

THE AUSTRALIAN *INSURANCE CONTRACTS ACT* TURNS 30

The *Insurance Contracts Act 1984* commenced operation in Australia on 1 January 1986. As such, it will turn 30 on 1 January 2016.

The *Insurance Contracts Act* brought more radical, far reaching and ubiquitous change than the changes that the *Insurance Act 2015* will introduce. As such, the story of the ICA, and the fact that the Australian insurance industry has endured and grown to accommodate the ICA, offers some reassurance and comfort to those in the UK insurance world who harbour foreboding about the commencement of the *Insurance Act* next year. In addition, some provisions of the *Insurance Act* have analogous provisions in the ICA, and the way those provisions have been interpreted by the Australian Courts and accommodated by the market may be of interest.

Aside from making comparisons with the *Insurance Act*, I will attempt to give an overview of the operation of the ICA with specific focus on its more contentious and problematic provisions, particularly section 54. I hope this will be of use and interest to those of you who have intermittent exposure to Australian risks.

The evolution of the *Insurance Contracts Act*

Before the advent of the *Insurance Contracts Act* Australian insurance law was widely regarded as a clumsy amalgam. Aspects of imperial statute law, common law, state law and some federal laws all played a part in forming the inconsistent insurance law landscape.

Generally, and particularly in the context of consumer insurances, the scales were tipped unfairly in favour of the insurer. Ordinarily insurers did not enforce all of the rights that may have been available to them in their legal armoury¹. If an insurer thought a claim was legitimate, and should, as a matter of principle, be paid, it would be paid even if some technical justification may have existed for declining indemnity. However, the reciprocal aspect of this proposition was that insurers often had the power to decline a claim if they thought for some reason it should not be paid as a matter of principle. In other words, the insurers held all of the cards and could play them as they saw fit. Needless to say, many legitimate claims were declined.²

¹ In *Deaves v CML Fire & General Insurance Co Limited* (1979) 143 CLR 24 Murphy J said: “*The existing state of insurance law is so favourable to insurers that any insurance company can easily frame its proposal forms and policy in such a way that only an extremely weary proponent will be able to recover. This has been tolerable only because, in general, insurers have not taken advantage of their superior position.*”

² For an excellent overview of the Act and its formation, see *Australian Insurance Contract Law: Out of the Chaos— A Modern, Just and Proportionate Reforming Statute*, The Hon Michael Kirby AC CMG (with
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On 9 September 1976 the then Federal Attorney-General, Robert Ellicott, delivered a reference to the Australian Law Reform Commission to provide a report on the existing law of insurance contracts. From that reference, the ALRC produced its 20th report (ALRC 20) on insurance contracts. Most of the recommendations contained in ALRC 20 found their way into the *Insurance Contracts Act*.

Marine Insurance

The ICA does not apply to those forms of insurance that had separate legislative treatment in 1984 such as Marine Insurance, Compulsory third party motor vehicle insurance and Worker's compensation insurance³.

Australia followed the UK by introducing the *Marine Insurance Act 1909*, which is essentially the same as the UK *Marine Insurance Act 1906*⁴. Given the international aspect of maritime insurance, and the perceived dominance of the London Market, it was thought best to leave Marine Insurance alone when the ICA was enacted.

In 2001 the Australian Law Reform Commission published a report in relation to Marine Insurance and the desirability of amending the Australian Marine Insurance Act⁵. The report made recommendations in relation to the amendment of a number of aspects of the Marine Insurance Act 1909, however, to date, those proposals have not been implemented and the Australian Marine Insurance Act remains substantially in its original form⁶.

Given that the *Insurance Act 2015* makes some changes to the *Marine Insurance Act 1906*, the Australian *Marine Insurance Act 1909* may become something of an outlier. However, any thought of amending it would pose the question of whether it should be amended to follow the amendments made to the *Marine Insurance Act 1906* (in the interests of international harmony),

assistance from James Morse) Paper delivered at the Australian Insurance Law Association National Conference, 2010. For an interesting and informed English perspective on the Insurance Contracts Act see Robert Merkin *Reforming Insurance Law: Is there a case for reverse Transportation?* A report for the English and Scottish Law Commissions.

³ Section 9 of the ICA. Reinsurance is also excluded. Marine Insurance, worker's compensation insurance and compulsory third party motor vehicle insurance (mandatory injury cover) were excluded from the terms of reference of the Law Reform Commissions terms of reference. While Worker's Compensation insurance and Compulsory liability cover for personal injury caused by motor vehicles are both covered by state legislation, both areas have been subject to mandatory minimum schemes for years before the advent of the ICA so both were left alone by the ICA.

⁴ Though, to the aggravation of those that work with both Acts, the numbering of the Australian Act is different.

⁵ <http://www.alrc.gov.au/report-91> ALRC 91.

⁶ Though most forms of consumer insurance have now been excluded from it by provisions of the ICA.

the ICA (in the interests of domestic harmony) or in accordance with the recommendations of ALRC 91.

Because the ICA is a much more advantageous to the insured than the MIA, there is usually substance to arguments about which Act applies. The ICA won't apply if the MIA does and there has been litigation to test the issue⁷.

Utmost good faith

The duty of utmost good faith has been part of the law of insurance since *Carter v Boehm* in 1766. At common law, whilst it had been accepted that the duty of utmost good faith applied during the term of the insurance contract,⁸ it ordinarily had ramifications in the context of the duty of disclosure. The duty of utmost good faith required the insured, before the contract was made, to disclose to the insurer all matters known to the insured that were relevant to the acceptance of the risk by a prudent insurer. If the insured breached that duty then the insurer could avoid the contract. Remedies for an insured for a breach of the duty of utmost good faith by the insurer were limited. Avoiding a contract of insurance was almost never a satisfactory remedy for the insured.

Pursuant to section 13 of the *Insurance Contracts Act* the duty of utmost good faith is an implied term of contracts of insurance⁹. Whilst there was a degree of uncertainty, it has now been determined that, as a contractual term, a breach of the duty by either the insurer or the insured can sound in damages¹⁰.

