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## Insurance Law and the Consumer

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# Insurance Law and the Consumer

## **Abstract**

Insurance covers the spectrum of human activity and endeavour. In consequence it is no surprise that tensions should develop between the demands Of the insurer, on the one hand and the insured, on the other. For instance, the AIDS epidemic has created a new dimension to the question of discrimination and the High Court decision in/IMP Society v Goulden has highlighted the question of how much latitude should be afforded to insurers in assessing what risks they will accept.

Professor Tarr argues that a careful balance must be maintained, especially in an area such as insurance where the essence of the insurance transaction is the transference of risk from one person to another. This transfer should take place in informed circumstances and without undue advantage being bestowed upon either party.

## **Keywords**

insurance law, transference of risk, Australia

# INSURANCE LAW AND THE CONSUMER



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*Insurance covers the spectrum of human activity and endeavour. In consequence it is no surprise that tensions should develop between the demands of the insurer, on the one hand and the insured, on the other. For instance, the AIDS epidemic has created a new dimension to the question of discrimination and the High Court decision in AMP Society v Goulden has highlighted the question of how much latitude should be afforded to insurers in assessing what risks they will accept.*

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## Introduction

For purposes of this article the consumer is the insured—the person or organisation who pays premiums for insurance cover, who engages the services of insurance brokers to arrange such cover or who deals with insurance agents in effecting insurance of various kinds over person, property or against liability.

Insurance law has been the subject of a variety of legislative reforms over the past 20 years. Many of these reforms have been introduced with a view towards curbing or eliminating perceived abuses, excesses or undesirable practices in the insurance market. For example, s 18 of the Insurance Act 1902 (NSW), which was added by s 6 of the Commercial Transactions (Miscellaneous Provisions) Act 1974 (NSW), permits a court to excuse a failure by the insured to observe or perform a term or condition of a contract of insurance which has not prejudiced the insurer. The then Minister for Justice, when introducing the Bill into the New South Wales' Parliament, described the provision in the following terms:

It is designed, of course, to prevent advantage being taken of a mere technicality. One ready illustration of the operation of the provision is where a person who has held a driver's licence for many years has by oversight neglected for a few days to renew his driver's licence and during that short period is involved in a collision for which he is in no way responsible. Under the strict terms of his policy his indemnity can be withheld as he is in breach of the condition that the vehicle must be driven by a licensed driver, but it could not be suggested that the insurance company is in any way prejudiced in such a case.<sup>1</sup>

<sup>1</sup> [1974] Parliamentary Debates (NSW) 1705; for a recent example involving s 18, see *McNiece Bros Pty Ltd v National Employers Mutual General Insurance Association Ltd* (1985) 3 ANZ Insurance Cases 60-631; *Accident Insurance Mutual Ltd v Sullivan* (1986) 7 NSWLR 65.

More recently, on the national level, the Insurance Contracts Act 1984 (Cth) and the Insurance (Agents and Brokers) Act 1984 (Cth) have made a tremendous impact upon insurance law and a large number of the reforms have been introduced in the 'consumer interest'.<sup>2</sup>

It is not legislation alone which is of significance in the context of insurance law and the consumer. The courts are not slow to invoke longstanding principles of construction such as the *contra proferentem* rule,<sup>3</sup> nor are they reluctant to address questions of inequality in bargaining power and the problems of unjust or inequitable contracts.<sup>4</sup>

However, such legislation and judicial interventions are not without their repercussions. Legislation is not enacted in a vacuum but in a dynamic economic system, and it may be patently wrong to assume that merely because legislation has increased consumer rights vis-a-vis insurers in the market-place that it necessarily follows that they will be better off, financially or socially, in the long term.<sup>5</sup> Similarly the temptation in hard cases for judicial leniency in construction of contracts or application of substantive rules must be tempered by the flow-on effects which the doctrine of precedent dictates.<sup>6</sup>

A careful balance must be maintained, especially in an area such as insurance where the essence of the insurance transaction is the transference of risk from one person to another. This transfer should take place in informed circumstances and without undue advantage being bestowed upon either party. This article examines some particular issues and endeavours to evaluate whether such a balance has been achieved.

## Liability for agents and brokers

Insurance agents and brokers perform vitally important functions in the insurance arena. However, in the performance of their various tasks a number of major problems have arisen.

First and foremost has been the difficulty in determining whose agent in law a particular intermediary is. This question is of particular significance where a misstatement in a proposal or non-disclosure is in issue, and where this misstatement or non-disclosure derives from an agent's fraud or recklessness, or incompetence in performing the task undertaken. For

2 See the Australian Law Reform Commission, *Report on Insurance Contracts* (No 20 1982) paras 16-29.

3 For recent examples, see: *Manufacturers' Mutual Insurance Ltd v Stargift Pty Ltd* (1985) 3 ANZ Insurance Cases 60-615; *Australian Aviation Underwriting Pty Ltd v Henry* (1988) 5 ANZ Insurance Cases 60-836.

4 See, for instance, *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.

5 See Tarr, 'Consumer Protection Legislation and the Marketplace' (1983) 5 Otago LR 397, 415.

6 As Russell LJ observed in *Sydall v Castings Ltd* (1967) 1 Q B 302, 321 such temptation must be resisted as being akin to acceding to the appeal of Bassanio in the Merchant of Venice.

'Bassanio:

'And, I beseech you, Wrest once the law to your authority: To do a great right, do a little wrong'.

