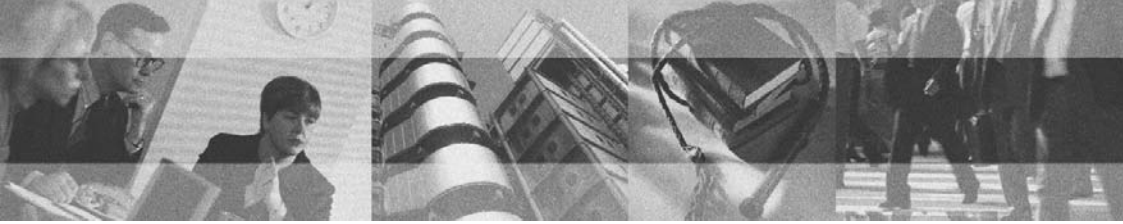


INSURANCE CONTRACTS LAW REFORM – SOME LESSONS FROM AUSTRALIA

Paper for BILA journal by Chern Tan, Minter Ellison Lawyers

In 1984, the *Insurance Contracts Act* (**the Australian Act**) was enacted in Australia, which introduced a broad range of reforms to Australian insurance law. Two significant aspects of the reforms were changes to the common law in respect of (1) an insured's duty of disclosure and (2) remedies available to an insurer for non-disclosure or misrepresentation by an insured.

In Australia, the duty of disclosure is viewed from the insured's perspective, rather than that of a '*prudent insurer*'. If there is a breach of that duty or there is a pre-policy misrepresentation, the insurer cannot avoid the policy, except in the case of fraud (in which case the insured can apply to the Court to alleviate any harshness or unfairness caused by the insurer's denial of the claim).

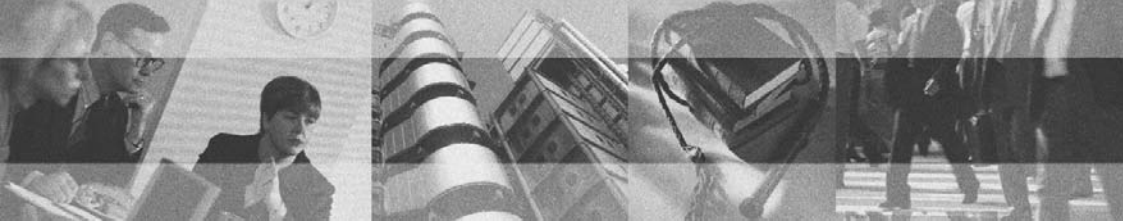
Recently, law-makers in the United Kingdom have been considering a reform of the common law in this regard. On 17 July 2007, the English and Scottish Law Commissions published a consultation paper entitled '*Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured*' (**the Consultation Paper**). Their proposal for reform is similar in some aspects to current Australian law.

This paper identifies similarities between the Law Commissions' proposals and the Australian Act in this area, examines some of the key issues and problems that have arisen in the general insurance context under the Australian Act in these areas, and discusses how those problems may be avoided under the Law Commissions' current proposals. Issues arising in the life insurance context are beyond the scope of this paper.

Duty of disclosure

The Law Commissions' paper outlines a number of criticisms with the common law on the duty of disclosure. Relevantly, the criticisms included that the duty may operate as a trap – even if an insured is aware he or she has such a duty, they may not know what would influence a prudent insurer. Another criticism is that policyholders may be denied claims even when they have acted honestly and reasonably. If they gave inaccurate or incomplete factual information because a question was unclear or outside their area of knowledge, the duty would be breached (see the Consultation Paper, paragraph 1.12).

The Australian law reformers had also identified these problems. In Australia, the law was changed in 1984 so that the insured was obliged to disclose only what they actually knew, and then only if they also knew, or ought to have known, that the information was relevant to the insurer. The onus was placed on the insurer to follow up with the insured any ambiguous answers given during the proposal stage.



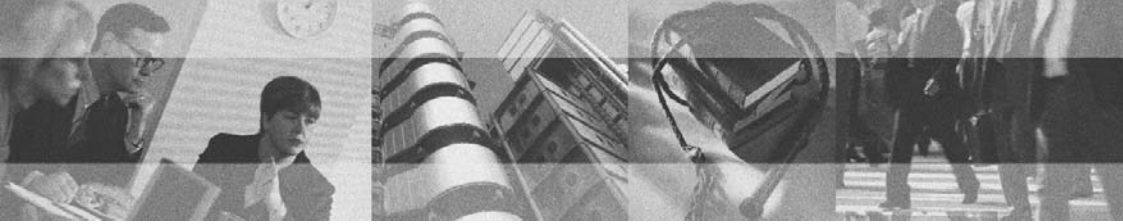
Section 21 of the Australian Act states that (emphasis added):

> "The insured's duty of disclosure
>
> (1) Subject to this Act, an insured has a duty to disclose to the insurer, before the relevant contract of insurance 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.
>
> (2) The duty of disclosure does not require the disclosure of a matter:
>
> (a) that diminishes the risk;
>
> (b) that is of common knowledge;
>
> (c) that the insurer knows or in the ordinary course of the insurer's business as an insurer ought to know; or
>
> (d) as to which compliance with the duty of disclosure is waived by the insurer.
>
> (3) Where a person:
>
> (a) failed to answer; or
>
> (b) gave an obviously incomplete or irrelevant answer to;
>
> a question included in a proposal form about a matter, the insurer shall be deemed to have waived compliance with the duty of disclosure in relation to the matter."