There are other significant provisions of the Act in relation to the duty of good faith. Section 12 provides that the part of the Act that incorporates section 13, must not be read down or restricted in any way by any other law, including the subsequent provisions of the Act.¹¹

Section 14 provides that parties to the contract of insurance may not rely upon a provision of the contract to the extent that to do so would be inconsistent with the implied term of utmost good faith. So, for example, in circumstances where a policy is issued with an exclusion in it, that was in fact not intended by the insurer, and, if the policy was interpreted to incorporate that

⁷ Most notably and importantly, the decision of the High Court in *Gibbs v Mercantile Mutual Insurance (Australia) Ltd* (2003) 214 CLR 604

⁸ *Ajax Insurance Company v Bio-Distillers Chemicals*.

⁹ Pursuant to s.13(3) (inserted in 2013), the obligation of utmost good faith is now also a statutory obligation under the Act, meaning that a breach of the duty is potentially a matter for the regulator.

¹⁰ *Moss & Moss v Sun Alliance Australian Ltd* (1990) 6 ANZIC 60-967.

¹¹ The section also provides that, in the context of disclosure, the duty does no more than require compliance with the duty of disclosure. That duty is set out in Part IV of the Act and is discussed subsequently.

exclusion, the premium levied by the insurer would be extortionate, the insurer could not rely upon the exclusion because of the effect of sections 13 and 14¹².

The importance of section 13 in Australia is very significant. In part because of the fact that the duty is now a contractual obligation, giving rise to an entitlement to claim damages for breach, Australian Courts have firmly rejected the proposition that the tort of bad faith, well recognised in many American jurisdictions, does not exist in Australia¹³.

Even so, a breach of the duty of the contractual obligation of utmost good faith, does not, of itself, entitle an insured to recover payment for a claim not covered by the policy. In *CGU Insurance Limited v AMP Financial Planning Pty Ltd*¹⁴, the High Court held that, even if an insurer had breached the duty, that did not, of itself, entitle the insured to indemnity in circumstances where the policy did not otherwise respond. Rather, there needed to be a logical connection between the breach of the duty and the consequent damage to the insured. That did not equate to an entitlement to indemnity under the policy.

Section 13 was recently amended to add subsections 13(2) – 13(4) to the section. Section 13(2) now provides that a failure by a party to a contract of insurance to comply with the provisions implied in the contract by subsection 1 is a breach of the requirements of the Act. In a recent Queensland decision, the insured argued that the new section 13(2) gave rise to a statutory duty.¹⁵ This argument was rejected by the court. Rather, the inclusion of the new section 13(2) did no more than provide a trigger for ASIC to exercise powers of a regulatory nature against an insurer who breached the duty of utmost good faith.

The decision in *Matton Developments Pty Ltd v CGU Insurance Limited* also includes a useful discussion of the duty of utmost good faith:

It follows that the duty of utmost good faith will require an insurer to act in accordance with commercial standards of decency and fairness, and with due regard to the insured's interests, but will not require the insurer to put the interests of the insured above its

¹² *Baradon Contracting Pty Ltd v GIO General Limited* (NSW Supreme Court, Allen J, unreported 13 June 1996). It seems likely that, while the duty applies to both parties to the contract, in practice it may be of more value to insureds. See, for example, *Banks v NRMA Insurance Ltd* (1988, NSWSC) where an insured was able to enforce a contractual entitlement to reinstatement of premises, even though reinstatement was unlikely.

¹³ *Lomsargis v National Mutual Life Association of Australasia Ltd* [2005] 2 Qd R 295; *CGU Workers Compensation (NSW) Ltd v Garcia* 14 ANZIC 61-746 (a non-ICA case); *Re Zurich Australian Insurance Ltd* [1999] 2 Qd R 203;

¹⁴ (2007) 235 CLR 1; 2007 High Court of Australia, 36.

¹⁵ *Matton Developments Pty Ltd v CGU Insurance Limited* [2015] QSC 72.

*own*¹⁶. The duty of utmost good faith does not equate to, nor is it synonymous or analogous to, a fiduciary duty¹⁷. An insurer is legitimately entitled to:

- a reasonable period of time to make further inquiries of all the circumstances giving rise to a claim, including inquiries of the insured and those involved in its occurrence;
- put an insured to proof if suspicious of the bona fides of the claim; and
- decline indemnity if the circumstances giving rise to the claim fall outside the insurable interest or an exclusion clause is applicable to the circumstances.

The Insurance Act 2015 curtails some aspects of the duty of utmost good faith¹⁸. Given the important role the duty continues to play in Australia by force of section 13, there is something of a parting of the ways between the Australian and UK stances with respect to the duty of utmost good faith.

Disclosure

There is a particular disclosure regime that exists under the *Insurance Contracts Act*. In fact, there are two. A more limited regime exists in relation to consumer contracts pursuant to which insurers can ask only specific questions which must be answered accurately by the insured.¹⁹ However, given our focus on professional indemnity insurance, I will not dwell on the consumer disclosure regime.

At common law, the most important manifestation of the duty of utmost good faith was with respect to the duty of disclosure. Even though the duty of utmost good faith is now an implied term of the contract by s.13, the ICA expressly provides that the remedies under the Act for misrepresentation and non-disclosure are the only remedies available²⁰.

Pursuant to section 21, an insured must disclose to the insurer matters known to the insured to be relevant to the decision of the insurer to accept the risk and if so on what terms and matters that a

¹⁶ *Zurich Australian Insurance Ltd v Metals & Minerals Insurance Pte Ltd* (2007) 209 FLR 247.

¹⁷ *CGU Workers Compensation (NSW) Ltd v Garcia* (2007) 69 NSWLR 680.

¹⁸ See sections 14(1) and 14(2).

¹⁹ Section 21A of the *Insurance Contracts Act*. A consumer contract is set out in the Regulations to the Act and generally includes home and contents, contents, motor vehicle insurance and personal travel insurance where the insured is an individual.

²⁰ Section 33. In effect, Part IV of the Act (Non-Disclosure and misrepresentations) are a codification of the duty and the remedies: *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606.

reasonable person in the circumstances of the insured could be expected to know to be a matter so relevant.