But Portia retorted:

'It must not be; there is no power in Venice

Can alter a decree established:

Twill be recorded for a precedent, and many an error, by the same example, will rush into the State: it cannot be'.

example, in *Jumna Khan v Bankers & Traders Insurance Co Ltd*<sup>7</sup> an illiterate insured effected insurance on his house through an agent of the defendant insurer. At the request of the agent, he signed a blank proposal form. Without asking the insured any questions, the agent then filled in the form and neglected to disclose the occurrence of a previous fire and a refusal of cover. The Full Court of the Supreme Court of New South Wales upheld the insurer's right to repudiate liability when a loss occurred. Street CJ held that the insured's illiteracy did not relieve him of his duty to exercise care and, by signing the proposal, the proponent had adopted it as his own. This decision was upheld by the High Court.<sup>8</sup> Misstatements attributable to an agent's fraud or recklessness have also been resolved against an insured on the basis that the agent's authority from the insurer is regarded as an authority to receive the proposal, and in so far as the agent writes down the answers the agent is seen as the agent or amanuensis of the insured—in treating the agent as no more than the right hand of the insured for the purpose of completing the proposal the unfortunate consequences of agents' misguided actions have been visited upon insureds.<sup>9</sup> The courts have in more recent times endeavoured to attribute to the insurer the responsibility for the agent's conduct in completing the proposal form—for example, in *Stone v Reliance Mutual Insurance Society*<sup>10</sup> and *Deaves v CML Fire & General Insurance Co Ltd*<sup>11</sup>—but, generally speaking, the common law is unsatisfactory in this area and this is compounded by insurance industry practice of protecting itself by contractual provisions excluding the insurer's responsibility for the conduct of its agents.

The basic rule of agency that the principal is bound by any of the acts of the agent within the scope of the agent's actual or apparent (ostensible) authority and by any unauthorised act which the principal chooses to ratify, is departed from in the Insurance Agents and Brokers Act 1984 (Cth). One of the most far-reaching provisions of the Act is s 11 (1) which provides as follows:

An insurer is responsible, as between the insurer and an insured or intending insured, for the conduct of his agent or employee, being conduct—

- (a) upon which a person in the circumstances of the insured or intending insured could reasonably be expected to rely; and
- (b) upon which the insured or intending insured in fact relied in good faith,

in relation to any matter relating to insurance and is so responsible notwithstanding that the agent or employee did not act within the scope of his authority or employment, as the case may be.

A number of points must be made in relation to this section. First, as far as the scope is concerned it should be borne in mind that it deals

7 (1925) 25 SR (NSW) 422, esp 426-427.

8 (1925) 37 CLR 451.

9 See, for example, *Newholme Bros v Road Transport & General Insurance Co Ltd* [1929] 2 KB 356.

10 [1972] 1 Lloyd's Rep 469 (Megaw and Stamp LJ regarding the case as turning on its special facts; that is, that the agent was expressly authorised to complete proposal forms; Denning LJ (at 475) endeavours to construct a more general principle of liability for an agent's mistake).

11 (1979) 23 ALR 539 (fine distinction drawn between clear misrepresentations and innocent non-disclosure to distinguish *Newholme* and *Jumna Khan* cases; see Stephen J at 558 ff).

with the responsibility of the insurer for the conduct of its agent or employee. The identification of these persons is made much easier by further reforms. The Act defines a broker as 'a person who carries on the business of arranging contracts of insurance, whether in Australia or elsewhere, as agent for intending insureds'.<sup>12</sup> Insurance agents are not expressly defined in the Act but their identification is greatly facilitated by s 10 (which came into operation on 1 July 1986), as this section makes it mandatory for persons who arrange or hold themselves out as entitled to arrange contracts of insurance as agents for insurers to operate under a written agreement with the insurer or insurers in questions. This written agreement will clearly evidence an agency to arrange insurance cover on behalf of an insurer and it will be an offence not to comply with this provision.<sup>13</sup> A complement to s 10, is s 12. This section (which commenced on 1 August 1988) deems insurance intermediaries, other than brokers, to be agents of the insurer 'in relation to any matter relating to insurance and as between an insured or intending insured and an insurer'. The conjoint effect of ss 10 and 12 is to require insurance agents to operate under written agreements and to fix the insurer in the role of principal as far as the agent's insurance dealings with insureds are concerned. Moreover the particular situation of intermediaries acting under binders has not escaped the legislature's attention. The conjoint effect of ss 9 and 15 of the Act is to deem a broker to be an agent of the insurer when exercising final underwriting or claims settlement functions pursuant to binder agreements.

Secondly, the statutory responsibility imposed upon the insurer by s 11 (1) for the conduct of its agent or employee is in relation to conduct '(a) upon which a person in the circumstances of the insured or intending insured could reasonably be expected to rely; and (b) upon which the insured or intending insured in fact relied in good faith'. The expression 'in the circumstances of the insured' takes account of the personal idiosyncrasies of the particular insured such as background, illiteracy, or blindness, but there must be a reasonable expectation of reliance on the conduct by a person in the circumstances of the insured, and actual reliance in good faith must be shown. The kinds of conduct caught by s 11 (1) are limited only by the words 'in relation to any matter relating to insurance'. This casts a very wide net and would, it is submitted, make an insurer responsible for its agent's or employee's advice as to investment or tax advantages associated with life insurance.