Section 22 requires the insurer to notify the insured in writing of this duty. Failure to do so precludes the insurer from relying on any non-disclosure (except in the case of fraud).

In 1998, section 21A was inserted into the Australian Act, which applies to what will be referred to in this paper as '*consumer policies*' (eg home & contents, domestic motor vehicle and travel policies). It recognises that consumers are far more likely to misapprehend what factors are relevant to an insurer's assessment of risks. The section places the onus on the insurer to ask specific questions, the answer to which if inaccurate is treated as a misrepresentation and may give the insurer remedies. The section allows the insurer to, in addition, ask a general question to disclose any '*exceptional circumstances*' which is not a matter that the insurer could reasonably be expected to make the subject of a specific question. The insurer bears the onus of proving what '*exceptional circumstances*' are. If the insurer does not comply with section 21A, the insurer is deemed to have waived the insured's obligation to disclose. Section 21A applies only to new policies, that is, it does not apply to renewals.

Section 26 gives protection to the insured in respect of misrepresentations. The insured is not guilty of a misrepresentation if his or her statement was made on the basis of a reasonable belief. Further, the insurer may treat a statement as a misrepresentation only if a reasonable person in the circumstances could be expected to have known that the statement would have



been relevant to the decision of the insurer whether to accept the risk, and if so, on what terms. Section 24 provides that warranties are to be treated as statements to which section 26 applies.

The Law Commissions have proposed a regime for the United Kingdom that has similarities to the Australian Act. They propose a similar distinction between consumer insurance and business insurance – consumers will not have a duty to volunteer information. They also propose that whether a misrepresentation or non-disclosure (in the case of business policies) has occurred should be determined from the point of view of the reasonable person in the circumstances. One major difference between the Law Commissions' proposal and the Australian Act is that the Law Commissions propose the parties to a business policy may contract out of the regime (see Part 12 of the Consultation Paper, paragraphs 12.1-12.43). In Australia, any term that increases the insured's obligation or reduces the insured's rights beyond that set out in the Act is unenforceable.

Lessons from Australia

While most believe that sections 21 and 21A operate to strike a fair balance between the interests of insurers and insured, there have been uncertainties surrounding the meaning of particular key words in the sections. For example, the words '*known to the insured*' raise the questions: does what is '*known*' include what can be inferred or what is mere belief; does it include constructive knowledge or an agent's knowledge?

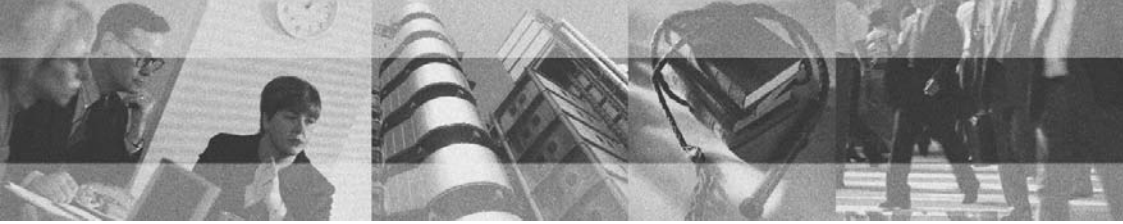
It is now settled that '*known*' means:

> '*…more than suspected or believed. What is required is that the matter should be the subject of true belief, held with sufficient assurance to justify the term "known".*' (Permanent Trustee Australia Ltd v FAI General Insurance Co Ltd (1998) 10 ANZ Insurance Cases 61-408 per Hodgson CJ of the New South Wales Supreme Court, and affirmed by the High Court: (2003) 12 ANZ Insurance Cases 61-565.)

Accordingly, an insured who was concerned about a number of symptoms, but who was constantly told by doctors that she was in good health, was held not to have had the relevant knowledge (no true belief). In another case, an insured who knew its premises were being used to supply nail products, but not that the use involved the storage of inflammable liquids, defeated the insurer's argument that a reasonable person could be expected to know the nail products were inflammable ('*known*' did not mean '*inferred*'). The mere fact that an insured ought in the ordinary course of business to have known is insufficient.

