

THE FUNDAMENTALS OF INSURANCE LAW: ENDURING CONSTANTS IN THE WINDS OF CHANGE?*

- 1 I would like to begin by acknowledging the traditional custodians of the land on which we meet and to pay my respect to their Elders and lawmakers past and present, and extend that respect to other Aboriginal people who are here today.
- 2 The spreading of risk through insurance has been central to economic and social activity for centuries. Indeed, it has been most aptly said that “*the origin and growth of insurance is at the centre of the idea of a commercial society ... [w]here there was wealth there was risk and where there was risk there was insurance*”.¹ Whilst insurance had a foothold in the legal and regulatory regimes of the early 18th century, it is to Lord Mansfield that common lawyers turn for its foundational common law principles, and in particular, to the seminal decision of *Carter v Boehm*².
- 3 It is always interesting to know the circumstances out of which such seminal decisions arise. In the case of *Carter v Boehm* the relations between France and Britain were strained, as they often were and have been throughout history. Trade was also vibrant. Industry was innovative. Colonisation was rampant. In 1760, the French attacked Fort Marlborough, a British trading post in Sumatra. Roger Carter, the Governor of Fort Marlborough, had taken out a policy of insurance against the fort being destroyed by, taken by, or surrendered unto, any European enemy.³
- 4 Boehm, the insurer, refused to indemnify the Governor on the basis that he had not disclosed that the fort, which was really in the nature of “*a factory or settlement for trade*”, was badly supplied with stores, arms and ammunition

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¹ Ian Enright, “William Murray – Lord Mansfield – Life, times and legacy – Good Faith and Good Works” (2016) 27 *Insurance Law Journal* 75 at 94.

² *Carter v Boehm* (1766) 3 Burr 1905.

³ (1766) 3 Burr 1905 at 1911.

and was generally in poor condition to repel an attack from a European enemy. Furthermore, the Governor feared that an attack from the French was imminent.⁴

- 5 Against that background and in that context, Lord Mansfield enunciated the principle so familiar today: the doctrine of utmost good faith. His Lordship said:

“Insurance is a contract based upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the underwriter trusts to his representation and proceeds upon the confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk as if it did not exist. ... Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain from his ignorance of that fact, and his believing the contrary.”⁵

- 6 Today’s world is very different. However, there remain certain aspects of modern life that might be seen as a replication of Lord Mansfield’s time: international relations are unsettled; trade is vibrant and industry is innovative, indeed disruptive. We thus continue to live in a “*commercial society*” – the concept which developed out of the philosophical, political, religious and industrial revolutions of the 16th and 17th centuries.⁶

- 7 And, as was the case in Lord Mansfield’s time, insurance sits centre stage in modern commercial society. However, unlike the relative simplicity of risks of trade and commerce that underpinned the insurance market of the 18th century, the modern insurance market is complex and multifaceted. In 2015, there were \$105 billion of premiums in the Australian insurance market, and the finance and insurance industry contributes in the order of \$150 billion per

⁴ (1766) 3 Burr 1905 at 1913-1914.

⁵ *Carter v Boehm* (1766) 3 Burr 1905 at 1909-1910.

⁶ Ian Enright, “William Murray – Lord Mansfield – Life, times and legacy – Good Faith and Good Works” (2016) 27 *Insurance Law Journal* 75 at 93.

annum to Australia's economy.⁷ Within that market, the sophistication of insureds varies immensely.

8 Notwithstanding the sophistication of the market, the principle of utmost good faith enunciated in 1766 remains central to insurance law, albeit its application has been extended by statute. It is the recent developments in respect of the duty of utmost good faith that I principally focus on in this paper, before turning to recent developments in the insured's separate statutory duty of disclosure, as well as the principles governing the interpretation of insurance contracts.

9 Given the introduction of the *Insurance Contracts Act 1984* (Cth) and the amendments to the Act in 2013, insurance law delivers up an exquisite suite of statutory and common law principles and concepts. An understanding of their interaction is fundamental for the modern insurance lawyer as is the vast regulatory regime which now sits umbrella-like over the insurance industry more generally. Justice Kirby's warning that:⁸

“... where statutory provisions are engaged, attention must primarily be addressed to those provisions and to their terms, and not to earlier judicial elaborations of the common law or of other statutory provisions” (citations omitted)

is thus particularly apt, as is a clear understanding of the principles of statutory construction.

10 Although the current jurisprudence of the High Court emphasises the importance of text in the construction of statutes: see for example

⁷ OECD, *OECD Insurance Statistics 2016: Australia*, (April 2017, http://www.oecd-ilibrary.org/finance-and-investment/oecd-insurance-statistics_2307843x); Australian Bankers' Association Inc., Economic contribution of the finance and insurance industry (April 2017, http://www.bankers.asn.au/images/uploads/ArticleDocuments/148/ABA-129770-v1-Economic_contribution_of_banks_for_website_April_2017.pdf).

⁸ *SST Consulting Services Pty Limited v Rieson* [2006] HCA 31; 225 CLR 516 at [89]. See also *Certain Lloyd's Underwriters Subscribing to Contract No IH00AAQS v Cross* (2012) 248 CLR 378; [2012] HCA 56 at [23]-[26] (French CJ and Hayne J).