Thirdly, of vital importance are the concluding words to s 11 (1) which provide that the insurer is 'responsible notwithstanding that the agent or employee did not act within the scope of his authority or employment, as the case may be'. This represents a total departure from the common law position, and the Australian Law Reform Commission in advocating this step had the following to say:

In dealing with an insurance agent, a member of the public is likely to rely exclusively upon the agent's knowledge and experience. He is not in a position

12 Insurance Agents and Brokers Act 1984 (Cth) s 9. This accords with the common understanding of brokers as enunciated in the case law; see, for example, Lush J in *Norwich Union Fire Insurance Society Ltd v Brennans (Horsham) Pty Ltd* [1981] VR 981, 985.

13 Insurance (Agents and Brokers) Act 1984 (Cth) s 10 (6). The validity of a contract of insurance is not affected by a contravention of s 10.

to know, or to become informed of, the mysteries relating to the scope of an agent's authority. The present law determines the rights of insurer and insured partly by reference to arrangements between insurer and agent and partly by reference to the authority which persons in the agent's position normally have. Each of these is beyond the knowledge and experience of many members of the public. What is within their knowledge and experience is what an insurance agent represents to them as being within his authority. To place restrictions by reference to an agent's actual and apparent authority is necessarily to discriminate against those persons in the community who, by reason of their background, education and training, are lacking in knowledge, are most in need of advice and assistance and are most likely to rely uncritically on the advice of the insurer's agent. They are likely to constitute a large number of the insuring public, including a sizable proportion of the migrant population. A rule which requires the conclusion reached in *Jumna Khan* has little claim to respect. For this reason, the Commission suggested in its discussion paper that responsibility be imposed on an insurer for its agent's conduct, irrespective of any limitation which might be suggested by the present requirement of actual or apparent authority.<sup>14</sup>

The Life Insurance Federation of Australia was, and presumably is still, critical of this reform as being 'too far-reaching'; the specific example of an agent giving unauthorised and faulty advice on the making of a will while negotiating life cover was cited by this organisation.<sup>15</sup> Moreover NRMA Insurance Limited argued that small country agencies could depart from providing very limited insurance facilities and types of cover, into the unauthorised areas of livestock or worker's compensation insurance and the insurer would be held accountable.<sup>16</sup> In essence the Australian Law Reform Commission's unsympathetic response to the arguments put forward by LIFA and NRMA suggested that careful drafting of the statutory provisions would resolve the LIFA situation, and that reliance in the situation put forward by NRMA would be difficult to prove.<sup>17</sup> With respect, by attributing responsibility to an insurer for conduct of an agent or employee 'in relation to any matter relating to insurance' it is difficult to see how an insurer can avoid responsibility, for example, for a life agent's estate planning or property settlement advice when allied to the negotiation of life cover; given that investment linked life cover (unbundled insurance) dictates that discussion should range into financial matters, the insurer is doubly hard pressed to escape liability. Moreover, it does not seem unfeasible that because conduct is to be assessed by reference to the personal idiosyncrasies of the particular insured that many instances of insurer liability could arise in situations outlined by NRMA. The requirement of reliance will not be too difficult to satisfy. However, the value judgment has been made that insurers should bear responsibility for the conduct of their agents—even outside the scope of their actual or apparent authority or employment—on the basis that the imposition of additional cost on the industry and, ultimately, on the public at large, is preferable than for it to be borne by a small number of insureds for whom the burden may be ruinous.

Section 11 (2) provides that 'the responsibility of an insurer under subs (1) extends so as to make the insurer liable to an insured or intending

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<sup>14</sup> *Report on Insurance Agents and Brokers* (No 16 1980) para 37.

<sup>15</sup> *Ibid* para 38.

<sup>16</sup> *Idem*.

<sup>17</sup> *Report on Insurance Agents and Brokers* (No 16 1980) para 39.

insured in respect of any loss or damage suffered by the insured or intending insured as a result of the conduct of the agent or employee'. This statutory liability in damages does not require that the agent's or employee's conduct is tortious—all that is required is conduct in relation to a matter relating to insurance causing loss or damage.<sup>18</sup> Contractual provisions designed to limit or exclude the insurer's responsibility for the conduct of his agent are ineffective,<sup>19</sup> and, in addition to proceeding against the insurer, the insured's right to take action against the agent or employee is not affected.<sup>20</sup> Finally, not only is any attempt to contract out of the responsibilities allocated by s 11 ineffective, it is an offence to seek to avoid such responsibilities through an agreement or contractual stipulation.<sup>21</sup>

Section 11 is, therefore, a very far-reaching provision and has a significance far beyond its relative obscurity in the midst of a statute which is basically about occupational licensing. Section 11 will override the express terms of any agency or employment document as far as an insured's reliance on an agent's or employee's conduct is concerned - save where the conduct is so outrageous that a person in the circumstances of the insured could not reasonably be expected to rely, or where there is no actual reliance, or bad faith. Insurers will have to exercise greater care in the selection and training of their agents if they are to avoid an unwanted acquaintance with the rigours of s 11.

