RECENT AUSTRALIAN INSURANCE LAW REFORM - THE INTENT AND THE RESULT

A MODEL FOR ENGLAND?

By The Honourable Mr Justice Derrington

Dramatic changes have been witnessed in the development of Australian insurance law in recent times. So similar are the values and legal culture of our countries that it would be surprising if England were not to respond to its perception of the successes of the Australian experiment. Favourable comment has already been generously bestowed on it by at least one English enquiry into the topic. This discussion is designed to stimulate further interest in its progress in the hope of spurring legislative action there, as some of my English friends fervently desire in the interest of this valuable social instrument.

Despite the quality of the drafting of the recent Australian legislation[1], there is undoubtedly a need for some tidying up, but any discussion that would descend to such detail would be beyond the purpose of this paper. Equally, there are many interesting but minor technical changes to the law and practice which regrettably must escape attention here. It is more fitting to focus upon the broader and more significant features of fundamental change in order the better to meet the point of the discussion within suitable limits of space.

The Common Law

As a prefatory observation designed to show that serious reform is in the air, something more profound than the robust application of the contra proferentum principle or judicial tenderness towards the position of the insured, it is desirable to mention briefly one important recent development of the Australian common law in respect of insurance contracts.

In 1989 the High Court by a scholarly decision held[2] that at least in respect of contracts of liability insurance the doctrine of privity of contract in an insured person was not part of the common law of Australia. This meant that an insured person to whom the cover of a policy was extended could enforce the insurer's promises of indemnity in respect of his or her own cover despite that the person was not a party

to the insurance contract, either directly or through agency or trust. This means that the insurer's discretion to dishonour the so-called "honour policies" does not exist and in such cases it is now dependent upon the merits of its contractual position. Few fair-minded people will mourn the departure of the former state of affairs that had attracted much judicial criticism.

Since the High Court's decision, courts at a lower but authoritative level have extended the principle to property[3] and the contractor's all risks insurance[4]. Presumably it will also be applied to other forms for there appears to be no impediment to this in the reasoning of the watershed decision.

At this point it is relevant to advert to a contemporaneous related legislative change which was adverted to by the High Court in its reasoning as indicative of conventional accord with the justice of the principle that it was espousing. That change had been enacted in the Insurance Contracts Act, 1984, which was then proclaimed but not yet operative. Although the relevant provision[5] was expressly limited to insurance contracts, it reflected other legislation of general application that was already extant in some Australian states and in New Zealand. In brief it enables a person who has a beneficial interest in a policy but who is not a contracting party to enforce the interest directly against the insurer, subject otherwise to the terms of the policy.

The "Basis Policy"

Under the common law, another of the most unjust and criticised terms appearing in some policies was that whereby the insured warranted the truth of the answers in the proposal to the questions posited by the insurer. This was the "basis" policy and despite the attempts by the courts to ameliorate its injustices by requiring strict compliance with certain qualifications before such a term could operate[6], there were many cases where it did so in a most undesirable way[7]. An innocent error that was in fact totally immaterial to the insurer's decision as to whether to accept the proposal or similarly irrelevant to the subsequent claim would be used to avoid the policy and defeat the claim.

The Insurance Contracts Act ("the Act") has reformed this by substituting such a statement's status as a warranty with the status of a pre-contractual statement only[8] Read with the other provisions of the Act, including particularly those dealing with misrepresentation, this metamorphosis permits the insured's default to be treated on the merits according to its practical effects.

Conditions

A cognate injustice at common law was the effect of a breach of a condition[9]. This invested the insurer with the right to reject a claim or avoid the policy, depending on the circumstances and this irrespective of whether the breach was of any real effect or whether it contributed to the loss. The efforts of Lord Denning[10] to circumvent this injustice had little lasting success[11].

The Act has now remedied this in a simple direct and powerful way[12] and the limits of the cure are still being worked out. In effect it provides that where an insurer is entitled by reason of a post-contractual act (which by definition includes an omission) of the insured or some other person to refuse to pay a claim, then it may not so refuse except to the extent proportionately that the act prejudiced the interests of the insurer. If the insurer proves that the act could reasonably be regarded as being capable of causing or contributing to an insured loss, the onus shifts to the insured to show either that no part of the loss was caused by the act or that some part of it was not so caused. In the latter case the insurer may not refuse to indemnify in respect of that part. The insurer may not refuse where the act was necessary to protect the safety of a person or to preserve property, or where it was not reasonably possible for the person not to do the act. It should be noted that the expression of this provision is not limited to conditions so that it avoids any circumvention by drafting.