In Hammer Waste Pty Ltd v QBE Mutual Ltd [2002] NSWSC 1006, Palmer J said:

> '*(I)n s 21(1)… the word "know" is used in its ordinary sense; it implies actual, not constructive, knowledge both on the part of the insured and on the part of any agent or employee of the insured whose "knowledge" is to be imputed to the insured. The obligation to disclose something "known" can attach only to something which, at the time for disclosure, a person actually has in his or her consciousness or else something which exists in some record or other source of information which the person actually knows about and to which the person has access. So, for example, I "know" my driving licence number for the purposes of s 21(1)… even though I cannot recite it off hand because I actually know that it is to be found in the plastic card in my wallet.*'



Knowledge of an insured's agent can be imputed to the insured. This is not necessarily inconsistent with Hodgson CJ's description in *Permanent Trustee* of what qualifies for the term '*known*'. It is a recognition that businesses conduct their affairs through others; in particular, companies conduct business through individuals. Those individuals must '*know*' a matter in the way described by Hodgson CJ for the duty to arise in the company to disclose.

In A & D Douglas Pty Ltd v Lawyers Private Mortgages Pty Ltd [2006] FCA 520, Dowsett J applied Australia and New Zealand Bank Ltd v Colonial and Eagles Wharves Limited (1960) 2 Lloyd's Rep. 241, where McNair J observed that:

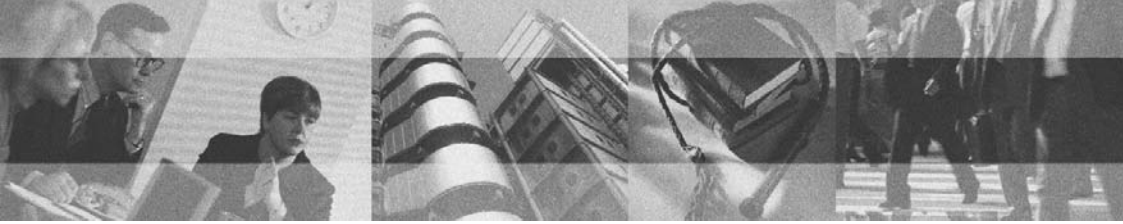
> '*[I]t is not the knowledge of all agents or servants that is imputed to the proposer of any marine insurance, but only the knowledge of quite a limited class, namely, the broker who actually places the insurance, the master or the ship agent, or, to use Lord Halsbury's phrase, "his general agent for the management of his shipping business."*'

Justice Dowsett also quoted with approval the authors of MacGillivray on Insurance Law (10th edition at paragraph 18-012) when they said knowledge of only those agents who are responsible for keeping the insured informed about the subject matter of the insurance, either because they are responsible for placing the insurance or because they have the management of it for the insured, can be imputed to the insured. If such an agent owes a duty to communicate information which is relevant to the insurance, but fails to do so, the insured is deemed to know what in the ordinary routine of his business he should have been told if the agent had performed his duty. However, the insured will not be deemed to know facts which, whether or not owing to the deficient organisation of the business, no agent was responsible for communicating to the insured.

His Honour qualified this by saying that an agent's knowledge of his or her own fraud or misconduct and matters relevant to it will not be imputed to the insured. It cannot be supposed that in the ordinary course of business, agents will disclose their own fraud, misconduct or serious breach of duty to their principal.

The Law Commissions' proposal is to simplify section 18(1) of the *Marine Insurance Act 1906* and is different to the Australian law in that the duty is not limited to what the insured actually knew, but extends to what the insured ought to have known (see the Consultation Paper, paragraph 12.27). This shifts the balance in favour of the insurer a little and will protect the insurer against the particularly obtuse insured. However, the proposed duty will apply only in relation to business policies and, in practice, is unlikely to achieve very different results to that in Australia given Australian case law on the imputation to an insured of the knowledge of its agents. Where the result might differ is when the relevant agent has been guilty of fraud. It could be argued that the insured ought to have known of the fraud and that the constructive knowledge is fatal to the insured's claim.

Under section 21, once it is established that the insured '*knew*' of a matter, the insurer must go on to prove one of two things. The first is that the matter was one that the insured actually '*knew*' was relevant to the insurer (and **not** some hypothetical '*prudent*' insurer). If that cannot be proved, the alternative is to prove that a reasonable person in the circumstances would have known the matter was relevant to the insurer. These tests are similar to those proposed by the Law Commissions.



The words '*a reasonable person in the circumstances*' raise the questions: what are the circumstances referred to; to what extent do they include a particular prospective insured's idiosyncrasies? Until recently, there has been debate in Australia as to whether *'the circumstances'* of a reasonable person include both '*extrinsic*' factors (eg the circumstances in which the policy was entered into) and '*intrinsic*' factors (eg the individual idiosyncrasies of the insured). The latter might include imperfect understanding of English, cultural background or unfamiliarity with insurance or business practice.