A second major area of concern relating to insurance intermediaries has been the problem of broker bankruptcies. Nice questions as to liability for payment of premiums have arisen.<sup>22</sup> Is the insured liable to make further payment to an insurer where the insured has already paid a broker for the premium due for the policy in question, but before transmission of this premium the broker has gone into liquidation? As far as marine insurance is concerned, the position is that where a marine policy is effected on behalf of an insured by a broker, the broker is directly responsible to the insurer for the premium in the absence of an agreement to the contrary; that is, the insured is discharged from any further responsibility to pay the premium where for whatever reason the broker defaults.<sup>23</sup> Sutton<sup>24</sup> explains that Marine Insurance Act provisions to this effect derive from the English Court of Appeal decision in *Universe Insurance Co of Milan v Merchants Marine Insurance Co Ltd*<sup>25</sup> where it was held that by long-established custom in marine insurance the insurer looks to the broker alone for payment of the premium and not to the insured. However the position as regards general insurance was only

18 Callaghan, South Australian Law Society Seminar Notes, November 1984, p 6.

19 Insurance (Agents and Brokers) Act 1984 (Cth) s 11 (4).

20 Ibid s 11 (3).

21 Ibid s 11 (5).

22 See, for example, *Ernest Harding Niemann Pty Ltd v Heartsvue Insurance (Australia) Ltd; Re Palmdale Insurance Co Ltd (in liq)* [1982] VR 921 (Vic SC); *Norwich Winterthur Insurance (Australia) Ltd v Con-Stan Industries of Australia Pty Ltd* [1983] 1 NSWLR 461; (1983) 2 ANZ Insurance Cases 60-513 (NSW CA); *Evans and Lyford v Monadelphous Corp Pty Ltd and Lombard Insurance Co Ltd* (1983) 2 ANZ Insurance Cases 60-152 (WA SC).

23 See Marine Insurance Act 1906 (UK) s 53; Marine Insurance Act 1908 (NZ) s 53; Marine Insurance Act 1909 (Cth) s 59; *Evans and Lyford v Monadelphous Corp Pty Ltd and Lombard Insurance Co Ltd* [1983] 2 ANZ Insurance Cases 60-152 (WA SC).

24 *Insurance Law in Australia and New Zealand* (1980) 181.

25 [1897] 2 QB 93.



settled in *Norwich Winterthur Insurance (Australia) Ltd v Constan Industries of Australia Pty Ltd*<sup>26</sup> where it was held that in the absence of specific arrangements between the broker and insurer as to the payment of premiums, or of an established mercantile custom or usage, at common law the payment of a premium to a broker in respect of a non-marine insurance policy does not relieve the insured of liability to make another payment where the broker does not pay the insurer the premium. This is the logical outcome of the analysis of the parties' legal position; in the overwhelming number of cases the broker will be acting as agent for the insured in arranging cover and making payment, and payment by the principal of the premium to his agent does not amount to payment to the third party, the insurer. The insured, of course, has his remedies against the broker to account for any premium paid to him and also for any loss suffered by the insured through any failure to secure satisfactory cover.

The Australian Law Reform Commission<sup>27</sup> was not impressed with the palliative of an insured's right to proceed against a broker in liquidation, and instead advocated that the insurer should bear the risk of the broker 'going under'.<sup>28</sup> The professional indemnity insurance and trust account requirements under the Act<sup>29</sup> are designed to safeguard against broker insolvency, and the requirement of expeditious remission of premiums is aimed at reducing the amount of insured's funds in the hands of brokers for long periods of time.<sup>30</sup> However, over and above these measures is s 14 of the Insurance (Agents and Brokers) Act 1984 (Cth). Subsection (1) provides that payment by an insured to an intermediary, including a broker, of moneys such as a premium under or in relation to an insurance contract is a discharge to the insured. The same rule applies in relation to anticipatory payments by an intending insured if the anticipated insurance contract is subsequently concluded. Conversely, it is also provided in s 14 (3) that payment by an insurer to an insurance intermediary of moneys such as claims settlement moneys and return premiums under or in relation to a contract of insurance does not discharge any liability of the insurer to the insured in respect of those moneys. Callaghan comments:<sup>31</sup>

The effect of s 14 is to equate the broker and any other insurance intermediary to an agent of the insurer authorised to accept payment on the insurer's behalf, and to deny him the status of an agent authorised by the insured to accept payment on the insured's behalf. A new broom, and a nice clean sweep!

The Australian Law Reform Commission<sup>32</sup> in advancing this new regime pointed out that the insurer is the one who acquiesces in a broker's temporary treatment of premium money as his own, who extends credit, and who is better placed to apprehend impending insolvency; moreover, insurers can protect themselves against the loss of claims settlement and return premium moneys by making payment direct to the insured, or by only making payment against the receipt of the insured, or by issuing

26 [1983] 1 NSW LR 461; (1986) 60 ALJR 294.

27 *Report on Insurance Agents and Brokers* (No 16 1980) para 44.

28 *Ibid* para 51.

29 See Tarr, *Australian Insurance Law* (1987) Ch 2.

30 Insurance Agents and Brokers Act 1984 (Cth) s 27.

31 South Australian Law Society Seminar Notes, November 1984, p 9.

32 *Report on Insurance Agents and Brokers* (No 16 1980) para 51.

their cheques in the name of the insured rather than the broker, payable to order and crossed 'not negotiable account payee only'. For these reasons the Australian Law Reform Commission felt that insurers were better placed to protect themselves and should bear the risk of loss of moneys be it premiums, claims settlement amounts or return premiums. Consequently as far as broker insolvencies are concerned the insurer carries the risk of losing premiums and having to pay claims or return premiums twice over. However the risk of this eventuating is reduced by the statutory regulation of brokers and, in particular, by the establishment of insurance broking accounts and the preferential distribution rights afforded insurers from such accounts.