The application of this remedy causes little difficulty in practice for courts are well versed in the art of attribution of blame and the adjustment of rights according to the apportionment of causal responsibility. The difficulty comes when the act or omission is related to a feature that arguably goes to the description of the basic cover, as distinct from the exclusions and conditions that modify it.

A rumble of discussion throughout the industry was generated when the New South Wales Court of Appeal held[13] (and the High Court refused special leave to appeal to it) that the section had a dramatic effect on a "claims made and notified" policy. The claim was made during the policy period but the notification was not given during that time. It was held that the failure to notify was an omission to which the section applied because although the scope of the cover was defined by reference to the required act, the cover really related to claims made during the policy period, and the requirement of notification was in quality no more than a condition as to notice that had been incorporated into the basic insuring clause as a drafting technique.

The limits of this approach were exposed in another decision of the same court that followed soon after[14]. In a policy of a similar type which also contained a provision that where the insured was aware of the existence of circumstances that might give rise to a claim outside the policy period, a notice thereof given to the insurer during the policy period would have the effect of bringing the claim, whenever made, within the cover. The insured failed to give notice of such circumstances although they were known to him.

Inspired no doubt by recent precedent, he sought to invoke the section in the same way to circumvent the effects of his omission, but the court denied him this remedy. It saw a distinction in the case where the effect of the notice was to extend the cover. This rendered the giving of the notice a true element of the definition of the cover. The refinement of this reasoning was adverted in the judgment of a single judge in a somewhat similar case,[15] with the same result, and there seems to be a clear message that the section will certainly not be further extended in its operation.

Utmost Good Faith, Disclosure and Misrepresentation

Disclosure and misrepresentation together form another area of fundamental upheaval through this legislation and its provisions on this subject constitute a code. The doctrine of utmost good faith is preserved as an implied term of the contract of insurance, (which itself resolves some controversy as to the precise nature of the principle) and that behaviour is required of both parties in respect of any matter between them arising under or in relation to the contract. However, this is subject to the specific provisions controlling disclosure.

As to that the duty is still limited to disclosure, before the contract is entered into, of material matters that are known to the insured. It is the prescription of materiality that is interesting. It is any matter of relevance to the decision of the insurer whether to accept the risk and, if so, on what terms[16]. This would seem to anticipate recent English developments for the matter need only be relevant to the insurer's decision. It need not be decisive.

The content of the change here is mostly obvious. Materiality is measured by reference to the significance of the relevant fact to the actual insurer[17], and while that quality was formerly a necessary element of actionable non-disclosure[18], the position now is that it is the only such element. There is no longer any reference to the materiality of the matter to a prudent insurer, though that issue may arise in an

indirect and disguised form in respect of the question of imputed knowledge, which will be discussed shortly. No doubt the view of a prudent insurer may also be adverted to in order to test the truth of an assertion that the point was material to the actual insurer, but this is only a matter of circumstantial evidence and not one determinative of the relevant measure.

Materiality accepted, the recognition of it is a further element necessary to the duty to disclose. Under the Act this knowledge can exist in two ways, either of which is sufficient - the insured may subjectively know it or a reasonable person in the circumstances could be expected to know it. Several possibilities are encompassed by this.

Some matters may be directly known from the circumstances to have some specific relevance to the insurer. Other matters may not be so directly known to be material but in the circumstances should be deduced to be so by reason of the nature of the fact in the context of an insurance transaction and the nature of the particular cover sought. In such cases it should be inferred that insurers generally, including the actual insurer, would regard such a matter as material.

While the focus of the enquiry must always be directed to the actual insurer, absent any idiosyncratic circumstances to the contrary, in drawing such an inference a reasonable person would need to consider in the abstract the materiality of the matter to the insurer as a reasonable insurer and this is close in substance to the test of the prudent insurer. Consequently, this feature does not depart as significantly as may first seem from the former position. There may be some debate as to where an insurer has an easier task in proving that the reasonable person could be expected to know it rather than that such a person would know it.