On 30 July 2008, the High Court of Australia in CGU Insurance Ltd v Porthouse [2008] HCA 30) cited with apparent approval the case of Twenty-first Maylux Pty Ltd v Mercantile Mutual Insurance (Aust) Ltd (1990) 6 ANZ Insurance Cases 60-954, which held that '*intrinsic*' factors were irrelevant considerations.

The High Court observed in CGU Insurance Ltd v Porthouse that:

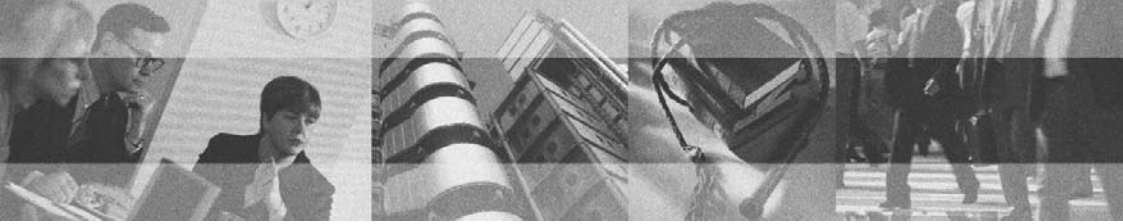
> '*A test of disclosure, which operates by reference to both the insured's actual knowledge and the knowledge of a reasonable person in the same circumstances, is calculated to balance the insured's duty to disclose and the insurer's right to information. The insurer is protected against claims where the insured's disclosure is inadequate because the insured is unreasonable, idiosyncratic or obtuse and the insured is protected from exclusion from cover, provided he or she does not fall below the standard of a reasonable person in the same position.*'

Accordingly, the High Court found that an exclusion which used similar language as section 21(1)(b) applied because a reasonable person in the insured barrister's position would have known that an allegation might be made against him in respect of a liability covered by the professional indemnity policy. Whereas the insured gave evidence that he did not believe that an allegation might be made, the High Court said a reasonable barrister aware of the potential error in his or her advice and the likely consequences for the client, would have known that an allegation might be made. Interestingly, the High Court commented that it was open for either party to adduce evidence about the common practice of barristers, to assist the court in determining whether a reasonable barrister would have known that an allegation might be made.

Similarly, in Green v CGU Insurance Limited [2008] NSWSC 825, Einstein J held that directors who failed to disclose material changes in their company's financial position since its last audited accounts and the potential withdrawal of financing by its bankers, breached their duty of disclosure because reasonable directors in their position would have known they were relevant matters to the insurer.

Finally, a '*matter relevant*' is limited to matters relevant to the risk sought to be covered by the insurance. It does not extend to commercial factors, such as the insured's intent not to renew the temporary cover being sought (Permanent Trustee Australia Ltd v FAI General Insurance Co Ltd (2003) 12 ANZ Insurance Cases 61-565). The words '*relevant to the decision of the insurer whether to accept the risk, and if so, on what terms*' in the section focus on the acceptability of '*the risk*' and matters extraneous to that are irrelevant.

The above principles would also apply to section 26 and would limit the circumstances in which statements by an insured would be misrepresentations.



Proposed amendments in Australia to sections 21 and 21A

In February 2007 an '*exposure*' draft of amendments to the Australian Act was released for public comment. The amendments included changes to the duty of disclosure. In particular, it is proposed that '*the circumstances*' of a reasonable person would include but would not be limited to:

- the nature and extent of the insurance cover to be provided under the relevant contract of insurance;
- the class of persons for whom that kind of insurance cover is provided in the ordinary course of the insurer's business; and
- the circumstances in which the relevant contract of insurance is entered into, including the nature and extent of any questions asked by the insurer.

They are all '*extrinsic*' factors, but they are not intended to be exhaustive. While they tend to suggest that what is relevant are '*extrinsic*' factors, the proposed amendments do not confirm that '*intrinsic*' factors are not to be taken into account. However, as discussed above, the High Court's recent decision in *Porthouse* can be cited as authority in favour of this proposition.