Commissioner of Taxation v Consolidated Media Holdings Ltd [2012] HCA 55; 250 CLR 503, where the High Court said, at [39]:

“ ‘This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text’. So must the task of statutory construction end” (citations omitted)

there are likely to be important historical common law influences in the interpretation of provisions where the governing statute incorporates concepts such as utmost good faith. In a different context, Gleeson CJ observed that:

“Legislation and the common law are not separate and independent sources of law; the one the concern of parliaments, and the other the concern of courts. They exist in a symbiotic relationship.”⁹

- 11 However, in accordance with principle, reference is first to the statutory text before reading the decided cases in which the underlying legal concepts were developed as part of the common law. A return to the statutory text is then required.¹⁰ Starting with common law principles will lead to an error in the analysis.
- 12 The position in relation to the principles governing the interpretation of insurance contracts is different. Statute has not altered the well-established common law principles of construction although those principles have undergone elucidation by the High Court and other appellate courts in recent years.

The duty of utmost good faith

- 13 The duty of utmost good faith is now entrenched in Statute. Section 13 of the *Insurance Contracts Act* provides that a contract of insurance is a contract based on the utmost good faith, and implies a term of utmost good faith in every contract to which the *Insurance Contracts Act* applies. Unlike the

⁹ *Brodie v Singleton Shire Council* [2001] HCA 29; 206 CLR 512 at [31].

¹⁰ The Hon Justice Kenneth Hayne AC, “Keynote Address – The *Insurance Contracts Act* and the Courts or Litigation in the Age of Statutes”, National Conference, Australian Insurance Law Association National Conference (Melbourne, Thursday, 17 October 2002).

common law position where the duty, for the most part, was played out in the area of pre-contractual disclosure, and where the impracticality of the remedy of avoidance to an insured meant that an insurer was effectively immune from its rigours, under s 13 the duty is mutual and contractual. Importantly, pursuant to s 12 of the *Insurance Contracts Act*, the duty of utmost good faith is not to be limited or restricted by any other law or provision of the Act save that the duty of disclosure to an insurer is created as a separate and comprehensive obligation under s 21.

- 14 By making the duty of utmost good faith an implied term of the contract, the *Insurance Contracts Act* fundamentally altered the remedies available for breach. At common law, the remedy for breach of the duty of utmost good faith was “avoidance”, whereby the other party could avoid the contract from its inception. Under the *Insurance Contracts Act*, breach of the duty of good faith is a breach of an implied term of the contract. The aggrieved party can thus sue for damages under the contract in accordance with ordinary principles of *Hadley v Baxendale* contractual damages¹¹ and, where appropriate, the doctrine of specific performance,¹² which will be of particular relevance where it is the insured who is seeking the remedy.
- 15 Where it is the insurer who is seeking a remedy for breach, adequate remedies are probably provided by the Act itself: for example, s 54 provides for the insurer to reduce its liability under a claim by the amount that fairly represents the extent to which the insurer’s interests were prejudiced by the breach, s 56 provides for the insurer to refuse payment of a fraudulent claim, but proscribes avoidance of the contract, and s 60 provides for the cancellation of a contract of general insurance in certain circumstances.¹³

¹¹ *Hadley v Baxendale* (1854) 9 Exch 341; *Camellia Properties Pty Ltd v Wesfarmers General Insurance Ltd* [2013] NSWSC 1975; (2014) 18 ANZ Ins Cas 62-000 at [126] (Sackar J).

¹² See F G Hawke, “Consequences for an insurer of failure to act with utmost good faith” (2016) 27 *Insurance Law Journal* 229 at 230.

¹³ F G Hawke, “Consequences for an insurer of failure to act with utmost good faith” (2016) 27 *Insurance Law Journal* 229 at 230.

- 16 A finding that an insurer has breached the duty of utmost good faith does not automatically entitle an insured to indemnity under the policy. In *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR 1 at [16], which is discussed below, Gleeson CJ and Crennan J said:

“[T]he Act does not empower a court to make a finding of liability against an insurer as a punitive sanction for not acting in good faith. If there is found to be a breach of the requirements of s 13 of the Act, there remains the question how that is to form part of some principled process of reasoning leading to a conclusion that the insurer is liable to indemnify the insured under the contract of insurance into which the parties have entered.”

There must be “*at least one other premise*” between the finding of a breach of the duty of utmost good faith and the finding that the insurer is liable to indemnify the insured.¹⁴ The insured must still prove that the insured was on risk in respect of the liability incurred.

- 17 There has, from time to time, been discussion as to whether the duty of utmost good faith, at common law or as implied by statute, will give rise to other causes of action, particularly in tort. In *Lomsargis v National Mutual Life Association of Australasia Ltd* [2005] 1 Qd R 295; QSC 199, McMurdo J declined to recognise a tort of bad faith concurrent with the contractual duty implied by s 13 of the *Insurance Contracts Act*. His Honour considered, at [58], that “*no reason of principle or policy warrants the recognition of such a tort, and ... there are good reasons for not doing so*”. That appears to be the accepted position in Australia.
- 18 In 2013, the *Insurance Contracts Amendment Act 2013* (Cth) amended s 13 to provide that a breach of the duty of utmost good faith is a breach of the requirements of the Act. This allows for the intervention of ASIC, which may exercise its powers under the *Corporations Act 2001* (Cth) to vary, suspend or cancel an Australian financial services licence, or ban persons from providing financial services: s 14A. ASIC can also bring a representative action on

¹⁴ *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR 1 at [16].

