for resurrecting the company so that it can be sued, although in most cases a dissolved company will be insolvent so that the 1930 Act will be available to the third party up to the point of dissolution and thereafter it will have to be restored to the register in any event.

### *Refusal of proposal*

**8.41** The assured is, under s 75 of the 1984 Act,<sup>529</sup> entitled on request to be given reasons for any refusal by the insurers to offer him cover, or to offer him cover on less advantageous terms than would normally be available. This applies also to a refusal to renew and a decision to cancel. There are restrictions on disclosure for life policies where the policyholder is not the life assured, reasons relating to the health of the life assured not being disclosable. Further, in the case of an own-life or other policy to which the assured’s health is relevant, disclosure may at the insurers’ option be made to a doctor nominated by the assured rather than directly to the assured himself. In addition, insurers are not required to provide information which puts at risk the interests of the insurers or some other person. The section is backed by criminal sanctions.

### *Renewal of policies*

**8.42** The ALRC in its 1982 Report<sup>530</sup> pointed out that insurers under non-life policies<sup>531</sup> typically send out renewal notices to their assureds inviting renewal and it is plainly in their

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<sup>526</sup> Implementing ALRC 20, para 340

<sup>527</sup> Including a company which has been dissolved: *Norsworthy v SGIC* 1999, unreported (SA Sup Ct). Treasury Review II recommended that the section be extended to two further situations: where the assured is alive and can be found but the third party cannot recover any amount owed to them as a judgment has been executed against the assured but the judgment has not been satisfied; and a third party beneficiary is liable under a contract of insurance but cannot, after reasonable enquiry, be found. These proposals are included in the draft Insurance Contracts Amendment Bill 2007.

<sup>528</sup> Law Commission Report No 272, 2001.

<sup>529</sup> ALRC 20, para 214.

<sup>530</sup> ALRC 20, para 264.

interests to do so. However, insurers may neglect to send out the relevant notice, or they may take the view that they do not wish to renew, and in either case the policy could terminate without the assured becoming aware of the fact. Accordingly the ALRC recommended that cover should be automatically extended if the insurers failed to notify the assured of its expiry. Section 58 of the 1984 Act accordingly provides that if the policy provides cover for a particular period and is not of a kind which it is usual to renew by negotiation, the insurers must no later than 14 days before expiry give the assured a notice in writing informing the assured of the due date of expiry and whether or not the insurers are willing to negotiate a renewal.<sup>532</sup> If the insurers fail to give due notice, and the assured has not before expiry insured elsewhere, the insurance is deemed to continue. Once the assured has obtained cover elsewhere, the deemed insurance comes to an end. The assured is not required to pay any premium for any period of cover, although if there is a loss then the assured is required to pay something to the insurers: in the event of a total loss the full premium which would have been payable had there been renewal is payable,<sup>533</sup> and if there is a partial loss then the assured must pay a proportional part of the premium based on the period until the claim as against the period of the original policy. Necessarily the section does not apply if the insurers have validly cancelled the policy before the 14 day notice period,<sup>534</sup> and the ALRC specifically rejected the idea that insurers should be deprived of the right to refuse to renew<sup>535</sup> although there is of course an obligation to provide reasons for refusal to renew on the request of the assured.<sup>536</sup>

**8.43** As far as the UK is concerned, it is the practice of insurers to issue renewal notices warning the assured of the duty to disclose material facts and maintaining premium payment arrangements. They are not, however, obliged to do so, and in particular they are not obliged to give any indication of an intention not to renew.

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<sup>531</sup> Life policies are continuous, so the renewal issue does not arise.

<sup>532</sup> Sutton, paras 3.217 to 3.224. It would seem that the assured can utilise this provision indefinitely, although Treasury Review II, 2004, para 8.16, felt that the notion of perpetual renewal was theoretical and that no change in the law was required.

<sup>533</sup> Treasury Review II, 2004, has recommended that the full premium should be payable even though there is only a partial loss: recommendation 8.3. The draft Insurance Contracts Amendment Bill 2007 adopts this recommendation by modifying s 58(4)(b) to provide that “*if a claim is made under the contract, there is payable by the insured to the insurer, as a premium in respect of the contract, an amount equal to the amount that, if the original contract had been renewed for the same period and on the same terms and conditions, would have been payable by the insured in respect of the renewal.*”

Repeal subsections 58(5) and (6)

<sup>534</sup> *CIC Insurance Ltd v Bankstown Football Club Ltd* (1995) 8 ANZ Ins Cas 61-232.