The Law Commissions took into account the proposed amendments to the Australian Act (see the Consultation Paper, paragraphs 4.114 and 4.115). However, they considered it was fair that in addition to the factors listed above, idiosyncrasies which the insurer knew about are taken into account in determining what was reasonable in the circumstances. They wrote (at paragraphs 4.116 and 4.117):

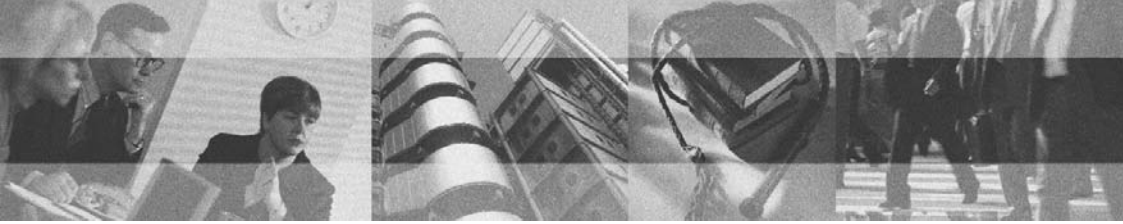
> '*There is a difficult policy balance here. The insurer cannot be expected to know about every idiosyncrasy of every insured. It cannot know that the person completing the form has suffered bereavement, or understands very little about house maintenance or medical terms. On the other hand, it seems harsh to penalise a policyholder for falling below some objective standard when the failure was quite reasonable given their particular circumstances.*
>
> *We think that the basic test should be objective. The insurer cannot be expected to make allowances for particular characteristics of which it does not know.*'

Amendments are also proposed to section 21A of the Australian Act, which apply to consumer policies only. Under the amendments, the insurer's ability to ask general questions about '*exceptional circumstances*' will be removed. In practice, many insurers do not pose such questions because there is uncertainty about what circumstances are '*exceptional*'. Many insurers, therefore, rely on specific questions only. The other proposed amendment affecting section 21A is that it will apply to renewals, and not just new policies.

Remedies for the insurer

The Law Commissions observed that an insurer's remedy at common law for misrepresentation and non-disclosure may be overly harsh on the insured (see the Consultation Paper, paragraph 1.12). The insurer could avoid the policy and refuse to pay all claims, even where the insurer would have paid had full disclosure been made.

In Australia, the insurer's remedy of avoidance is limited to cases of fraudulent misrepresentation or non-disclosure. In cases of innocent or negligent misrepresentation or non-disclosure, the insurer's remedy is to be put in a position as if the misrepresentation had



not occurred or full disclosure had been made. If the insurer would have issued the policy on the same terms knowing the full facts, the insurer cannot rely on the misrepresentation or non-disclosure to deny the claim. However, if the insurer would have acted differently, the insurer is entitled to reduce its liability to the extent that reflects its prejudice. The insurer's liability to pay a claim could be reduced to nil (Commercial Union Assurance Company of Australia Ltd v Ferrcom Pty Ltd (1991) 6 ANZ Insurances Cases 61-042), for example, if the insurer would not have issued the policy at all or would have included an exclusion had it known the truth. If the insurer would have insisted on a higher deductible or premium, then its liability would be reduced by the difference between the higher deductible or premium and the actual deductible or premium.

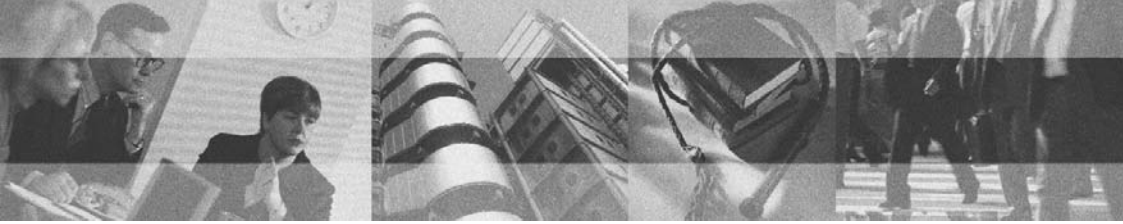
The relevant section of the Australian Act that modifies the common law in respect of general insurance is section 28 (section 29 applies to life insurance, which is beyond the scope of this paper). Section 28 states:

> 'General insurance
>
> (1) This section applies where the person who became the insured under a contract of general 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 where 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) If the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract.
>
> (3) If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under subsection (2) 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.'

The Law Commissions are proposing a similar regime in the United Kingdom (see the Consultation Paper, paragraphs 12.19 and 12.37), although they are proposing that for business policies the parties are free to agree that the regime does not apply to their contracts of insurance. In addition, it is proposed that there be different consequences for fraudulent, negligent and innocent non-disclosure or misrepresentation.

Fraudulent misrepresentation or non-disclosure

In Australia, the distinction is only between fraudulent and non-fraudulent pre-contract behaviour. The word '*fraudulent*' in section 28(2) is not defined in the Australian Act. Australian case law has determined that it means deliberate dishonesty or deception, or acting recklessly,



without care whether it be true or false (Plasteel Windows Australia Pty Ltd v Heath Underwriting Agencies Pty Ltd (1990) 6 ANZ Insurance Cases 60-944). This is consistent with the Law Commissions' proposal (see the Consultation Paper, paragraph 12.8).