### Utmost good faith and fraud

Part II of the Insurance Contracts Act 1984 (Cth)—ss 12 to 15 inclusive—is headed 'The Duty of Utmost Good Faith' and s 12 of the Act provides that Pt II is not limited or restricted in any way by any other law, including the subsequent provisions of the Act, with one exception in relation to the insured's duty of disclosure.<sup>33</sup> Section 13 states that a contract of insurance is a contract based on utmost good faith and 'there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith'. This provision is supplemented by s 14 (1) which provides that a party cannot rely on a term of a contract if to do so would be to fail to act with the utmost good faith. These provisions are of enormous importance. First, it is made quite clear that the paramount obligation upon the parties is to observe utmost good faith towards one another—the only limitation upon this pervasive duty is that the insured's duty of disclosure as specified in s 21 is not to be rendered more onerous by reference to a provision such as s 13.<sup>34</sup> For example, s 21 imposes obligations as to pre-contract disclosure of information, and it would presumably not be open to an insurer to argue a breach of the duty of utmost good faith in circumstances where the insured failed to disclose a material circumstance which arose during the currency of the contract of insurance—success in such an argument would render the duty of disclosure more onerous. Secondly, the legislation makes it clear that the duty of utmost good faith applies to all aspects of the relationship between insurer and insured. The duty arises 'in respect of any matter arising under or in relation to' a contract of insurance.<sup>35</sup> Consequently the duty has potential application to a wide range of relations including settlement of claims, admissions and denials of liability. Thirdly, there is implied into every contract of insurance to which the Act applies a provision requiring each contracting party to observe utmost good faith. Given the paramountcy of this duty of utmost good faith, s 14(1), which precludes a party from relying upon a provision in an insurance contract if reliance upon such provision would be to fail to act with utmost good faith, is inserted *ex abundanta cautela*.<sup>36</sup> The

33 See Tarr, *Australian Insurance Law* (1987) 81.

34 See s 12.

35 Section 13. Generally, see Lücke, 'Good Faith and Contractual Performance', in P Finn (ed), *Essays in Contract* (1987) Ch 5.

36 Section 13; so the 'no-reliance provision' is clearly only a specific instance of the application of the duty of utmost good faith.

paramountcy of the general duty of utmost good faith in the relationship between the parties dictates that when an emerging fact situation necessitates a choice between the strict application of a consensual term and application of the statutory implied term of utmost good faith, the latter must prevail. In deciding whether reliance by an insurer on a provision of the contract of insurance would be to fail to act with the utmost good faith, the court must have regard to any notification of the provision that was given to the insured, whether a notification of a kind mentioned in s 37 or otherwise.<sup>37</sup> Section 37 proscribes an insurer from relying on a provision in a contract of insurance which is not usually to be found in similar insurances, unless, before the contract was entered into, the insurer either gave the insured a copy of the policy or provision, or 'clearly informed the insured in writing' of the effect of the provision.<sup>38</sup> Clearly where this section is complied with, or where other clear notification of the provision in question has occurred, the insured will presumably have entered into the transaction with 'open eyes', and the insurer cannot be readily criticised if it seeks to rely upon the provision, even if it is unusual. Bad faith would be difficult to demonstrate in such circumstances.

Under s 15(1) of the Insurance Contracts Act 1984 (Cth) it is provided that the Act constitutes a code for relief in respect of harsh, oppressive, unconscionable, unjust, unfair or inequitable contracts, or from the consequences in law of making a misrepresentation, and any other legislation providing for such relief is of no application to contracts within the purview of the Act.<sup>39</sup> Relief, within the context of s 15(2), includes relief by way variation, avoidance or termination of a contract. Thus, as Sutton observes:<sup>40</sup>

... [S]uch legislation as the Contracts Review Act 1980 (NSW) and the Misrepresentation Act 1971-72 (SA) will be inapplicable, although any common law principles of relief from unconscionable contracts will continue to apply, since s. 15(1) refers only to legislation and s. 7 preserves common law and equitable rules.

Clearly the Commonwealth Parliament was of the view that the reaffirmation of the requirement of uberrima fides in its guise of a contractual duty would be sufficient to control the nature and exercise of consensual terms in contracts of insurance covered by the Act. It is likely that Pt II of the Insurance Contracts Act 1984 (Cth) will influence insurers and their advisers in the careful drafting of policy terms, and in their enforcement or reliance upon strict terms. It should be noted that the wording of s 15(1) does not have the effect of excluding the operation of ss 52(1) and 52A of the Trade Practices Act 1974 (Cth) to pre-contract conduct by non-contracting parties (such as an insurance

37 Insurance Contracts Act 1984 (Cth) s 14 (3).

38 As amended by the Statute Law (Miscellaneous Provisions) Act (No 1) 1985 (Cth).

39 Section 15 was amended by the Statute Law (Miscellaneous Provisions) Act (No 1) 1985 (Cth) to make it clear that the operation of any laws providing relief in respect of contracts will not apply to contracts of insurance subject to the Act.

40 (1985) 13 ABLR 48, 49.

intermediary<sup>41</sup>) or to post-contract unconscionable dealings or misleading conduct by the insurer or any other party, such as the insurer's agent.

In light of this paramount obligation to observe utmost good faith, the latitude extended to fraudulent insureds in certain provisions of the Act is surprising. For instance, even in those circumstances where an insurer is entitled to avoid a contract of general insurance or life insurance for fraudulent misrepresentation or non-disclosure, the fraudulent customer is not necessarily lost. As Callaghan observes:<sup>42</sup>

This tender statute will strain the quality of mercy on his behalf, or invite the judiciary to do so (seated for this purpose under an umbrageous Palm Tree).