<sup>535</sup> ALRC 20, para 265. One exception arises in relation to liability insurance, where insurers are required to indemnify the assured for claims arising after the policy has expired as long as the policy provided cover for the notification to the insurers during the currency of the policy of circumstances which might give rise to a claim: this is now s 40(3) of the 1984 Act, discussed *supra*.

<sup>536</sup> Insurance Contracts Act 1984, s 75, discussed *supra*.

## *Cancellation of policies*

**8.44** The Insurance Contracts Act 1984 contains detailed provisions relating to the cancellation of policies by insurers. Section 59,<sup>537</sup> as amended, precludes terms which permit cancellation of a policy without notice, although the section appears not to preclude reliance on a term providing for automatic termination on a given event.<sup>538</sup> Instead, the insurers must give at least 14 days' notice of cancellation of a non-life policy, and at least 20 days' notice of cancellation of a life policy.<sup>539</sup> Cancellation of a non-life policy is permitted under s 60 where the assured is in breach of any of his fundamental duties under the legislation, in particular the duty of disclosure or the duty not to make fraudulent claims,<sup>540</sup> and cancellation is also permitted for non-payment of premiums.<sup>541</sup> Any cancellation which does not conform to these provisions is of no effect,<sup>542</sup> and even where cancellation is operative the assured is entitled to written reasons for the cancellation under s 75 of the 1984 Act. The right of cancellation extended to general insurers under s 60 in respect of breach of duty by the assured does not apply to life insurance. Treasury Review II, 2004, considered whether general and life insurance should be brought into line on this point, but the ultimate conclusion was that life insurers could rely upon the common law and specific cancellation clauses in their policies to replicate s 60 and accordingly that no change in the law was required.<sup>543</sup>

**8.45** There is no equivalent requirement in English law, and it is standard practice to include in certain classes of cover – in particular marine and aviation policies – a right of cancellation on notice by the insurer whether or not there is a reason to do so: such clauses have been challenged but found to be valid,<sup>544</sup> a concept heavily criticised by the ALRC. These policies also include automatic termination provisions in circumstances where the risk has been altered in some significant fashion. It might be thought that the Australian solution is half-hearted in its attempts to protect the assured: the right to cancel on notice for no reason – although likely to be exercised if the insurer anticipates an increased risk – is wholly unjustifiable by any standards, although equally there is no real objection to automatic termination or termination on notice if the assured fundamentally alters the insured risk (a concept in any event recognised by the common law<sup>545</sup> and possibly not affected by the 1984 Act<sup>546</sup>).

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<sup>537</sup> Implementing ALRC 20, paras 246-249.

<sup>538</sup> *Waterman v Gerling Australia Insurance Company P/L* [2005] NSWSC 1066 (late payment of premium). This case is contrary to the recommendations of ALRC 20, and has the effect of validating premium warranties. Any adoption of s 59 in England should make it clear that automatic termination clauses are void.

<sup>539</sup> Other than in cases where the life policy has been forfeited for non-payment of premiums. Treasury Review II, 2004, saw no need to change these time limits: see para 7.59.

<sup>540</sup> The operation of s 60 is discussed below. An insurer in liquidation may, under s 61, cancel its policies.

<sup>541</sup> S 62: see *supra*.

<sup>542</sup> Insurance Contracts Act 1984, s 63.

<sup>543</sup> Para 7.55.

<sup>544</sup> *Sun Fire Office v Hart* (1889) 14 App Cas 98

<sup>545</sup> *Swiss Reinsurance Co v United India Insurance Co Ltd* [2005] Lloyd's Rep IR 341.

<sup>546</sup> *QBE Mercantile Mutual Ltd v Hammer Waste Pty Ltd* [2003] NSWCA 356, in which the common law authorities were considered but distinguished on the facts.

## **Matters in the 1984 Act already a part of domestic law**

**8.46** Finally, there is a set of provisions dealt with by the 1984 Act which are already regulated by English law.

### *Arbitration*

**8.47** There is a prohibition on use of arbitration clauses in insurance policies in s 43 of the 1984 Act. English law does this only in respect of consumer policies, under the Arbitration Act 1996, ss 89-91, sections which have the effect of applying the Unfair Terms in Consumer Contracts Regulations 1999 to arbitration clauses.

### *Third party rights*

**8.48** The Contracts (Rights of Third Parties) Act 1999 abolished the doctrine of privity of contract in England. In its stead, the Act allows a person who is the intended, named, identified or identifiable beneficiary of a contract to enforce any rights conferred on him by the contract. The legislation applies to insurance, and on the face of things a third party beneficiary under a policy is entitled to bring suit against the insurers. Regrettably, virtually all policies issued since the Act came into force in May 2000 contain an express exclusion for the Act, so that the position remains as it was at common law and a third party beneficiary has no claim unless the assured acted as agent<sup>547</sup> or trustee for the beneficiary.