The remedies that arise in the case of a breach of the duty of disclosure depend upon whether the breach was innocent or fraudulent. In the case of fraudulent non-disclosure or misrepresentation, the insurer is entitled to avoid the contract pursuant to section 28(2). Of course, proving fraud is always difficult. In circumstances where fraud cannot be proved, or where the misrepresentation or non-disclosure is negligent or innocent, the insurer is entitled to be placed in the position it would have been in but for the misrepresentation or non-disclosure.²¹ So, for example, if an insured had disclosed a certain aspect of the risk, that would have resulted in the imposition of a higher deductible, then, in the event of a claim, the insurer would indemnify the insured as if the higher deductible had been applied.

Uncertainty existed for a period of time in relation to the remedy that was available to the insurer if, in the case of an innocent misrepresentation or non-disclosure, the insurer would have declined the risk entirely. After some uncertainty, that issue has now been resolved – the insurer can reduce its liability to nil.²²

The remedies available for a breach of the duty of disclosure are similar to the remedies available under the *Insurance Act 2015* for breach of the duty of Fair Presentation. Under both Acts, where the breach is deliberate²³, the insurer can avoid the contract.

If the breach is not deliberate, under the ICA the insurer is entitled to be placed in the position it would have been in but for the breach. This is also the case under the Insurance Act 2015, though under the Insurance Act, there is the further and more finessed remedy where a higher premium would have been charged pursuant to which the amount payable in respect of the claim can be reduced proportionally²⁴.

²¹ Section 28(3).

²² This issue was originally laid to rest in the context of a reduction to nil in the case of section 54. However, subsequent cases in the context of non-disclosure have confirmed that the position applies in relation to a non-disclosure where the insurer can prove that it would not have accepted the risk on any terms: *Zurich Australian Insurance Ltd v Contour Mobel Pty Ltd* (1990) 6 ANZIC 60-984; *Rocco Pezzano Pty Ltd v Unity Insurance Brokers Pty Ltd* (1995) 8 ANZIC 61288; *Naomi Marble & Granite Pty Ltd v FAI General Insurance Company Ltd & Anor* [1997] QSC 76.

²³ Section 28(2) ICA and section 2, Schedule 1 Insurance Act 2015. The ICA uses the word fraud. The Insurance Act refers to 'deliberate or reckless'.

²⁴ Schedule 1, 6(1) and 6(2). Under the ICA the insurers liability for the claim is simply reduced by the amount of the additional premium, giving the insured, in a proportional sense, a windfall gain.

In *Prepaid Services Pty Ltd v Atradius Credit Insurance NV*²⁵, Justice Meagher said:

[That section 28(3)] requires an inquiry as to the position the insurer would have been in if the relevant [non-disclosure or] misrepresentation had not been made. It is the same as would be made if the insurer was claiming damages for non-disclosure or misrepresentation in the amount by which it seeks to have the insured's claim reduced. Accordingly, it must establish on the balance of probabilities what it says its position would have been if the non-disclosure or misrepresentation had not occurred. That is so notwithstanding that the hypothesis upon which the reduction of liability is based is not an historical fact.

Fraud

The ICA has a few specific provisions in relation to fraud.

As has been mentioned, an insurer can avoid a contract for fraudulent non-disclosure or misrepresentation. In the context of non-disclosure or misrepresentation, section 31 gives a court the power to disregard avoidance (for fraud) if it would be harsh and unfair not to do so, and allow the insured to recover such amount as the court considers just and equitable in all the circumstances. The power may only be exercised where the prejudice to the insurer is no more than minimal and the court must have regard to the need to deter fraud²⁶.

Section 56 deals specifically with fraudulent claims and provides that the insurer may not avoid the contract²⁷ but may refuse to pay the claim. The section again gives the court a discretion to allow the insured to recover such amount as is considered just and equitable in the circumstances.

The remedies for fraud under the ICA are thus similar to the remedies for fraud under the *Insurance Act 2015*. Under both, making a fraudulent claim entitles the insurer to refuse to pay the claim and the insurer is empowered to cancel the policy prospectively²⁸.

²⁵ [2013] NSWCA 252.

²⁶ Sections 31(2) and 31(2).

²⁷ Making a fraudulent claim is a ground for cancelling a contract of insurance pursuant to s.60(1)(e). However, any such cancellation is only prospective and, as such, does not affect any antecedent claim.

²⁸ *Insurance Act* s.12(1); ICA s.56(1) and s.60(1)(e).

Basis clauses

Before the advent of the ICA contracts of insurance in Australia often included 'basis' clauses elevating all pre-contractual representations to contractual warranties²⁹. If any such representation was wrong a breach of warranty may well have been established thereby entitling the insurer to avoid the claim or the contract³⁰. As such, a basis clause could give an insurer a remedy without regards to materiality.

Section 24 of the ICA has the effect of converting into representations what would otherwise be warranties on the part of the insured with respect to the existence of a state of affairs³¹. As such, the insurer then has such remedies available to it as would arise with respect to misrepresentations, thereby invoking issues of materiality and (with respect to remedy) proportionality.

It would seem that, pursuant to section 9(2), the position under the Insurance Act with respect to basis clauses will be effectively the same as under the ICA.

Third parties

The ICA enables a person, who is not a party to a contract of insurance, to recover on the policy, without being troubled by issues of privity of contract³².

The main section is section 48, which provides that a third party beneficiary can recover on a contract of insurance pursuant to the terms of the contract. An insurer has the same defences to a claim by a third party as it would to a claim by the insured³³, in addition to any defence that may be available against the third party, though a lack of privity is not one of them. As a result of some amendments to the Act in 2013, many of the other remedial provisions of the Act now also apply to third party beneficiaries.

This is not an issue addressed in the Insurance Act because, on my understanding, it had already been addressed by the *Contracts (Rights of Third Parties) Act 1999*.

²⁹ *Deaves v CML Fire & General Insurance Co Ltd* (1979) 23 ALR 539

³⁰ ALRC 20 at paragraph 170

³¹ *Advance (NSW) Insurance Agencies Pty Ltd v Matthews & Anor* (1989) 5 ANZIC 60-910.