behalf of the insured if it is of the opinion it is in the public interest to do so: s 55A *Insurance Contracts Act 1984* (Cth).¹⁵ However, the accepted wisdom is that that s 13 does not create a statutory duty concurrent with the insurer's contractual obligations.¹⁶

- 19 The explanatory memorandum for the 2013 amendment legislation explains that the rationale for this change is that enforcing compliance with the duty of utmost good faith through private legal action may be too great an expense for some parties and does not provide long-term solutions to systemic breaches of utmost good faith committed over time.¹⁷
- 20 Given the public interest requirement that grounds ASIC's intervention under s 55A, it is likely that ASIC would only bring a representative action in the case of systemic breaches of the duty of utmost good faith, with individual transactions better pursued by the Financial Services Ombudsman or the Superannuation Complaints Tribunal. ASIC has not yet brought proceedings under the section, but the power to do so is nonetheless a significant addition to the enforcement remedies for breach by an insurer of the duty of good faith.¹⁸
- 21 Recently, in ASIC's report on the findings of its review, prompted in part by perceived culture problems of claims handling in the life insurance industry, ASIC stated that there is a policy reform initiative underway to enable ASIC to seek civil penalties where insurers have breached the duty of utmost good faith. Currently, other than bringing representative action under s 55A, an insurer's breach of the duty of utmost good faith only enlivens ASIC's

¹⁵ Under s 55A, ASIC may only bring a representative action where it is satisfied that the insured or any third party beneficiary under the contract has suffered damage or is likely to suffer damage because of a breach of the requirements of the Act, and ASIC has obtained the written consent of those on behalf of whom the action is being brought or continued.

¹⁶ *Matton Developments Pty Ltd v CGU Insurance Limited (No 2)* [2015] QSC 72 at [268] (Flanagan J).

¹⁷ Explanatory Memorandum to the *Insurance Contracts Amendment Act 2013* (Cth), at [1.6].

¹⁸ ASIC, *Report 498: Life insurance claims: An industry review* (October 2016, <http://www.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>) at [146].

licensing powers.¹⁹ ASIC also recommended that the exemption for “*handling insurance claims*” be removed from the conduct provisions of the Corporations legislation.²⁰ It is also worth noting that, in February this year, the *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* (Cth) came into force. That Act, which will take effect on 1 January 2018, amends the *Corporations Act 2001* (Cth) to remove the exemption from the ban on conflicted remuneration for life insurance providers, who often receive high up-front commissions which, according to the second reading speech, incentivises policy replacements where there is no consumer benefit.²¹

22 The other significant change to the duty of utmost good faith enacted in 2013, and one which goes not to enforcement but to the scope of the duty, is the extension of that duty to third party beneficiaries: s 13(3). Section 13(4) limits the duty of utmost good faith in relation to third party beneficiaries, by providing that it only applies after the contract is entered into. A “*third party beneficiary*” is defined in s 11 to mean a person who is not a party to the contract but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends.

23 A recent decision of the New South Wales Court of Appeal illustrates the practical significance of the 2013 extension to third parties, given current employment and executive salary packages. In *TAL Life Ltd v Shuetrim; MetLife Insurance Ltd v Shuetrim* [2016] NSWCA 68 (*TAL v Shuetrim*), Mr Shuetrim made claims for total and permanent disablement benefits (TPD benefits) under two insurance policies taken out by the Trustee of his superannuation. Those policies were issued by TAL Life and MetLife, who

¹⁹ ASIC, *Report 498: Life insurance claims: An industry review* (October 2016, <http://www.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>) at [368].

²⁰ ASIC, *Report 498: Life insurance claims: An industry review* (October 2016, <http://www.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>) at [48].

²¹ Second reading speech, *Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2017* (Cth).

were the appellants in the two proceedings which were heard together in the Court of Appeal. Mr Shuetrim was not a party to the contracts. The TPD clauses in the two policies were in similar terms.

- 24 After some delay, TAL and MetLife denied Mr Shuetrim's claims. The insurance policies in question were entered into prior to the 2013 amendment to the *Insurance Contracts Act*. Therefore, the Act only imposed obligations of utmost good faith upon the parties to the contract, here the insurer and the Trustee of the superannuation fund. In addition, the trust deed did not impose any obligations on the Trustee to form an opinion on the claim; if that were the case, Mr Shuetrim would more readily have been able to rely on the obligations owed by a Trustee to a beneficiary in equity and under statute.²²
- 25 In these circumstances, there were difficulties in identifying the duty that TAL and MetLife owed to Mr Shuetrim as a member of the superannuation fund.²³ There was a question as to whether Mr Shuetrim was himself entitled to directly enforce the policy, or whether the proper party was the Trustee in circumstances where the Trustee was the party entitled to payment pursuant to the policy. Mr Shuetrim's statement of claim did not grapple with any of these issues, and consequently neither did TAL or MetLife's defences.²⁴ This was perhaps not surprising given the complexity of the contractual arrangements, and in particular the interposition of the trust relationship between the insured and Mr Shuetrim.
- 26 In the result, it was not necessary for the Court to express a final view on the precise duty owed by either insurer to Mr Shuetrim. Nor was it necessary to express a final view on the nature of the right sought to be vindicated by Mr Shuetrim.²⁵ On the evidence, the Court of Appeal was not satisfied that he met the definition of total and permanent disablement in the insurance

²² At [50].

²³ At [47].