Pursuant to s 31 a court is given an overriding power to disregard avoidance if it would be harsh and unfair not to do so and the insurer has not been significantly prejudiced by the failure or misrepresentation.<sup>43</sup> The judge in the exercise of his discretion must 'juggle and weigh (these) hairy coconuts'<sup>44</sup> and in addition must have regard to the need to deter fraudulent conduct in relation to insurance and must 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.<sup>45</sup> Moreover, the court may consider any other relevant matters.<sup>46</sup> If a court decides to exercise its discretion in favour of an insured, the effect is to preserve the claim in respect of the loss and the contract is not resuscitated or reinstated;<sup>47</sup> as well, it should be noted the amount recoverable lies within the court's discretion as instead of allowing recovery of the whole amount, the court may give judgment for part of the amount as it thinks just and equitable in the circumstances.<sup>48</sup>

With respect to misstatements of age, s 30 of the Insurance Contracts Act 1984 (Cth) provides that there is to be no avoidance of a contract of life insurance even if a misstatement is fraudulent. Instead, the sum insured is adjusted in accordance with a formula provided in the Act and the adjustment has a retrospective effect. The effect of this provision, and its forerunner, s 83 of the Life Insurance Act 1945 (Cth),<sup>49</sup> is to substitute for the benefits provided under the contract benefits which are

41 See, for example, *Gates v City Mutual Life Assurance Society Ltd* (1986) 4 ANZ Insurance Cases 60-691; *Gokora Pty Ltd v Montgomery Jordan, Stevenson Pty Ltd* (1986) 4 ANZ Insurance Cases 60-727. Section 33 of the Insurance Contracts Act 1984 (Cth), in providing that the insurer's remedies in respect of misrepresentation and non-disclosure are to be found in the Insurance Contracts Act alone, does not affect the submission that the insured may call s 52 and s 52A of the Trade Practices Act 1974 (Cth) in aid in the circumstances outlined.

42 'The New Insurance Legislation', Seminar Paper for The Law Society of South Australia, 17 April 1985, p 18.

43 Insurance Contracts Act 1984 (Cth) s 31(1), (2).

44 The expression is that of Callaghan, 'The New Insurance Legislation', Seminar Paper for The Law Society of South Australia, 17 April 1985, p 18.

45 Insurance Contracts Act 1984 (Cth) s 31(3).

46 *Idem*.

47 Insurance Contracts Act 1984 (Cth) s 31(4).

48 *Ibid* s 31(1).

49 Section 83 will continue to regulate the position as far as contracts not covered by the Insurance Contracts Act 1984 (Cth) are concerned—essentially, contracts of life insurance entered into before 1 January 1986. See the Life Insurance Act 1945 (Cth) s 86A.

reasonable having regard to the true age of the life insured. No time limit is imposed for such variation to be made.

A final example is afforded by s 56(2) of the Insurance Contracts Act 1984 (Cth). While the Australian Law Reform Commission<sup>50</sup> accepted that fraud had to be discouraged they considered that 'a rule that fraud in respect of one claim taints other claims under the same policy can operate most unevenly between an insured with a number of separate policies and one with a composite policy covering numerous risks'. They advocated, therefore, that where the total loss of the insured's claim would be seriously disproportionate to the harm which the insured's conduct has or might have caused, a court should be entitled to order the insurer to pay to the insured an amount which is just and equitable in the circumstances.<sup>51</sup> This recommendation is adopted in s 56(2) of the Insurance Contracts Act 1984 (Cth) which provides that:

In any proceedings in relation to [a fraudulent] claim, the court may, if only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair, order the insurer to pay, in relation to the claim, such amount (if any) as is just and equitable in the circumstances.

There are some totally irreconcilable positions adopted by the Insurance Contracts Act 1984 (Cth). A paramount obligation upon the parties to observe utmost good faith as enunciated in ss 12 and 13 of the statute does not sit (even uneasily) with a judicial discretion to excuse fraudulent claims, non-disclosure or misrepresentation, or a provision that precludes an insurer from avoiding a life insurance contract for fraudulent misstatement as to age. The Act recites in s 12 that the duty of utmost good faith is not limited or restricted in any way by any other law, including the subsequent provisions of the Act; does this mean that provisions purporting to disregard fraudulent conduct are ineffective? There can be no doubt that fraud is manifestly at odds with the principle of utmost good faith. An insurer has a difficult task in providing proof of fraud and there is considerable merit in the comments of Chilwell J in *Gibbs v New Zealand Insurance Co Ltd*<sup>52</sup> where the learned judge stated that, as a matter of public policy, an insured should lose all standing in a court of justice where he knowingly makes false statements of losses he did not sustain, in addition to those he did sustain. Conversely it may be asserted that the Act introduces an appropriate degree of flexibility to avoid disproportionate penalties for minor and trivial frauds. However, it is hoped that the words 'minimal' and 'insignificant' in s 56 (2), for example, will not receive a generous latitude in construction and that the need to deter fraudulent conduct will receive a ready recognition.

## Construction of contracts

The application of the maxim *verba chartarum fortius accipiuntur contra proferentem* results in the adoption of the construction most favourable to the insured to resolve any ambiguity, as almost invariably it will be the insurer who has framed the document under consideration. There

<sup>50</sup> *Report on Insurance Contracts* (No 20 1982) para 243.

<sup>51</sup> *Idem*.