Australian case law has also determined that the insured may be fraudulent even if the insured failed to disclose because of a breach of section 21(1)(b), ie the insured did not actually know that the matter was relevant to the insurer, but a reasonable person in the circumstances would have. However, to establish fraud, it must be proved that the insured was at least guilty of gross recklessness (Plasteel case).

Although the insurer may avoid the policy for fraud without showing how it would have acted differently had the truth been known, section 31 allows a court the power to alleviate any harshness to the insured by reason of the avoidance (although the court does not have the power to reinstate the policy). The Australian law reformers believed that the insurer should not be able to deny the insured the ability to recover under the policy in those cases where the event giving rise to the claim was not related to the fact which had not been disclosed or had been misrepresented. Section 31 states (emphasis added):

'Court may disregard avoidance in certain circumstances

(1) In any proceedings by the insured in respect of a contract of insurance that has been avoided on the ground of fraudulent failure to comply with the duty of disclosure or fraudulent misrepresentation, the court may, if it would be harsh and unfair not to do so, but subject to this section, disregard the avoidance and, if it does so, shall 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.

(2) The power conferred by subsection (1) may be exercised only where the court is of the opinion that, in respect of the loss that is the subject of the proceedings before the court, the insurer has not been prejudiced by the failure or misrepresentation or, if the insurer has been so prejudiced, the prejudice is minimal or insignificant.

(3) In exercising the power conferred by subsection (1), the court:

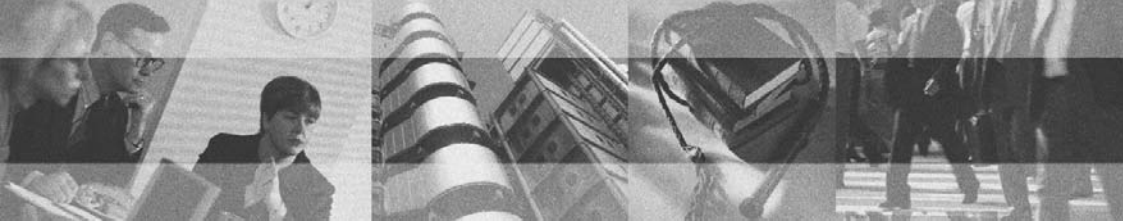
(a) shall have regard to the need to deter fraudulent conduct in relation to insurance; and

(b) shall weigh the extent of the culpability of the insured in the fraudulent conduct against the magnitude of the loss that would be suffered by the insured if the avoidance were not disregarded;

but may also have regard to any other relevant matter.

(4) The power conferred by subsection (1) applies only in relation to the loss that is the subject of the proceedings before the court, and any disregard by the court of the avoidance does not otherwise operate to reinstate the contract.'

Section 31 has led to a reluctance by some insurers to rely on fraud to refuse to pay a claim. There is usually some level of uncertainty as to how a discretion like the one in section 31 might be exercised by a court. In addition, fraud can often be difficult to prove. If the insurer is able to reduce its liability to nil under section 28(3) and prove that it would not have granted



the policy had it known the truth, the insurer would often take that route. This is because exercising its rights under the section 28(2) to avoid the policy, exposes the insurer to the discretion under section 31 and a judge's view as to whether the insurer's prejudice is minimal or insignificant and the avoidance is harsh and unfair. Even if there were a rare case where the insurer wishes to recover previous claim payments on the basis of non-disclosure or misrepresentation, it could do so under section 28(2) coupled with the common law principles of payment under a mistake of fact. In addition, the insurer has the right to cancel the policy under section 60 for any type of non-disclosure or misrepresentation.

The distinction in remedies between fraudulent and non-fraudulent misrepresentation or non-disclosure ought to be maintained, because fraud should be deterred. However, the effect of section 31 is to take much of the '*bite*' out of section 28(2). In Advance (NSW) Insurance Agencies Pty Ltd v Matthews (1989) 5 ANZ Insurance Cases 60-910, the High Court of Australia said as follows in relation to the interplay between sections 28 and 31:

> '*[T]here is nothing inherently unjust in providing as a matter of general principle that an insurer is entitled to avoid a contract of insurance which it would not have entered into but for a fraudulent failure to disclose a material matter. Moreover, it would be inherently unjust for the person responsible for that fraudulent non-disclosure to be able to compel performance of the contract by the insurer.*'

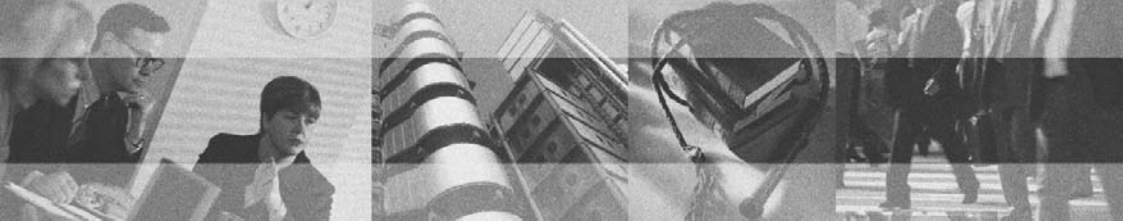
In truth, the scope of section 31 probably goes beyond what the Australian law reformers were concerned to avoid, that is, insurers avoiding the policy even though the event giving rise to the claim was not related to the fact which had not been disclosed or had been misrepresented. The section is not framed in terms of connection between loss and non-disclosure, but in terms of harshness to the insured and minimal prejudice to the insurer.