²⁴ At [47].

²⁵ At [58].

policies. This conclusion did not turn on the resolution of the challenging questions concerning third party beneficiaries.²⁶

27 Had the 2013 amendments been in force, Mr Shuetrim would have come within the statutory definition of third party beneficiary, as members of the superannuation fund were specifically referred to in the policy and accordingly would have had the benefit of the insurer's contractual duty of good faith.

28 There was another question that was more squarely in issue in the case, and which is worth mentioning briefly. The TPD clause in the relevant policies required Mr Shuetrim to provide "*proof to the satisfaction of*" the insurer that he met the definition of TPD. In other words, the clause required as a precondition to recovery that the insurer be satisfied that the insured qualified for the benefit.

29 Had the court determined that the insurer breached its duty of utmost good faith by unreasonably determining the claim against the insured, there would have been a very important question of what orders the court may make. Can the court determine whether the requisite state of affairs exists, and order payment of the sum which would have been payable had the insurer's opinion been duly formed?²⁷ Or should it remit the question to the insurers to determine in accordance with the duty of utmost good faith?²⁸

30 There is a line of authority that the court can and should determine the insured's entitlement to the benefit, rather than referring the matter back to the insurer. That line of authority commences with *Butcher v Port* (1985) 3 ANZ Ins Cas 60-638; 1 NZLR 491, and, in NSW, *Edwards v The Hunter Valley Co-op Dairy Co Ltd* (1992) 7 ANZ Ins Cas 61-113 (McLelland J). It has since been applied in intermediate appellate courts in NSW, Victoria, Queensland

²⁶ At [209].

²⁷ *McArthur v Mercantile Mutual Life Insurance Co Ltd* [2002] 2 Qd R 197 at [72].

²⁸ *TAL Life Ltd v Shuetrim; MetLife Insurance Ltd v Shuetrim* [2016] NSWCA 68 at [217] (Emmett AJA).

and Western Australia.²⁹ In *McArthur v Mercantile Mutual Life Insurance Co Ltd* [2002] 2 Qd R 197, a decision of the Queensland Court of Appeal, Muir J, with whom McMurdo P agreed, applied this line of authority with what his Honour described as “some misgivings”.³⁰ McPherson JA explained his doubts more fully, but ultimately followed that line of authority.³¹ In the 2015 NSW Court of Appeal decision of *Birdsall v Motor Trades Association of Australia Superannuation Fund Pty Ltd* [2015] NSWCA 104; 89 NSWLR 412, Basten JA echoed these misgivings. His Honour suggested that in the appropriate case this line of authority may need to be reconsidered.³²

31 TAL raised this issue in *TAL v Shuetrim*. However, because it had run its case at trial as if the court was able to determine the insured’s entitlement to the benefit, the Court held that TAL was not entitled to raise this argument on appeal.³³ Justice Leeming, with whom Emmett AJA and I agreed, also reviewed the authorities and concluded that, although the doubts expressed by McPherson and Basten JJA were not without force, TAL had not shown compelling reasons why the Court of Appeal should alter the existing state of the law which is presently settled throughout Australia and in the UK and has been applied on a number of occasions by first instance and intermediate appellate courts.³⁴

32 Thus, it remains the law in Australia that, where a clause in a policy of insurance requires the insurer to form an opinion as to the insured’s

²⁹ *TAL Life Ltd v Shuetrim; MetLife Insurance Ltd v Shuetrim* [2016] NSWCA 68 at [156]-[188]. See *Hannover Life Re of Australasia Ltd v Sayseng* [2005] NSWCA 214; 13 ANZ Ins Cas ¶90-123 at [47], [50]; *Birdsall v Motor Trades Association of Australia Superannuation Fund Pty Ltd* [2015] NSWCA 104; 89 NSWLR 412; *McArthur v Mercantile Mutual Life Insurance Co Ltd* [2002] 2 Qd R 197; *Beverley v Tyndall Life Insurance Co Ltd* [1999] WASCA 198; 21 WAR 327; *HCF Life Insurance Company Pty Ltd v Kelly* [2002] WASCA 264; *Hannover Life Re of Australasia Ltd v Colella* [2014] VSCA 205; 18 ANZ Ins Cas 62-036.

³⁰ At [72].

³¹ At [20].

³² At [25].

³³ At [164]-[167].

³⁴ At [168]-[188]. It is well-known that Intermediate appellate courts and trial judges in Australia should not depart from decisions in intermediate appellate courts in another jurisdiction unless they are convinced that the decision is plainly wrong: see *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; 230 CLR 89 at [135]

entitlement to a benefit, and the insurer unreasonably determines against the insured in breach of the duty of utmost good faith, the court has the power to determine whether the insured is entitled to the benefit under the policy and make orders accordingly.

Scope and content of the duty of utmost good faith

- 33 What then is the scope and content of the duty of utmost good faith as implied into insurance contracts following the enactment of the *Insurance Contracts Act*? By s 13 of the *Insurance Contracts Act*, the duty of utmost good faith applies to all matters arising under or in relation to the contract. The broad language of s 13 makes it clear that the duty applies in the formation stage of the contract³⁵ as much as when the contract is on foot. This conclusion is reinforced by s 13(4), which provides that the duty to third party beneficiaries only operates after the contract is entered into. Section 13(4) would have no work to do if the duty did not apply in the formation stage of the contract.
- 34 At the time of the enactment of the *Insurance Contracts Act*, there was “*some doubt*” as to whether the common law duty of utmost good faith extended to the determination and payment of claims.³⁶ Certainly there were no reported cases in Australia applying the duty of utmost good faith to the payment of claims.³⁷ Indeed, as indicated above, before the passage of the *Insurance Contracts Act*, there was no reported case in which the common law duty clearly operated to the benefit of the insured.³⁸ This was partly because the remedy of avoidance of the contract, which was the only remedy available, was of little use to an insured.