<sup>52</sup> Unreported, High Court, Auckland, New Zealand, 6 December 1983, A 173/80 at 204-205.

can be little quarrel with the widespread application of the contra proferentem rule in the insurance context as the rule is based on the principle that a person is responsible for ambiguities in his/her expression, and may not induce another to contract on the supposition that the words mean one thing, at the same time hoping that a court which has to construe them will give them another meaning, more to his/her advantage.<sup>53</sup> As the insurer drafts his own policies and other documents such as proposals and cover notes he is in a position to ensure that precision and clarity is attained and it is, therefore, eminently reasonable that any ambiguity should be resolved in this way.<sup>54</sup> Obviously before the contra proferentem maxim can be applied there must be a genuine ambiguity, as the maxim has no application where on a fair and reasonable construction the word or provision is unambiguous.<sup>55</sup>

While the application of the contra proferentem rule may be seen as a legitimate means to redress imbalances in bargaining power and to protect consumers in cases of ambiguity, the judicial latitude shown to insureds in the construction of certain policy expressions is more difficult for insurers to accept. This is particularly the case in areas of compulsory insurance. The latitude, for example, afforded to the expression 'caused by or arising out of the use of a motor vehicle' (or words not materially distinguishable) in compulsory third party motor vehicle policies is legion. The words have been held to encompass:

- Where a car fell off its jack in the defendant's driveway, after the defendant had removed the car's wheel, injuring his 7 year old son;<sup>56</sup>
- Where a car whilst undergoing repairs in a service station and unable to be mechanically propelled was pushed along with its bonnet up so that the 'driver' was unable to see and collided with a pedestrian;<sup>57</sup>
- Where an electrical authority serviceman, in the course of servicing an appliance, returned to his panel van to obtain a part, and the rear doors swung shut on his back;<sup>58</sup>
- Where a cyclist collided with a stationary vehicle at night which was unlit, unattended and correctly parked.<sup>59</sup>

53 *Anderson v Fitzgerald* (1853) 4 HLC 484, 510-511; Voet, *Commentarius ad Pandectas* 18.1.27, in describing the Roman origins of the rule put the matter thus: 'Dubious pacts are to be construed against the party by whom they are imposed, as everyone must impute it to his own imprudence that he has not expressed himself more plainly.' See also *Black King Shipping Corp v Massie: The Litsion Pride* [1985] 1 Lloyd's Rep 437, 469.

54 Compare: *Procaccia*, (1979) 14 Israel LR 74, 102. See also Liederman, 'Insurance Coverage Disputes in the United States: a Period of Uncertainty for the Insurer' [1986] LMCLQ 79, 83-85.

55 See *Manufacturers' Mutual Insurance Ltd v Stargift Ltd* (1985) 3 ANZ Insurance Cases 60-615; cf *Cameron v Commercial Union General Insurance Co Ltd* (1983) 2 ANZ Insurance Cases 60-542.

56 *Clement v Clement* (1984) 1 MVR 435.

57 *MVI Trust (WA) v Seeney* (1984) 1 MVR 443.

58 *Stewart v SCC* [1973] 1 NSWLR 444.

59 *Jorgensen v MAB* (1982) Victorian Motor Accident Cases 74-114, 74-134. Other cases concerning a cyclist colliding with a stationary vehicle with the same result following, include *Lamont v MAB* (1982) Victorian Motor Accident Cases 74-110, 74-134 and *Hodgkinson v MAB* (1982) Victorian Motor Accident Cases 74-118, 74-134. For another example of the width afforded to compulsory motor vehicle cover see the recent High Court decision in *Dickinson v Motor Vehicle Insurance Trust* (1987) 61 ALJR 553.

There can be little doubt that the policy underlying the compulsory insurance schemes is to ensure that the victims of accidents should have a solvent source to which they can turn and in the absence of a general no-fault liability scheme it is inevitable that the boundaries of existing compulsory schemes, whether fault based or not, for motor vehicle and work related injuries should occasionally in the view of insurers be stretched to achieve the policy objective of compensation.

In one of the great understatements in legal literature, Procaccia<sup>60</sup> observes:

Insurance policies are not likely to emerge, even at the present, as a major source of recreational reading.

Very few would disagree! Not only is the allegation made that policies are drafted in terms which are only intelligible to experts, but the information may be contained in a combination of any two or more of the proposal forms, the preamble, the definition section, clauses dealing with exclusions or conditions, and the schedule.<sup>61</sup> Compounding such problems are 'fine print' legibility difficulties which led one American judge to observe that:

[S]eldom has the art of typography been so successfully diverted from the diffusion of knowledge to the suppression of it.<sup>62</sup>

Of course, not all insurance policies and documents suffer from poor readability and strenuous efforts have been made by many insurers to express their forms in 'plain English'.<sup>63</sup> Moreover it must be recognised that the pursuit of simplification is not without its pitfalls and complications. Legalese may have the virtue of brevity and the benefit of precedent.<sup>64</sup> Both insurer and insured may be prejudiced by the abandonment of technical wordings which have been subject, in many instances, to a considerable history of judicial interpretation.<sup>65</sup> The adoption of 'plain English' is not, therefore, a panacea for all problems of construction and understanding of insurance documents—indeed, clarity may be eroded through the substitution of colloquial expressions and terms for the technical counterparts.

The Australian Law Reform Commission<sup>66</sup> took the view that many difficulties associated with insurance could be cured or alleviated through the prescription of standard cover in certain designated areas. The legislature accepted the Commission's recommendations in this area and the Insurance Contracts Act 1984 (Cth) and Insurance Contracts Regulations 1985 (Cth) provide for standard cover in respect of motor

60 'Readable Insurance Policies: Judicial Regulation and Interpretation' (1979) 14 Israel LR 74.