There are specific exceptions to the general duty of disclosure. It is not required as to a matter that diminishes the risk, that is of common knowledge, that the insurer knows or should know in the ordinary course of its business; or whether there is waiver. These accord with earlier principle but waiver is also deemed where the insurer accepts an unanswered or obviously partly-answered response to a question in the proposal. Moreover, if the insurer fails to give antecedent written notice to the insured clearly informing of the nature and effect of the duty of disclosure then it cannot rely on any non-disclosure that is not fraudulent.

The materiality of a misrepresentation is defined in the same general terms as in the case of non-disclosure but such conduct is excused in certain circumstances based on objective reasonableness. And a non-answer or an obviously incomplete one cannot be a misrepresentation.

Remedies for Non-Disclosure and Misrepresentation

More radical is the change effected through the remedies provided for non-disclosure and misrepresentation. The principal focus is on the distinction between fraud or mere error on the part of the insured, and the emphasis is on fairness. Needless to say, the insurer's right of avoidance of the contract is more extensive in the event of fraud but even then it is not absolute.

Even in that case the court may disregard the avoidance if it would be both harsh and unfair not to do so, but only if the court is of the opinion that in respect of the relevant loss the insurer has suffered only minimal, insignificant or no prejudice by the insured's fraud. In exercising this power the court must have regard to the need to deter fraud in insurance business and must weigh the extent of the insured's culpability against the magnitude of the loss that would be suffered if the remedy were refused. The specification of these matters does not exclude the consideration of other relevant matters.

In any event the insurer will not have any right to avoid the contract for non-disclosure or misrepresentation, even associated with fraud if knowing the truth of the relevant facts the insurer would still have entered into the contract for the same premium and on the same terms and conditions.

If the insurer is prevented or refrains from exercising its right to avoid the contract on any of these grounds, its liability in respect of a claim will be reduced so as to place it in the position that would have obtained if the insured's default had not occurred. It has been firmly established that this may reduce that liability to nil where, for example, the insurer would have declined the risk or would have inserted a term in the policy that would have allowed it to escape liability for the claim[19].

Claims by Third Parties Directly Against Insurers

Another useful provision[20] allows a third party claimant to proceed directly against the insurer where the insured has died or cannot after reasonable enquiry be found. It is an extension to the remedy already available in England and Australia that provides similar direct recourse in the event of the bankruptcy of the insured. This extension of the facility is not unknown in existing compulsory insurance schemes.

Trade Practices Act 1974 (Commonwealth)

In a paper dealing with the position of the consumer, it would be inappropriate to omit reference to this legislation. Among other things it[21] provides that a corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive. Intention and negligence are irrelevant. A person who suffers loss or damage by reason of a breach may recover the amount of it by civil action[22].

This encompasses insurance contract negotiations so that the liability of an insurer for loss caused by any statements by its agents that are in fact misleading or deceptive is strict. It enhances the position of the insured in such cases so that there is no diminution of the remedy where for example a misrepresentation is innocent.

The law on this is simple and clear. Any doubts have now been worked out in the long period since its inception. It is generally accepted as fair protection for consumers and in the insurance field attracts no more litigation than might be expected. Most cases relate to contested allegations of misleading or deceptive statements by insurance sales persons.

Consequently the regime is not seen to be oppressive. It raises the legal expectation of the standard of conduct of those dealing with the consumers and the industry has been comfortably responsible in general.

Conclusions

That is enough for present purposes. These are but some examples of a wide-ranging redefinition of the law that has been undertaken in this field. Its venture is bold while responsible and its cut is both wide and deep. The full flavour of the medicine can be discerned from this sample. Its efficacy is revealed in the results which the passage of time has uncovered in the judgments of the courts and the response of the industry.

Because of the general quality of its drafting and because the courts have willingly adopted the spirit of the reform by searching for the resolution of any ambiguity through the purpose of the provision, with a few exceptions which were satisfactorily worked out within a short time the results have generally conformed with expectation. The fairness which was the goal of the legislation has been achieved, which is satisfying to the courts as well as to the legislature for the conformity of the law to a just result is of importance to the judges, not least for its enhancement of public confidence in the legal system. They would be equally concerned with the converse.

While the beneficial reforms of the Act fell mostly to the insured side, the courts have not permitted them to become an instrument of unfairness to insurers. There have been several reported cases where the insurer has been successful because the courts have refused to lend themselves to an overexpansive interpretation of the sections of the Act invoked by overly hopeful but unmeritorious insured parties.