³⁵ *Camellia Properties Pty Ltd v Wesfarmers General Insurance Ltd* [2013] NSWSC 1975; (2014) 18 ANZ Ins Cas 62-000 at [109] (Sackar J). See Peter Mann, “The elusive second quadrant of utmost good faith: What is the scope of an insurer’s pre-contractual duty of utmost good faith?” (2016) 27 *Insurance Law Journal* 176.

³⁶ See *Camellia Properties Pty Ltd v Wesfarmers General Insurance Ltd* [2013] NSWSC 1975; (2014) 18 ANZ Ins Cas 62-000 at [107] (Sackar J).

³⁷ See *Camellia Properties Pty Ltd v Wesfarmers General Insurance Ltd* [2013] NSWSC 1975; (2014) 18 ANZ Ins Cas 62-000 at [107] (Sackar J).

³⁸ *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR 1 at [126] (Kirby J).

- 35 That position has been altered by the *Insurance Contracts Act*. Where the Act applies, the duty of utmost good faith may be invoked by the insured and there is little doubt that the duty applies to the determination and payment of claims. In *TAL v Shuetrim* the unreasonable determination of an insured's claim under the contract was considered, (*obiter*), to amount to a breach of duty, albeit that the Court considered it not to be relevant whether that be a breach of the duty of utmost good faith or of good faith and fair dealing.³⁹ In *Sudesh Sharma v Insurance Australia Limited t/as NRMA Insurance* [2017] NSWCA 55, McColl, Meagher and Payne JJA were also prepared to accept, *obiter*, that as an incident of the insurer's duty of good faith in that case, the insurer was obliged to determine a claim for indemnity in a timely manner and without due delay.⁴⁰
- 36 The duty also applies in respect of the pleading of defences to a claim for indemnity. In *Silbermann v CGU Insurance Ltd* (2003) 57 NSWLR 469; [2003] NSWCA 203, the insurer sought to rely upon an exclusion clause as a defence to a claim for indemnity by a director of a company which had gone into liquidation. Hodgson JA, with whom Tobias JA and I agreed in this respect,⁴¹ said at [51]:

“... the obligation of good faith means that the insurer can rely on any defence only if it has reasonable grounds to do so; and generally this would require legal advice given on the basis of full instructions as to facts and evidence known to the insurer.”

In *Ensham Resources Pty Limited v Aioi Insurance Company Limited* [2012] FCAFC 191; 209 FCR 1 at [68], Lander and Jagot JJ said that the obligation of utmost good faith “*continues to operate upon the party in any litigation arising under the contract of insurance*”.

³⁹ At [154]. At [113], Leeming JA expressed the view that the amendments to s 13 of the *Insurance Contracts Act* will heighten the duty to which an insurer is subject.

⁴⁰ At [109] citing *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR

1.

⁴¹ At [1], [78].

- 37 However, there is authority for the proposition that, once litigation has commenced, the duty of good faith is superseded or exhausted by the rules of litigation.⁴² This is not inconsistent with what was said in *Silbermann and Ensham*. The better view, or at least a better expression of the position, is that the duty continues to exist, but its content will depend on the particular circumstances of the case, including the proper application of the rules of litigation.⁴³
- 38 Thus, in *Wiltrading (WA) Pty Ltd v Lumley General Insurance Ltd* [2005] WASCA 106; 30 WAR 290, a case concerning s 23 of the *Marine Insurance Act*, which provided that a contract of marine insurance was a contract based upon the utmost good faith, Steytler P, McLure JA agreeing, held that the duty of good faith did not preclude the insurer from amending its defence to allege that the insured had breached a warranty under the policy, in circumstances where the insurer had up until that time conducted its defence without taking the breach of warranty point. In other words, the duty of good faith did not prevent the insurer from changing its position in the litigation so as to raise a legitimate defence in circumstances where the amendment was permissible under the applicable rules of Court.

Content of the duty of utmost good faith

- 39 In *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* [2005] FCAFC 185; 146 FCR 447, Emmett J, with whom Moore J agreed, said that the concept of utmost good faith, in the context of insurance, “*encompasses notions of fairness, reasonableness and community standards of decency and fair dealing*”, and that dishonesty was not a prerequisite for a breach of the duty: at [89].

⁴² *Wiltrading (WA) Pty Ltd v Lumley General Insurance Ltd* [2005] WASCA 106; 30 WAR 290 at [75] (Steytler P); *Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd (The "Star Sea")* [2003] 1 AC 469; *Agapitos v Agnew* [2003] QB 556; W I B Enright, R M Merkin, *Sutton on Insurance* (4th Edition, 2015, Thomson Reuters) at [6.190].

⁴³ See *Wiltrading (WA) Pty Ltd v Lumley General Insurance Ltd* [2005] WASCA 106; 30 WAR 290 at [75] (Steytler P).