³² At least in the context of liability insurance, the High Court of Australia arrived at a similar conclusion in *Trident General Insurance Co Ltd v McNeice Bros Pty Ltd* (1988) 165 CLR 107 at around the time of the introduction of the ICA. While that decision was given after the advent of the ICA, it dealt with a policy of insurance that pre-dated the ICA and was not governed by it.

³³ Section 48(3). Of course, specific defences may arise as against the third party beneficiary.

Other insurance provisions

Section 45 of the ICA makes other insurance provisions³⁴ void. While recent authority³⁵ has made the operation of the provision a little more involved, it does render void most generic other insurance provisions thereby avoiding the complications that arose as a result of the widespread use of such clauses.

Section 54

Section 54 is probably the most significant and impactful provision of the *Insurance Contracts Act*. It is intended to provide a broad remedy to insureds that prevents insurers from declining claims in certain circumstances. It focuses on effect and not form and, as such, is a much more broad reaching provision than its closest equivalents in the Insurance Act, sections 10 and 11.

Before the advent of the *Insurance Contracts Act*, it was common for insurers to insert a number of provisions in policies that enabled the insurer to decline indemnity as a result of certain acts of the insured, even if those acts were not causative of any particular loss under the policy. So, for example, insurers may have imposed a warranty on an insured compelling the insured to do or not do certain things. As a matter of insurance law, the imposition of such a warranty operated in a similar way to a condition in other contracts such that a breach of the warranty discharged the insurer from further liability.

In addition, insurers imposed conditions precedent upon their obligation to make payment. So, for example, it may have been a condition precedent to the insurer's obligation under a professional indemnity policy that notification of the claim be provided within seven days of the loss occurring. Generally, the insurer was entitled to rely upon the breach of such an obligation to discharge its ongoing liability. In addition, policies were subject to exclusions and, if an insured fell within the scope of a particular exclusion as a result of some act, even if that act played no part in precipitating the loss that was being considered, the insurer could decline indemnity.

In this context, section 54 was introduced. It is expressed in very general language so that it operates by reference to the effect of the policy of insurance, rather than any particular drafting mechanism. It focuses upon substance and effect and not matters of form.

³⁴ The section applies to provisions that have the effect of limiting an insurers obligation to pay because the insured has entered into another contract of insurance. As such it applies to all forms of other insurance provisions including rateable proportion provisions.

³⁵ *Zurich Australian Insurance Ltd v MMI Pte Ltd* [2007] 14 ANZIC 61-728

Broadly, section 54 is engaged if the effect of the policy of insurance is that the insurer can decline a claim in whole or in part by reason of some act³⁶ of an insured³⁷, occurring after policy inception, that enables the insurer to decline the claim in part or in whole.

Section 54 divides such acts into two classes being those that are potentially causative of loss under the policy, and those that are not potentially causative of loss. Section 54(1) deals with acts that are not potentially causative of loss under the policy. In relation to such acts, the insurer cannot decline the claim by reason of the act save to the extent that the insurer can show that its interests have been prejudiced by the act. An example of a non-causative act is late notification of a claim under an occurrence based liability policy. Late notification of a claim cannot, of itself, give rise to liability under the policy and, as such, the late notification is a non-causative act within the scope of section 54(1). If the insurer cannot demonstrate any prejudice, the insured is entitled to indemnity in whole notwithstanding the breach of the notification provision. However, if the insurer can demonstrate that it has sustained some prejudice, such as the loss of some right of recovery that existed at the time that the claim should have been notified but has now been extinguished, the insurer can decline the claim to that extent. This can, in the appropriate cases, mean that the claim is declined in its entirety³⁸.

Sections 54(2)-(4) deal with causative acts. In the context of an act that potentially can give rise to a loss under a policy, the insurer can prima facie decline indemnity. However, if the insured can demonstrate that no part of the relevant loss was caused by the act, the insured is entitled to complete indemnity. If, alternatively, the insured can demonstrate that some portion of the loss was not caused by the act, then the insured can recover to that extent.

One important distinction between causative and non-causative acts is the onus of proof. In relation to non-causative acts, the insurer bears the onus of proving that it has sustained prejudice. In the context of causative acts, the insured bears the onus of proving that some or all of the loss was not caused by the act.

A simple illustration may be of assistance. Imagine a first party motor vehicle policy. The owner of the vehicle insured by that policy is sitting in his car at a set of lights when the car is struck from behind by a truck. The collision causes substantial damage to the car. Assume that the motor vehicle policy incorporated a condition precedent such that it was a condition of the

³⁶ An act includes an omission, s.54(6).

³⁷ Or some other person.

³⁸ Commercial Union Assurance Company of Australia Ltd v Ferrcom Pty Ltd & another (1993) 7 ANZIC 61-156.

insurer's obligation to make any payment that the vehicle was driven in a roadworthy condition at all times. In addition, assume that the policy incorporated an exclusion such that cover was excluded if the vehicle's tyres were bald at any time. Assume that, at the time of the collision, the tyres were bald, thus, prima facie, enlivening the exclusion and, on the basis that bald tyres makes a vehicle unroadworthy, also breaching the condition precedent. In the absence of section 54, the insurer could decline the claim in its entirety either because of the exclusion or the condition precedent. However, section 54 will come to the insured's aid.

Driving a vehicle in an unroadworthy condition is potentially causative of loss under a first party motor vehicle policy. As such, the claim must be considered under section 54(2)-(4). As the insured can show that no part of the loss was caused by the act of driving the vehicle in an unroadworthy condition, then the insured can recover for the full extent of the loss.

This illustration assumes that driving the vehicle in an unroadworthy state is an act, for the purposes of section 54. In my view, it is. However, the question does foreshadow some of the existing uncertainty and tension that has arisen in relation to section 54. Exactly what amounts to an act and what amounts to a state of affairs that is outside the scope of the policy is an issue of ongoing uncertainty.

Section 54 has been considered in a wide range of circumstances. In my opinion, it would be the most litigated section of the *Insurance Contracts Act*.