The Law Commissions have not, perhaps by reason of the difficulties outlined above, proposed a section like section 31 that applies to ameliorate the harshness of avoidance for fraud.

Proposed amendments in Australia to section 31

The Law Commissions did, however, ask for comment as to whether a discretion should be given to prevent avoidance where the insurer would have declined the risk, but the insured's fault is minor and any prejudice the insurer has suffered could be compensated adequately by a reduction of the claim (see the Consultation Paper, paragraph 12.20). In other words, the Law Commissions are considering a provision similar to section 31, but to apply to negligent non-disclosure and misrepresentation only.

The February 2007 '*exposure*' draft of amendments to the Australian Act also included changes to insurers' remedies. In this author's view, instead of reducing the kinds of uncertainties discussed above, the proposed amendments would increase them. It is proposed that section 31 be expanded to cover innocent or negligent misrepresentation or non-disclosure to give an insured who had been '*harshly*' denied a claim, in whole or in part, the ability to apply to a court to exercise its discretion in his or her favour.



Under the proposed amendments, the court will have the discretion to allow the insured to recover what is just and equitable if:

- the liability of the insurer in respect of the loss has been '*significantly*' reduced on the grounds of non-disclosure or misrepresentation;
- the court considers the reduction '*harsh and unfair*'; and
- there is no prejudice to the insurer, or the prejudice is '*minimal or insignificant*'.

It must be remembered that section 28(3) is triggered only if the insurer can establish that it would not have accepted the risk on the same terms, in which case it could reduce its liability. The proposed new section 31 applies only if the reduction of liability is '*significant*'. The obvious scenario to which this applies is where the insurer has reduced its liability to nil because it would not have accepted the risk had it known the truth. However, in this scenario, it could not be said that the prejudice to the insurer is '*minimal or insignificant*' within the meaning of section 31, given that the insurer has taken on a risk it would not have, if it had known the truth. Given the requirements of section 28(3), a significant reduction of liability is unlikely to be coupled with minimal or insignificant prejudice to the insurer. The proposed new section 31 would, in reality, have very limited application.

If it is determined that a discretion is necessary to protect an insured, then it is suggested that the proposed new section 31 should not be the model section. As discussed above, there is an internal inconsistency within the proposed new section and a disconnect with section 28(3). It is further suggested that the need to give insured's such a remedy is limited to consumers only. This is because consumers are likely to suffer greater hardship by an insurer's avoidance. It is suggested that a section like section 31 ought not apply to business policies. Indeed, the Law Commissions are not proposing such a provision apply to business policies and this author believes that should also be the approach in Australia.

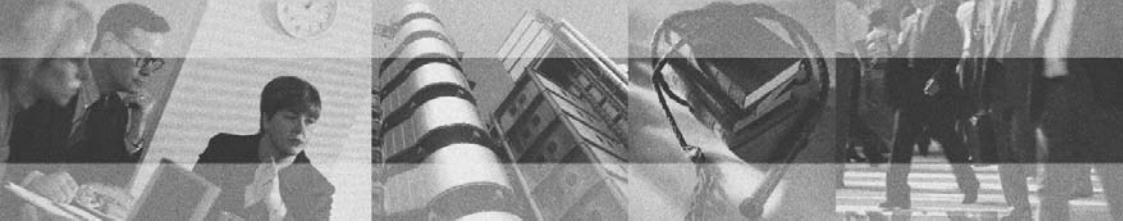
The Law Commissions' proposal for business policies

In the United Kingdom, the Law Commissions propose a default regime based on warranties by the insured. If the fact warranted is not true, the insurer may refuse to pay the claim if:

- the breach is material, ie the insurer could not refuse a claim for an inaccuracy that would not have influenced its decision; and
- the inaccuracy had some connection to the loss.

The latter requirement does not appear in section 28 of the Australian Act. With this requirement in place, the need for a discretion like the one in section 31 for claims on business policies is removed. It deals with the Australian law reformers' concern that insurers will deny claims where the event giving rise to the claim was not related to the fact which had not been disclosed or had been misrepresented. By reason of this requirement for a relevant connection, the Law Commissions' proposal would give insurers in the United Kingdom narrower scope (than in Australia) to exercise their remedies for non-disclosure and misrepresentation. That is, until the new proposed section 31 comes into force in Australia (if at all).