- 40 The decision of the High Court on appeal from the Full Court’s decision is the leading case on the meaning of “*utmost good faith*”: *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR 1 (*CGU v AMP*).⁴⁴ The High Court delivered a number of separate judgments in that case. Importantly, a common position in the judgments was that lack of utmost good faith is not to be equated with dishonesty only; in other words, one need not prove dishonesty to establish a breach of the duty of utmost good faith.
- 41 Gleeson CJ and Crennan J said at [15]:
- “... an insurer’s obligation to act with utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured. Such an obligation may well affect the conduct of an insurer in making a timely response to a claim for indemnity.”
- 42 Justice Kirby, at [139], endorsed the “*broad view*” taken by the Full Court, stating that it “*sets the correct, desirable and lawful standard for the efficient, reasonably prompt, candid and business-like processing of claims for insurance indemnity in this country*”. His Honour identified dishonesty, caprice and unreasonableness as touchstones for a breach of the duty of utmost good faith: at [131]. His Honour also said, at [176]:
- “... emphasis must be placed on the word ‘utmost’. The exhibition of good faith alone is not sufficient. It must be good faith in its *utmost* quality.” (footnotes omitted, emphasis in original)
- 43 As to the outer limits of the content of the duty of utmost good faith, Kirby J said at [72] that an insurer, acting in good faith, can “*put the insured to proof where it rejects a claim, where it is suspicious about it or where it has bona fide reservations concerning its obligations to indemnify the insured*”.⁴⁵ It has also been said that the duty of utmost good faith does not require a party to

⁴⁴ *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR 1 (*CGU v AMP*).

⁴⁵ See also *Allianz Australia Insurance Ltd v BlueScope Steel Ltd* [2014] NSWCA 276 at [271] (Ward JA).

surrender any commercial advantage of which they may seek to take advantage during negotiations.⁴⁶

44 Callinan and Heydon JJ said, at [257]:

“Utmost good faith will usually require something more than passivity: it will usually require affirmative or positive action on the part of a person owing a duty of it.”

45 Their Honours then noted:

“It is not necessary, however, for the purposes of this case, to attempt any comprehensive definition of the duty, or to canvass the ranges of conduct which might fall within, or outside s 13 of the Insurance Act.”

46 The duty of utmost good faith is a reciprocal duty. It follows that the standard by which conduct is adjudged should be the same for insured and insurer. In *Camellia Properties Pty Ltd v Wesfarmers General Insurance Ltd* (2014) 18 ANZ Ins Cas 62-000; [2013] NSWSC 1975 at [118], Sackar J said:

“... some of the decided cases indicate that a less stringent standard of conduct applies to an insured (only honesty is required) as opposed to an insurer (reasonable conduct is required). ... It is difficult to find a basis for that distinction either in the language of s 13 or in High Court authority.”

Thus, his Honour noted that some cases suggest that honesty on the part of the insured is not always sufficient, and that an insured is required, as a manifestation of the principle of utmost good faith, to take reasonable steps to reduce or minimise the liability of the insurer.

47 It is perhaps unsurprising that the content of the duty of utmost good faith has not received comprehensive judicial elaboration since the enactment of the *Insurance Contracts Act* or, indeed, since *Carter v Boehm* was decided 250 years ago. The concept of utmost good faith is an evaluative concept

⁴⁶ *Allianz Australia Insurance Limited v Anthony Vitale and Anor* [2014] NSWSC 364 at [125] (Sackar J), citing *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 and *Camellia Properties v Wesfarmers General Insurance Ltd* [2013] NSWSC 1975; *Matton Developments Pty Ltd v CGU Insurance Limited (No 2)* [2015] QSC 72 at [247] (Flanagan J).

operating in a particular context. The context is one of risk. The nature of the risk will be as various as the types of insurance cover and the nature and extent of the cover. Stated simply, risk will be of a different order depending on whether one is looking at household insurance, life insurance, freight shipping insurance, officers and directors' policies, or public liability insurance, in respect of which claims can be massive.

48 For that reason the concept of utmost good faith is best articulated in general terms, as it was in *CGU v AMP*, so as to be adaptable to a specific context. Formulations such as “*decency and fairness*”, “*reasonableness*” and “*due regard to the interests of the insured*” are well understood evaluative concepts in commerce and in law as much as in everyday parlance and leave room for flexible application to the particular facts of the case.

49 Indeed, Brenda McGivern has described the duty as responsive and overtly normative, rather than prescriptive, in nature.⁴⁷ Having said that, McGivern sees a tension between responsiveness and predictability or certainty in the operation of a legal duty. McGivern draws a comparison with the development of the law on duty of care in negligence, noting that the “*salient features*” approach to determining whether a duty arises in any given case led to the emergence of “*a collection of factors that, taken together and considered alongside recognised categories, give shape and greater predictability to the demands of the duty of care*”.⁴⁸ Those salient features were set out by Allsop P in *Caltex Refineries (Qld) Pty Limited v Stavar* [2009] NSWCA 258; 75 NSWLR 649.⁴⁹ They included, with appropriate adaption, “(a) the foreseeability of harm; (b) the nature of the harm alleged; (c) the degree and nature of control able to be exercised by the defendant to avoid harm; (d) the degree of vulnerability of the plaintiff to harm from the

⁴⁷ Brenda McGivern, “A tale of two duties: Utmost good faith and reasonable care” (2016) 27 *Insurance Law Journal* 261 at 265.