For example, although the Act does not say so, it has been held that in appropriate circumstances a non-contracting party to the insurance who enjoys the benefit of cover is affected by any breach by the contracting party of the duty in utmost good faith to make full disclosure and the insurer is entitled to its rights under the Act for any breach[23].

This has led to a general acceptance of the thrust of the reform by the industry so that there has been no noticeable movement towards amendment of the remedies that it provides. The imperative need for greater fairness to consumers in the areas affected was generally recognised and accepted. There will be the necessary emendation of the first version of the Act by way of fine tuning common to such sea changes in the law, but it is unlikely that any of the positions now established will be reversed or will be sought to be reversed.

Manifestly the success of the Australian solution does not predicate that it is the only or the best one. No doubt when England is sufficiently stirred to move in the same direction some improvements will be found; but hopefully the Australian model will provide a useful paradigm, in the same way that English reform of the past has so often provided Australia with guidance of great value.

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1 Insurance Contracts Act 1984 which came into operation on 1 January 1986.

2 *Trident Insce Co. Ltd -v- McNiece Bros Pty Ltd (1988) 165 CLR 107. Cf. Vandepitte -v- Preferred Accident Insce Corpn of New York* (1933) A.C. 70. As it will be seen below, this is not the only case where the High Court has departed from English authority which resulted in injustice to the insured. Commentators on comparative law generally describe the common law in Australia and Canada as less conservative than that in England and, happily, more conservative than that in the United States.

3 *Barroora Pty Ltd -v- Provincial Insce (Aust) Ltd* (1992) 7 ANZ Insce Cases 61.103.

4 *Cooperative Bulk Handling Ltd -v- Jennings Industries Ltd* (1995) 8 ANZ Insce Cases 61.286.

5 Section 48.

6 See eg. *Deaves -v- CML Fire & General Insce Co. Ltd* (1979) 143 CLR 24 as to which there is departure from the English rule. Cf *Joel -v- Law Union & Crown Insce Co.* (1908) 2 KB 431, 437; Rozanes -v- Bowen (1928) 32 Lloyd's List rep. 98, 103.

7 See eg. *Mackay -v- London General Insce Co. Ltd* (1935) 51 Lloyd's List Rep. 201.

8 Section 24.

9 See *Pioneer Concrete (UK) Ltd -v- National Employers' Mutual General Insce Assn Ltd* (1985) 1 Lloyd's Rep 274, 278 where it was held irrelevant that the insurer's reliance on the breach was devoid of merit. *Motor & General Insce Co. Ltd -v- Pavy* (1994) 1 Lloyd's Rep 607, 612.

10 *Barrett Bros (Taxis) Ltd -v- Davies* (1986) 2 Lloyd's Rep. 1.

11 *Motor & General Insce Co. Ltd -v- Pavy* (supra), reflecting the view expressed in *Farrell -v- Federated Employers' Insce Assn Ltd* (1970) 1 Lloyd's Rep 129. However, it might be noted that even the more liberal climate in Australia did not engender support for Lord Denning's technical line of reasoning: eg. Deaves -v- CML Fire & General Insce Co. Ltd (supra) at 54-5.

12 By section 54.

13 *East End Real Estate Pty Ltd -v- C.E. Heath Casualty & General Insce Ltd* (1992) 25 NSWLR 400.

14 *FAI General Insce Co. Ltd -v- Perry* (1993) 7 ANZ Insce Cases 61.164.

15 *Antico -v- C.E. Heath Casualty & General Insce Ltd* (1995) 8 ANZ Insce Cases 61.208

16 *Pan Atlantic Insce Co. Ltd -v- Pine Top Insce Co. Ltd* (1994) 3 WLR 677 (H.L).

17 *21st Maylux -v- Mercantile Mutual Insce (Aust) Ltd* (1990) VR 919.

18 *Visscherif -v- Scottish Metropolitan Assce Co. Ltd* (1922) 27 Com Cas 1982; *Berger -v- Pollock* (1973) 2 Lloyd's Rep. 442, 463; Pan Atlantic (supra)

19 *Ferrcom Pty Ltd -v- Commercial Union Insce Co. of Aust Ltd* (1993) 67 ALJR.

20 Section 48.

21 By Section 52.

22 Section 82.

23 *C.E. Heath Casualty & General Insce Ltd -v- Grey* (1993) 7 ANZ Insce Cases 61.199.