Much of the early litigation in relation to section 54 focused on claims made and notified policies. In *East End Real Estate Pty Ltd v CE Heath Casualty & General Insurance Ltd* (1992) 7 ANZIC 61-151, a claim was made against an insured during the term of a claims made and notified policy. The insured did not notify its insurer in relation to the claim. After the policy expired, the insured sought indemnity and the insurer declined on the basis that it had not received notice of the claim during the policy term as required under the policy. In response, the insurer argued that section 54 excused the late notification of the claim.

An issue that was raised by the insurer, and considered by the Court of Appeal, was whether section 54 should operate in these circumstances, given that there is a more specific provision of the *Insurance Contracts Act* that addresses some notification problems that can arise under claims made and notified policies. Section 40(3) of the *Insurance Contracts Act* is a statutory deeming provision pursuant to which an insured can notify circumstances during the term of a policy and, in the event that a claim is made after the expiration of the policy term, that claim is deemed to have been made during the term of the policy. The insurer argued that, given the

existence of section 40(3) in the Act, the legislature cannot have intended that section 54 operate in the manner promoted by the insured. This argument was rejected. The Court observed that the two sections dealt with different situations.

When the Court examined the language of section 54, it concluded that it covered the circumstances of the claim before the Court. The effect of the policy was that, because of some act of the insured, namely the late notification of the claim, the insurer could decline indemnity. As late notification of the claim was an act that could not give rise to loss under the policy, the act was addressed under section 54(1). Whilst the claim was remitted for the issue of prejudice to be considered, the strong likelihood is that the insurer could not demonstrate prejudice and, as such, that the insured was entitled to indemnity.

This remains authority for the proposition that late notification of a claim under a claims made and notified policy is an act that is excused by section 54. This is so whether the policy imposes a condition obliging the insured to give notice, or whether the operative provision of the policy only responds to claims notified during the policy period. In either case, the '*effect*' of the policy is that the insurer can decline indemnity. As such, section 54 is enlivened.

The next field of debate in relation to section 54 and claims made and notified policies was in relation to late notification of circumstances. After some false starts, the High Court of Australia finally determined that late notification of circumstances was an act that was forgiven by section 54, at least in relation to policies that incorporated a contractual deeming provision.³⁹

However, a different outcome seems to arise in policies that do not incorporate deeming provisions. In those circumstances, it has been held⁴⁰ that section 54 does not forgive late notification of circumstances⁴¹. In the absence of a contractual deeming provision, an insured needs to rely upon the statutory deeming provision found in section 40(3) to entitle it to cover for a claim made after the policy period based upon circumstances known during the period. As such, the insured effectively needs to argue that section 54 forgives the insured's failure to give notice under section 40(3). This argument has been rejected on the basis that the insurer is not declining indemnity because of the '*effect of the contract of insurance*' but rather because of the effect of a statutory provision.

³⁹ FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd (2001) 204 CLR 641.

⁴⁰ In a single court judgement of the Supreme Court of Queensland *CA&MEC McNally Nominees Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* [2001] QSC 388 and by the NSW Court of Appeal *Gosford City Council v GIO General Ltd* [2003] NSWCA 34. The High Court has yet to consider the issue.

⁴¹ *CA v ME; McNally Nominees Pty Ltd v HTW Valuers* [2001] QSC 388; *Gosford City Council v GIO General Ltd* [2003] NSWCA 34.

Accordingly, after many years of debate and jurisprudence, the position in relation to claims made policies in Australia now seems to be:

1. late notification of claims is excused and, ordinarily, no prejudice will flow such that the insurer will be obliged to indemnify if the claim has been notified after the expiration of the policy;
2. if the policy incorporates a contractual deeming provision, late notification of circumstances will be forgiven by section 54 and the insurer will be obliged to indemnify unless it can demonstrate prejudice, in which case, it can decline indemnity to that extent; and
3. in the absence of a contractual deeming provision, the insurer can decline indemnify if circumstances are notified late.

What is prejudice?

Consideration has been given to the issue of prejudice for the purposes of section 54(1).

In *QBE v Moltoni Corporation Pty Ltd*⁴², the High Court considered a claim under an occurrence based liability policy involving late notification. The policy required the insured to give notice as soon as practicable of any injury that may give rise to a claim under the policy. The policy also provided that due observance of the policy conditions was a condition precedent to the insurers liability. The insured did not give notice of such an injury until 17 months after it occurred. As late notification is a non-causative act, section 54(1) was relevant and the issue was what prejudice flowed to the insurer as a result of the late notification. The insurer argued that it had sustained prejudice in three ways – it had lost the ability to investigate the incident, the employee had returned to work as a demolition worker and had suffered a further injury which prevented it from investigating the injury sustained in the first accident and finally, that if it had been notified in a timely way it would have arranged rehabilitation different from that which was undertaken.

Ultimately, the insurer focused on the final argument; that it was precluded from earlier investigation and it would then have provided different rehabilitation and treatment which would have avoided the consequences of a premature return to work. In this context, the trial judge felt that the insurer had not proven prejudice. On appeal the High Court observed:

⁴² (2001) 205 CLR 149.
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No doubt, ..., the respondent had lost the opportunity to exercise, at an earlier date than it did, its undoubted rights under the policy to investigate the claim, to have the employee examined by a doctor of its choosing, and to have him undergo different treatment. That is, it lost an opportunity to reduce its liability. But for the reasons given earlier, the amount that fairly represented the extent to which the respondent's interests were prejudiced was not established by pointing to what might have been done; in this case, it was necessary to prove, to the requisite standard of proof, what would have been done. The trial judge was not persuaded that the respondent would probably have done what [the claims officer] said it would have done. In those circumstances, the respondent did not establish that its liability to the appellant should be reduced by any amount.

Another case that considered the meaning of prejudice for the purposes of section 54 is *Commercial Union Assurance Company of Australia Ltd v Ferrcom Pty Ltd & Anor.*⁴³ In this case, the insurer issued a policy in respect of unregistered mobile machinery. A condition of the policy required notification of any material change in circumstances. After the policy was entered into, an unregistered crane insured under the policy was registered. It was common ground that the insured breached the condition by failing to notify the insurer that the crane had been registered. The crane later overturned and was damaged.⁴⁴

The insurer adduced evidence that, if it had been notified of the change, it would have cancelled the existing policy and offered the insured another policy that included an exclusion for damage caused by overturning. In determining the prejudice that the insurer had suffered as a result of the breach of the condition, the High Court held that the relevant prejudice was the loss of the ability to cancel the policy which equated to the full extent of the claim. As such, the insurer could demonstrate prejudice and, as a consequence, could decline the claim.