⁴⁸ Brenda McGivern, “A tale of two duties: Utmost good faith and reasonable care” (2016) 27 *Insurance Law Journal* 261 at 270.

⁴⁹ At [101].

defendant's conduct, including the capacity and reasonable expectation of a plaintiff to take steps to protect itself; (e) the degree of reliance by the plaintiff upon the defendant; (f) any assumption of responsibility by the defendant; [and] (i) the nature of the activity undertaken ...”.

- 50 McGivern suggests a similar approach in relation to the content of the duty of utmost good faith. In particular, she suggests that relative vulnerability and control of the parties, norms of conduct in the insurance industry, and possible impact on commercial freedom are significant factors that inform the content and scope of the duty of utmost good faith in a given context. Indeed, she notes that considerations of the vulnerability of the insurer to deficient disclosure by the insured were at the forefront of Lord Mansfield's formulation of the concept of utmost good faith in *Carter v Boehm*.
- 51 Whilst the search for parameters in which to determine the content, and therefore whether there has been a breach of, the duty of good faith, is understandable and may provide structure and certainty to the inquiry, and may assume significance should the resolution of insurance claims enter the not so futuristic world of the Artificially Intelligent decision maker, the non-prescriptive approach taken by the High Court in *CGU v AMP* is unlikely to be overruled whilst ever there is a human making the “*judgment call*”. In the meantime, the inner and outer limits of the content of the duty of utmost good faith in its statutory form awaits further judicial determination. *CGU Insurance Limited v AMP Financial Planning Pty Ltd* [2007] HCA 36; 235 CLR 1 will remain a, and probably the, first port of call.
- 52 A question of interest is the extent to which the substantial body of common law which developed prior to the enactment of the *Insurance Contracts Act 1984* will remain relevant. I would suggest caution in referring to those decisions. Much has been written about the historical context in which the duty of utmost good faith developed. It was well described by Cory J of the

Supreme Court of Canada, in his Honour's judgment in *Coronation Insurance Co v Taku Air Transport Ltd* [1991] 3 SCR 622:

"When Lord Mansfield set the principle governing insurance contracts the world was a little different. It was a simpler if not, in some respects, a gentler place. The business of insurance was very different. Then policies of insurance were issued most frequently to cover a vessel, or its cargo. The contract was issued for the benefit of the insured. It was the owner as insured who would have the detailed knowledge of the vessel or its cargo. No one would know better than the owner of the incipient dry rot or the tendency of the ship to take on water in a fresh breeze. This was knowledge that the insurance company could not readily attain and it was appropriate to relieve the insurer of all responsibility for obtaining it."

- 53 The characteristics and surrounding circumstances of the life insurance policy entered into by the trustee of Mr Shuetrim's superannuation fund in *TAL Life v Shuetrim*, where Mr Shuetrim's insurance cover was in a superannuation deed with the trustee being the insured, are profoundly different to the insurance policies described by Cory J. The scale of the insurance market, the diversity of insurance products, and the sophistication of insurers has increased dramatically in the past 250 years. The relationship between Mr Shuetrim and the insurer makes the point. The relationship in that case may well have been characterised by an asymmetry of information, with the insurer possessing a detailed knowledge of the policy not shared by Mr Shuetrim. The policy in that case was broad in scope, applying to numerous insureds and indeed the policy did not make mention of specific beneficiaries but rather a class of beneficiaries. Moreover, there was a trust structure interposed in the insurance relationship, such that Mr Shuetrim himself who was not a party to the contract of insurance itself.
- 54 It is true that the essence of Lord Mansfield's seminal speech in *Carter v Boehm* remains the bedrock of the contractual duty of utmost good faith. However, the common law duty of utmost good faith focussed on pre-contractual disclosure. Under the statutory scheme, that is a separate duty. Should there ever have been a doubt, the duty of utmost good faith is one owed by both insurer and insured, with significant implications for the conduct

of the insurer. There is a consumer protection rationale to this shift.⁵⁰ The content of the duty of utmost good faith must be understood in this light. Statute has intervened. Fair dealing and decency is a centrepiece of the insurance market.

Insured's duty of disclosure

55 Let me turn to the insured's duty of disclosure. As I have noted, at common law the insured's duty of disclosure was an aspect of the duty of utmost good faith. Indeed, pre-contractual disclosure was the driving force behind the early development of the duty of utmost good faith.

56 The *Insurance Contracts Act* split up the duty of utmost good faith and the duty of disclosure. The insured's duty of disclosure is now covered by Part IV of the Act. What is immediately apparent is the detailed nature of Part IV of the *Insurance Contracts Act*. Indeed, in *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606 at 615 the majority of the High Court (Mason CJ, Dawson, Toohey and Gaudron JJ) held that Part IV is a statutory code which replaces the common law on non-disclosure, misrepresentation and incorrect statements by insured persons before entry into a contract.⁵¹ Accordingly, the circumstances in which it is legitimate to resort to the antecedent common law for the purpose of interpreting the statute are extremely limited.⁵²

57 The key provision is s 21, which imposes on the insured a duty to disclose every matter that is known to the insured and that the insured knows to be relevant to the decision of the insurer whether to accept the risk and on what terms, or that a reasonable person in the circumstances could be expected to

⁵⁰ See Explanatory Memorandum to the *Insurance Contracts Amendment Act 2013* (Cth), at [2.14]; *Matton Developments Pty Ltd v CGU Insurance Limited (No 2)* [2015] QSC 72 at [241] (Flanagan J).