Although the Law Commissions' proposal appears more restricted than section 28 of the



Australian Act, the Law Commissions propose that the parties may contract out of this default regime. This author believes that there is substantial merit in allowing parties, who are sophisticated and have similar bargaining positions, to arrive at an agreement as to the consequences of a breach of warranty. The qualification is that insurers may not contract out of the default regime in standard terms contracts, where this would defeat the insured's '*reasonable expectations*'. This would seem to protect smaller businesses who seek insurance, but are less sophisticated and may be in a lesser bargaining position than the insurer.

The Law Commissions have recently clarified what is meant by whether a term has met the insured's '*reasonable expectations*'. They say it means the following: have that term and its consequences been properly brought to the policyholder's attention? The Law Commissions explained that (*Reforming Insurance Contract Law: A Summary of Responses to Consultation* published on 13 October 2008):

> '*The idea was that it would catch situations where, for example, a clause was put into the small print of a contract with a small business saying that the consequence of all misrepresentations was avoidance, no matter whether they were material or honest*.'

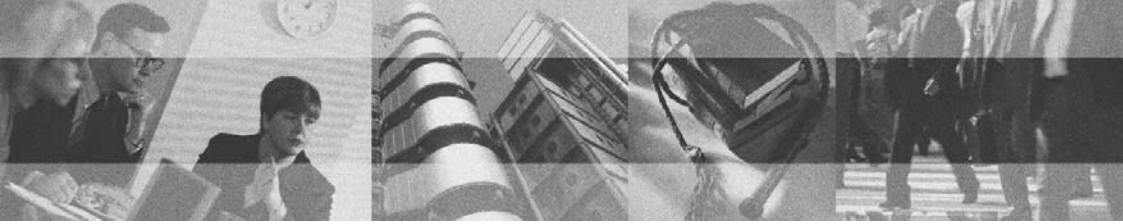
This is a similar concept to sections 35 and 37 of the Australian Act. For consumer policies, there are minimum prescribed terms. If an insurer wishes to offer terms more favourable to it than those minimum prescribed terms, section 35 requires it to give **clear** notice in writing **prior** to entering into the policy of the deviations from the minimum terms. This could include providing the insured with the policy wording before granting cover. In Marsh v CGU Insurance Ltd [2004] NTCA 1, the insurer gave notice by providing a copy of the policy to the insured before entering into the contract of insurance, which included an exclusion for flood damage. The Court of Appeal said the section requires the term to be in clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding. The Court rejected the argument that the policy wording was '*overloaded with information*', not '*user-friendly*' and lacked '*up front*' notice.

For business policies, there are no minimum prescribed terms, but the insurer must notify the insured in writing of any '*unusual terms*', which is described in section 37 as a term of '*a kind that is not usually included in contracts of insurance that provide similar insurance cover.*' Notification is, however, unnecessary if the policy is arranged through a broker as agent for the insured.

A failure to give the relevant notice under either sections 35 or 37 means that the insurer may not rely on those terms which ought to have been notified.

Conclusions

There are many similarities between the Law Commissions' proposals and the Australian Act. Although there are minor differences between what is proposed by the Law Commissions in respect of the duty of disclosure and sections 21 and 21A of the Australian Act, this author would suggest that the differences are unlikely to yield very different results. What the Law Commissions propose, which the Australian Act does not have, is the better defined '*circumstances*' in which you judge whether a reasonable person knows a matter to be relevant to the insurer. Whereas the Law Commissions propose to deal squarely with the question of what '*intrinsic*' factors ought to be taken



into account when determining those '*circumstances*', the proposed amendments in Australia do not.

In respect of remedies available to the insurer, the Law Commissions' present approach of leaving out a section 31 discretion in the case of fraud, but considering its inclusion in the case of non-fraudulent misrepresentation for consumers only, has much merit. If such a discretion is included, the proposed new section 31 is in this author's opinion not a good model for it. Another proposal which has much merit is allowing the parties to contract out of the restricted remedies of the insurer. However, care will be required in developing the qualification that the terms must be within the insured's '*reasonable expectations*' in cases of standard terms contracts. In this regard, sections 35 and 37 of the Australian Act may be a good starting point when developing the proposal further.

To borrow a phrase from Professor Merkin's report entitled '*Reforming Insurance Law: Is there a case for Reverse Transportation?*' prepared for the Law Commissions on the Australian experience of insurance law reform, this author believes that '*Reverse Transportation*' is a fair description for the Law Commissions' proposals discussed in this paper. A better description, however, is '*Reverse Transportation, but with enhancements*'.