What about fraud?

If an insurer can decline indemnity pursuant to s.56 because a claim is made fraudulently section 54 will not come to the aid of the insured. This is because the claim is declined by reason of a statutory provision not by reason of the effect of the contract of insurance⁴⁵.

⁴³ (1993) 7 ANZIC 61-156. Also of interest is the similar decision of *Gibbs Holdings Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* [2000] QCA 524, which considers what act must be considered for the purposes of s54. In that case if 54(2) applied the insured would have succeeded but, in that case, the majority felt it was 54(1) applied and that the insurer could decline indemnity.

⁴⁴ Minter Ellison Insurance Contracts Handbook 8th edition page 162.

⁴⁵ *To v Australian Associated Motor Insurers Ltd* [2001] VSCA 48.

What is an act?

The trigger for section 54's operation is 'some act of the insured or some other person'. Act includes an omission. What constitutes an act or omission, thereby potentially engaging section 54?

Generally, it is fair to say that the term has been interpreted broadly for the purposes of section 54⁴⁶. However, there are some limits. So, for example, under a claims made and notified policy, it has been held that, in circumstances where a claimant did not make a claim during the term of a policy, even though he could have done so, the failure to make a claim during the term of the policy was not an act of some other person that engaged section 54. In *Greentree v FAI General Insurance Co Ltd*⁴⁷, the New South Wales Court of Appeal was content that the failure of a third party claimant to bring a claim within the policy period was not an act or omission for the purposes of section 54. Subsequently, the High Court of Australia reviewed⁴⁸ the reasoning of the New South Wales Court of Appeal in *Greentree* and concluded that, whilst the decision was right, the reasoning of the Court of Appeal was not. The High Court said:

Section 54 directs attention to the effect of the contract of insurance on the claim on the insurer which the insured has in fact made. It is not concerned with some other claim which the insured might have made at some other time or in respect of some other event or circumstance. It requires the precise identification of the event or circumstance in respect of which the insured claims payment or indemnity from the insurer. For example, in Greentree the insured claimed indemnity against liability for a claim which the third party had first made on it outside the period of cover. ... The insured's claim necessarily incorporated a temporal dimension. The contract of insurance applied only if the third party's demand on the insured was within the period of cover. The insured's claim on the insurer therefore had to identify when the demand was made. That being so, the claim could not properly be described without that temporal element.

Even if the fact that the third party made no demand on the insured within the period of cover were to be an omission it is, nevertheless, of the first importance to recognise that the claim to which section 54 refers is the claim by the insured on the insurer that was actually made. It is not a claim for indemnity against some other demand (such, for

⁴⁶ See *Gibbs Holdings Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* [2000] QCA 524, which considers which of a few alternatives was the relevant 'act' for the purposes of s.54.

⁴⁷ (1998) 44 NSWLR 706.

⁴⁸ In *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) CLR 641.

example, as a demand assumed to have been made during the period of cover). Section 54 does not permit, let alone require, the reformulation of the claim which the insured has made. It operates to prevent an insurer relying on certain acts or omissions to refuse to pay that particular claim. In other words, the actual claim made by the insured is one of the premises which consideration of the application of section 54 must proceed. The section does not operate to relieve the insured of restrictions or limitations that are inherent in that claim.

However, a section 54 'act', can include acts that involve a third party. For example, in *Antico v Heath Fielding Australia Pty Ltd*⁴⁹ an insured claimed indemnity for defence costs under a D&O policy. The policy incorporated a condition that the insurer would not be liable to indemnify for costs unless it had consented to the costs being incurred. The insured had not sought or obtained consent before incurring substantial costs. The insurer declined indemnity on the basis that the condition had not been complied with. The insured argued that the failure to obtain consent was an omission (and as such an act) for the purposes of section 54 and that, as a consequence, the insurer could only decline indemnity to the extent that it could demonstrate prejudice⁵⁰. The High Court held that the failure to obtain consent was an act for the purpose of section 54 and that, as such, the insurer could only decline indemnity to the extent that it could demonstrate prejudice. The decision does not answer the question of what prejudice may have arisen, but confirms that the failure to obtain consent is an omission, notwithstanding that it involves the exercise of a discretion by the insurer⁵¹.

Whether there is an 'act' that engages s.54, or whether the relevant events are, by way of contrast, simply outside the scope of the contract of insurance has been said to depend upon whether the claim falls within the 'core' of the insurers promise⁵². While this analysis may be helpful, it does not, to my mind, answer the question.

Two recent decisions have also examined the issue of what amounts to an act for the purposes of section 54. *Johnson v Triple C Furniture and Electrical Pty Ltd*⁵³ involved a claim by the passenger of an aircraft who sustained injury when the aircraft crashed shortly after takeoff. The

⁴⁹ (1997) 146 ALR 385.

⁵⁰ Pursuant to s.54(1), given that a failure to obtain consent is a non-causative act.

⁵¹ The court did comment upon how prejudice may be assessed. In the event that the insurer refused consent the policy incorporated a dispute resolution provision in the form of a QC clause. As such, the measure of prejudice turned upon the likelihood that a QC would have given an unfavorable decision.

⁵² See for example Pynt, *Australian Insurance Law: A first reference*, 3rd Ed, at page 371, citing *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) 204 CLR 641.

⁵³ (2010) 243 FLR 336.

aircraft was owned by a company, Triple C Furniture and Electrical Pty Ltd. The pilot was a director of that company.