61 See, for example, *Guardian Assurance Co Ltd v Underwood Constructions Pty Ltd* (1974) 48 ALJR 307, 308, where Mason J described a policy as a 'jumble of ill-assorted documents expressed in that distinctive style which insurance companies have made their own'. Cited in Australian Law Reform Commission, *Report on Insurance Contracts* (No 20 1982) para 39.

62 *Delancey v Insurance Co* 52 NH 581, 587-588 (1873); per Doe C J cited by Procaccia, (1979) 14 Israel LR 74, 75.

63 See, for example, *Hajjar v NRMA Insurance Ltd* (1985) 3 ANZ Insurance Cases 60-647. See *Sutton*, (1985) 13 ABLR 298.

64 Procaccia, (1979) 14 Israel LR 74, 80.

65 Australian Law Reform Commission, *Report on Insurance Contracts* (No 20 1982) para 43.

66 *Ibid* para 69.

vehicle insurance (property damage), home buildings insurance, home contents insurance, sickness and accident insurance, consumer credit insurance, and travel insurance. The combined effect of the Act and the Regulations is that where an insured makes a claim under a prescribed contract (that is, a contract to which the standard cover provisions apply) and that claim is in respect of loss arising from an event prescribed in the Regulations, the insurer must pay the insured the minimum amount specified in the Regulations. The insurer cannot rely on the terms of the contract to deny liability or reduce the amount of liability below a certain prescribed minimum unless the insurer proves that, before the contract was entered into, he clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise) or the insured knew, or a reasonable person in the circumstances could be expected to have known, that the insurer was liable only for the lesser amount or that the particular risk was not covered by the contract of insurance.<sup>67</sup>

Unfortunately, the amendment to the proviso<sup>68</sup> to make it plain that the insurer can provide notice of derogation from the standard simply by providing a copy of the policy has greatly reduced the impact of the standard cover initiative. Clearly the Commission had in mind that no derogation from standard cover should be possible without a clear warning—delivery of a policy with non-standard terms included does not amount in my view to a clear warning.

## Conclusion

Insurance covers the spectrum of human activity and endeavour and in consequence it is no surprise that tensions should develop between the demands of the insurer, on the one hand, and the insured, on the other. For instance, the AIDS epidemic has created a new dimension to the question of discrimination<sup>69</sup> and the High Court decision in *AMP Society v Goulden*<sup>70</sup> has highlighted the question of how much latitude should be afforded to insurers in assessing what risks they will accept. Laissez-faire advocates suggest that market mechanisms should be left to operate unimpeded by government regulation, but there is also strong support for legislative intervention in areas where conflict arises between the insurers' interests and the consumer interest.

What is abundantly clear, though, is that a balance must be maintained between insurer and consumer. The situation which has arisen in the United States in the area of liability insurance is a classical instance of the consequences of imbalance. A rapid expansion in the scope of liability and huge damages awards have resulted in insurers ceasing to offer certain

67 Insurance Contracts Act 1984 (Cth) s 35(1), (2). As amended by the Statute Law (Miscellaneous Provisions) Act (No 1) 1985, s 3; Statute Law (Miscellaneous Provisions) Act (No 2) 1985, ss 2 (8), 3.

68 By the Statute Law (Miscellaneous Provisions) Act (No 1) 1985, s 3. See also Kelly, 'Amendments to the Insurance Contracts Act 1984 (Cth); 'Misuse of the 'Omnibus' Bill Procedure' (1987) 15 ABLR 275.

69 See Neave, 'Anti-discrimination laws and insurance—the problem of AIDS' (1988) 1 Insurance LJ 10.

70 (1986) 4 ANZ Insurance Cases 60-708.



types of cover or in increasing premiums to the point where insurance cover is not affordable. Graphic examples are given in a recent article:

On the Hawaiian island of Molokai, pregnant women who want a doctor in attendance when they give birth fly to neighboring Oahu or Maui. The five Molokai doctors who once delivered babies have stopped doing so because malpractice insurance would cost them more than the total of any obstetrical fees they could hope to collect.

Will County, Ill., last week closed its forest preserves until it can get a new liability policy on them—if that can be done at all—and Blue Lake, Calif. (pop. 1,200) has shut its skating rink, parks and tennis court. Hundreds of other towns in California and in New York State are 'going bare.' That is, they simply cannot get liability insurance.<sup>71</sup>

The law and its construction should not be so favourable to the consumer that it encourages dereliction of the consumer's responsibility to protect his/her own interests and neglect of the consumer's responsibility to the insurer. It is submitted that the examples cited above suggest that this proposition has not always been as prominent in the minds of those drafting legislation as it should be. In particular, in permitting a court to excuse a 'little' fraud, the legislature has diluted one of the most fundamental principles of insurance law. Moreover, from a practical viewpoint, as Marks and Balla <sup>72</sup> observe:

This provision for equitable relief presupposes that it is possible to dissect the claim which is made fraudulently so as to be able to determine that some part of it only involved fraudulent conduct. That part must be 'minimal' or 'insignificant'. It is difficult to see how it could be suggested that there was only a 'little fraud'. It seems akin to describing someone as being only a 'little pregnant'.

71 'Sorry, America, Your Insurance Has Been Cancelled' *Time*, 24 March 1986.

72 *Guidebook to Insurance Law in Australia* (2 edn 1987) 334.