**8.49** The Australian legislation, by contrast, has anticipated the 1999 Act in the context of insurance, but does not permit its exclusion. Under s 48 of the Insurance Contracts Act 1984,<sup>548</sup> a person who is not a party to a contract of insurance but who is specified or referred to in it (by name or otherwise) has a right to recover his loss from the insurers on the same terms as, and subject to the same defences available against, the assured himself. The principle has been extended to ordinary life policies and policies taken out in connection with a Retirement Savings Account.<sup>549</sup> The section has generated a significant amount of litigation by reason of its loose drafting,<sup>550</sup> and the Law Commissions will plainly not contemplate adopting a similar provision given that the English 1999 Act is a far clearer piece of legislation. There remains the possibility that the 1999 Act could be made compulsory in the context of insurance, but the prospect of this is remote and there is no reason why insurance should be treated differently to other contracts.

**8.50** The position of third party beneficiaries was given detailed consideration by Treasury Review II, and its recommendations<sup>551</sup> have been adopted by the draft Insurance Contracts Amendment Bill 2007. Treasury Review II noted that s 48 is the only provision which deals with

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<sup>547</sup> The agency has to be disclosed: *Talbot Underwriting Ltd v Nausch Hogan & Murray, The Jascon 5* [2006] Lloyd's Rep IR 531.

<sup>548</sup> Based on ALCR 20, paras 121-124.

<sup>549</sup> Insurance Contracts Act 1984, ss 48A and 48AA respectively.

<sup>550</sup> Mann, paras 48.10 to 48.40; Sutton, paras 2.79 to 2.98.

<sup>551</sup> Recommendations 10.2 to 10.4.



third party rights, but that section is confined to the right to recover: it says nothing about insurers owing any separate duties to third parties. The proposals do not align the rights of third parties with those of the assured in all cases, but there are a number of situations in which third parties have been given equivalent rights. Under the proposals:

- (1) There is a definition of “third party beneficiary” in s 11(1), being “*a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the insurance cover provided by the contract extends.*”
- (2) New ss 13(3)-(4) extend the insurers’ post-contractual duty of utmost good faith to a third party beneficiary. This means that claims handling and other obligations owed by insurers to the assured under s 13 are extended to beneficiaries.<sup>552</sup>
- (3) Third party beneficiaries are entitled to the benefits conferred by s 41 of the 1984 Act, so that a liability insurer owes the same duties to provide information to a third party beneficiary as he does to the assured: this point is discussed in more detail above.
- (4) Third party beneficiaries are to be given the right to receive policy documents under a revised version of s 74 of the 1984 Act.
- (5) The existing right of a third party under s 48 to make a claim under the policy is to be redrafted so as to import references to third party beneficiaries as defined in the addition to s 11(1). However, it is to be made clear under the revised version of s 48(3) that, in defending an action by a third party beneficiary, the insurers may raise, as against the third party beneficiary, any defence relating to the pre-contract or post-contract conduct of the assured, so that the beneficiary is subject to defences based on non-disclosure, misrepresentation or breach of one or other policy provision.<sup>553</sup>
- (6) Subrogation rights are not to be exercised against third party beneficiaries.

### *Variation of contracts of insurance*

**8.51** Section 53 of the Insurance Contracts Act 1984 outlaws any term which confers upon insurers the right to vary unilaterally the terms of the policy, to the prejudice of the assured or any third party. The section is limited in its operation to policies declared by the Insurance Contracts Regulations 1985. The list of policies excluded from s 53<sup>554</sup> is: construction; commercial; mechanical breakdown; products liability; accidental loss; credit; life; superannuation; sickness and accident; export credits; and aviation liability. In essence, therefore, domestic policies alone are covered. It may be, in the light of the extension of all but domestic policies, that this provision is replicated by the Unfair Terms in Consumer Contracts Regulations 1999, and indeed the 1999 Regulations may have wider effect.

<sup>552</sup> A position reached by the courts in any event: *Wylie v National Mutual Life Association of Australasia Limited* (1997) 217 ALR 324; *Hannover Life Re of Australasia Limited v Sayseng* [2005] NSWCA 214; *Dumitrov v S C Johnson & Son Superannuation Pty Ltd* [2006] NSWSC 1372.

<sup>553</sup> These changes are extended to ss 48A and 48AA.

<sup>554</sup> SR 1985 No 162, reg 31, as amended by SR 2000 No 118.