The policy incorporated an exclusion that provided that the policy did not 'apply whilst the aircraft, with the knowledge of [the insured] is operated in breach of' ... air safety regulations. At the time of the accident, the pilot had not completed a satisfactory aeroplane flight review within two years of the crash as required by air safety regulations. Evidence was adduced to show that the crash was caused by the poor flying habits of the pilot. The insurer declined indemnity on the basis of the exclusion. The insured contested the declinature and attempted to rely upon section 54. The Queensland Court of Appeal held that section 54 did not excuse the breach. The leading judgment was given by Chesterman J. In his view, the relevant act was the failure to pass the flying test within two years of flying. In His Honour's view, failing to pass the test was not an act or omission for the purposes of section 54 because it involved the assessment and discretion of another person. The pilot could not logically, according to Chesterman J, be said to have omitted to pass the test:

For the section to apply there must be some act or omission of the insured, or some other person, by reason of which the insurer may refuse to pay a claim upon it. One must therefore identify an act which would allow the appellant to refuse the respondent's claim on it. The act identified here was an omission: Mr Johnsons not having satisfactorily completed an aeroplane flight review within two years of the flight the subject of the claim. But for that omission, so that argument ran, the pilot would not have been in breach of regulation, the aircraft would not have been operated in breach of the regulation and the policy exclusion would not apply.

...

The circumstance that he had not satisfactorily completed a flight review was not an omission as the word is ordinarily understood and, as it is, in my opinion, used in section 54. He may have omitted to undergo the review but what was required was that he complete the review to some else's satisfaction. Obtaining that satisfaction was something Mr Johnson might achieve, or failed to achieve, but it was not something he could omit.

The second reason that Chesterman J identified as to why section 54 did not apply was that flying the aircraft without an appropriate qualification simply put the relevant event outside the scope of the policy⁵⁴:

The appeal, in my opinion, is of the second type. It is not a case in which the omission gives rise to a right in the insurer, ... to refuse the claim by reason of something in the policy. It is an omission which is relied on to give rise to a claim which the insured could not otherwise make. Because Mr Johnson had not satisfactorily completed the flight review, the respondent's claim for indemnity under the policy was excluded. The omission cannot change that, and it is not of the kind with which section 54 is concerned.

Finally, His Honour concluded that, if he was wrong in relation to the two previous points, in his opinion, the failure to undertake the flight review was an act that could potentially cause loss under the policy and that, therefore, section 54(2) applied. As the insured had not adduced any evidence to show that no part of the loss was caused by the act the insurer could decline indemnity on that basis.

The decision in *Triple C* was subject to a good deal of criticism⁵⁵. The view is expressed that, contrary to the opinion of Chesterman J, the relevant act was not the failure to pass the flight assessment, but rather, flying the aircraft without having the appropriate qualification. That does seem to be an act for the purposes of section 54.

Similar but different circumstances arose in *Maxwell v Highway Hauliers Pty Ltd.*⁵⁶ In this case, the insured, a trucking business, had a policy of insurance that incorporated an endorsement that required the drivers of the relevant trucks to have achieved a minimum score on a driver's test. The drivers were also required to be declared drivers for the purposes of an exclusion in the policy.

Two trucks were involved in accidents whilst being driven by drivers who had not passed the test and had not been declared. Accordingly, on its terms, the policy did not respond. The insurer declined indemnity. The insured argued that section 54 applied.

⁵⁴ On the basis of the High Court's comments cited earlier, that s.54 did not operate to relieve the insured of restrictions or limitations that are inherent in the claim.

⁵⁵ See, for example, *Section 54: The untidiness around the meaning of an 'act' and the scope of s.54(5)(b)* by Stefan Sudweeks and Phillip Lovatt, paper presented at AILA Conference, Perth 22 May 2015.

⁵⁶ [2013] WASCA 115.

At first instance and before the Western Australian Court of Appeal, the insured's argument was upheld. The Court of Appeal held that the relevant act was driving the trucks without the appropriate qualification, rather than the failure to pass the test to someone else's satisfaction. To the extent required, the Court disagreed with the Queensland Court of Appeal in *Triple C*.

The decision in *Highway Hauliers* subsequently went to the High Court. The High Court upheld the Court of Appeal's decision and allowed the insured to recover. It was held that the relevant act was the driving of the truck without the appropriate qualification. The insured had conceded that the act was not causative of loss under the policy. In other words, the insured had conceded that 54(1) applied. Further, it was not suggested that any prejudice flowed. As such, the only issue was whether section 54 applied. It was held that it did and that, as a consequence, the insured should recover.

The Court confirmed that section 54 directs attention to matters of substance and not form, as summarised in this note by the retired judge⁵⁷, Des Derrington QC⁵⁸:

In particular, no difference could be drawn between a term framed: as an obligation of the insured, eg “the insured is under an obligation to keep the motor vehicle in a roadworthy condition”; as a continuing warranty of the insured, eg “the insured warrants he will keep the motor vehicle in a roadworthy condition”; as a temporal exclusion from cover, eg “this cover will not apply while the motor vehicle is unroadworthy”; or as a limitation on the defined risk, eg “this contract provides cover for the motor vehicle while it is roadworthy”. The section focuses not on the legal character of a reason which entitles an insurer to refuse to pay a claim — falling outside a covered risk, coming within an exclusion or non-compliance with a condition — but on the actual conduct of the insured, that is, on some act which the insured does or omits to do. It is engaged when the doing of an act or the making of an omission would excuse the insurer from an obligation to pay a claim for a loss actually suffered by the insured.

The High Court made only limited comment in relation to *Triple C*, only expressly overruling it in relation to the proposition that section 54 did not operate in relation to a temporal exclusion⁵⁹. The Court did also say that the operation of the aircraft in breach of the regulation was an 'act'

⁵⁷ And co-author of *The Law of Liability Insurance*.

⁵⁸ <http://www.lawchat.com.au/recent-insurance-case-when-is-an-insurer-prevented-from-refusing-to-pay-a-claim-for-indemnity-by-the-hon-desmond-derrington-qc/>

⁵⁹ The exclusion there was that the policy 'did not apply' whilst the aircraft was being operated in breach of the relevant regulations.

for the purposes of section 54, confirming that it was that act, rather than the failure to pass the test, that fell for consideration. The decision itself was not overruled because, it would seem, the classification of the failure to undergo the flight review as an act that was potentially causative of loss was correct⁶⁰. As such, because the insured had not shown that no part of its loss was not caused by the act, the insurer could decline indemnity.

One decision that has been handed down since the High Court's decision in *Highway Hauliers* is a decision of the Western Australian District Court⁶¹, *Inglis v Sweeny* [2015] WA DC 34. In this case, a young girl was injured on a ride-on mower. The ride-on mower at the relevant time was being driven by a young boy at a property owned by the boy's parents. The injured infant commenced proceedings against the parents and the boy. However, it so happened that the mower in question was owned by the girl's parents and had been taken from the plaintiff's parents' property to the defendants' property. In those circumstances, the defendants issued a claim for indemnity or contribution against the plaintiff's parents. Those third parties were insured under a policy that incorporated an exclusion on the following terms:

'We will not cover your legal liability for:

...injury to any person who normally lives with you, or damage to their property.'

As the infant plaintiff resided with the insured, the insurer argued that the exclusion was enlivened. After determining that, as a matter of construction, the exclusion did apply, the District Court judge then considered whether section 54 applied. The third party insured argued that the fact that their daughter resided with them was an act, for the purposes of section 54. Somewhat surprisingly, the judge accepted this argument. As such, section 54(1) applied and the insurer was obliged to indemnify given that no prejudice arose as a consequence of the act.

This decision is under appeal. It has been subject to some adverse commentary⁶². It does seem odd to describe living at a particular residence as an act or omission. It seems more a state of affairs. Also, section 54 only deals with acts that occur after policy inception. Given that the infant plaintiff resided with her parents before policy inception, even if residence were an 'act'

⁶⁰ An application for special leave to appeal the decision in *Triple C* had been denied by the High Court.

⁶¹ Each State in Australia has a three-tiered court system. The lowest court on the precedent rung is the Magistrate's Court. After the Magistrate's Court, is the District Court (in some States called the County Court). Each State then has a Supreme Court, most of which have as part of that court a Court of Appeal. The ultimate appeal court from every State jurisdiction is the High Court of Australia. There is also a Federal Court regime that stands apart from the State systems. In terms of the weight of judgments, the Federal Court is ordinarily considered to be comparable to a Supreme Court.

⁶² See, for example, *Section 54: The untidiness around the meaning of an 'act' and the scope of s.54(5)(b)* by Stefan Sudweeks and Phillip Lovatt, paper presented at AILA Conference, Perth 22 May 2015.

for the purpose of s.54, given that it was simply a continuation of an existing arrangement, was it an act that occurred after inception? At the least, it must be an act that occurred both before and after inception.

Another decision that looks at the divide between acts and omissions, and limitations inherent in a claim is *Prepaid Services Pty Ltd v Atradius Credit Insurance NV*⁶³, that involved a claim under a trade credit policy. Relevantly, the policy insured trade debts where the terms were up to 30 days. The insured had, in fact, entered into trade credit arrangements with longer payment terms. The insurer declined indemnity on the basis that the claimed debts were not covered by the policy. The insured sought to rely upon section 54, arguing that entering into the trading arrangements with longer credit terms was an act for the purposes of section 54.

It was common ground that, if section 54 applied, the relevant section was s.54(1), as entering the longer trade terms was not an act that could cause loss under the policy. The only issue was therefore whether section 54 applied. The insurers argument was summarised in this way:

[The insurer] says that the subject matter of the insurance was losses suffered resulting from payment defaults ... and that the event or circumstance which engaged its obligation to indemnify was the failure during the policy period of [the debtor] to pay an invoiced payment obligation under the contract identified in item 6. The payment defaults giving rise to the losses for which [the insured] claims to be indemnified do not answer that description, and accordingly were not covered by the policy. Section 54(1) has no application because the reason for its refusal to indemnify is not some act or omission of the insured or of some other person.

The Court of Appeal's decision was given before the High Court's decision in *Highway Hauliers*. At the time, the competing Court of Appeal decisions in *Triple C* and *Highway Hauliers* were both available and were considered by the New South Wales Court of Appeal. The Court preferred the reasoning of the Western Australian Court of Appeal in *Highway Hauliers*, which, succinctly, gave the broader interpretation to the operation of section 54.

Even so, the New South Wales Court of Appeal held that section 54 did not apply to the circumstances before it:

⁶³ [2013] NSWCA 252.
ME_121070284_1 (W2007)

In the language of section 54(1), the effect of the policy is that Atradius may refuse to pay Optus Mobile's claim because it is in respect of a payment default which is not covered by the policy. The reason for Atradius' refusal to indemnify Optus Mobile is not in its act in contracting with BXP on different terms. The primary judge correctly concluded that section 54 did not apply to prevent Atradius from refusing to pay that claim.

Conclusion

While section 54 has been considered extensively for almost 30 years, and much of its operation has been clarified and explained, some uncertainty still exists in relation to the boundaries between acts and omissions disentitling an insured to cover that are amenable to section 54 and events which are simply outside the scope of the policy. Clearly there are limits, defining them is the point of interest.

And of the ICA as a whole? In a recent paper given by Justice Allsop⁶⁴, he described the Act in favourable terms, recognising its 'reasonable health and vigour, and its service to the commercial and general communities'. I agree. While I have practiced for (just) long enough to recall the doomsayers, I think most in the Australian insurance market would agree that the Act works well and most would also regard the prospect of a return to the pre ICA days as great leap backwards.

Perhaps Greg Pynt has said it best⁶⁵:

The ICA has been very beneficial. It has almost rid us of those two unpleasant contractual terms, the 'warranty' and the 'condition precedent', that haunted insureds for hundreds of years, and it has replaced them with the attractive s 54, which has so far given us no trouble that we couldn't handle.

Best of luck with the *Insurance Act*!

Ken Horsley
Minter Ellison
28 May 2015

⁶⁴ AILA Paper, Sydney June 2015, *Section 54 Resolved? And What has this got to do with non-disclosure and policy drafting?* The paper is a worthwhile read in relation to a number of issues. One of us clearly needs to work on our maths though – Justice Allsop begins his paper by acknowledging that the ICA 'turns 21 this year'!

⁶⁵ The quote is from his excellent text *Australian Insurance Law: A first reference*, 3rd Edition at page 382. However the quote itself is a paraphrased quote from Lord Denning in *Roles v Nathan* [1963] 2 All ER 908. In the original his Lordship was actually commenting on the Occupiers Liability Act.