⁵¹ *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606 at 615 (Mason CJ, Dawson, Toohey and Gaudron JJ).

⁵² *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1989) 166 CLR 606 at 615, citing *Gamer's Motor Centre (Newcastle) Pty Ltd v Natwest Wholesale Aust Pty Ltd* (1987) 163 CLR 236 at 243-244

so know. It also sets out some exceptions or limitations to this general duty. As regards remedies for breach, the key provision is s 28, which ameliorates the harsh common law position where an insurer was entitled to avoid a contract in the event of a non-disclosure or misrepresentation which affected the insurer's underwriting decision.⁵³

- 58 Under s 28, an insurer can only avoid a contract for fraudulent misrepresentation or non-disclosure, but can otherwise reduce its liability under the contract to reflect the position in which the insurer would have been in had the non-disclosure or misrepresentation not occurred. It is well-settled that the insurer can, in appropriate cases, reduce its liability to nil. Section 12 of the *Insurance Contracts Act* provides that, while the duty of utmost good faith is an overriding duty, it does not impose, in relation to the insured's duty of disclosure, any duty other than the duty of disclosure contained in Part IV.
- 59 The statutory duty of disclosure came under consideration in *Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited* [2017] NSWCA 71 (*Stealth Enterprises v Calliden*). That decision dealt with Part IV of the Act as it applied before the 2013 amendments. I will come back to these amendments later.
- 60 The outcome in *Stealth Enterprises v Calliden* illustrates the shift in the law of pre-contractual disclosure towards protection of the consumer. It also illustrates one of the inevitable outcomes where legislation applies in broad terms, as does the *Insurance Contracts Act*. The Act applies to all consumers, some of whom may not need the protection that it affords. That is not a criticism of the Act. But the reality is that in Australia, as elsewhere, it is well known that significant commercial activity is conducted by persons associated with criminal and/or antisocial groups. The principals in those groups are rarely commercially naïve.

⁵³ Remedies in relation to life insurance policies are governed by s 29.

- 61 There is a question whether those carrying on business activities, such as brothels, some security businesses and some nightclubs, are justified in standing anonymously behind a corporate structure. The use of corporate vehicles with separate legal personality is a central tenet of doing business and, indeed, apportioning risk in the Australian economy. So the answer may well be the rhetorical, “*why not?*”, provided the business is legal and carried on within the boundaries of the law. The flip side of the question is whether actual or even possible associations with individuals or groups with known criminal backgrounds or associations should be considered of significant concern to the insurer such that persons seeking insurance should have the obligation to disclose the association or even to make reasonable enquiries as to whether there are such associations.
- 62 In the particular circumstances of *Stealth Enterprises v Calliden*, the Court of Appeal held that the failure to disclose an association with the Comancheros bikie group did not entitle the insurer to avoid indemnifying the insured under the policy. The facts were as follows. Stealth Enterprises, who was the appellant in those proceedings, owned and operated a brothel from premises in the ACT. Calliden Insurance was the respondent insurer, who had insured the premises against property damage and public and product liability. The coverage was under the insurer’s “*Adult Industry Insurance Policy*”, which was marketed to the owners and operators of brothels. Stealth Enterprises’ premises were damaged by fire, and Stealth Enterprises made a claim under the insurance policy.
- 63 The insurer denied liability on the basis that Stealth Enterprises had failed to comply with its duty of disclosure under s 21 of the *Insurance Contracts Act*. There were two non-disclosures in issue. The first was that Stealth Enterprises had failed to disclose that the company’s manager and sole director were members of the Comancheros bikie gang. The second was that Stealth Enterprises had failed to disclose that the brothel’s registration had lapsed due to failure to lodge an annual notice. These non-disclosures were

not alleged to have been fraudulent such that the insurer could avoid the contract pursuant to s 28(2) of the *Insurance Contracts Act*. Accordingly, the insurer sought to reduce its liability to nil pursuant to s 28(3).

64 The insurer was successful at first instance, but not on appeal. There are four aspects of the Court of Appeal's reasoning that are of importance.

65 First, section 21 asks what the insured knew was relevant, or what a reasonable person in the circumstances could be expected to know was relevant.⁵⁴ This replaces the common law test of "materiality" as assessed by reference to the common law construct of the "prudent insurer".⁵⁵ Early in the life of the *Insurance Contracts Act*, there was some suggestion that the common law concepts of "materiality" and the "prudent insurer" were incorporated into the question of whether a matter was "relevant" for the purposes of s 21.⁵⁶ It is now accepted that these common law concepts should not be imported into the application of the *Insurance Contracts Act*.⁵⁷ The shift in focus from the insurer to the insured reflects the consumer protection rationale behind the Act, and is an attempt to strike a fairer balance between protecting insurers from assessing risk on incomplete information and protecting insureds from being left without cover.⁵⁸

66 In *Stealth Enterprises v Calliden*, the insured did not dispute the primary judge's findings that the matter of the association with the Comancheros was

⁵⁴ The position appears to be that s 21 does not require the disclosure of matters which might be taken into account but ultimately discarded as not affecting the underwriting decision: *Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited* [2017] NSWCA 71 at [31] (Meagher JA).

⁵⁵ *CGU Insurance Limited v Porthouse* [2008] HCA 30; 235 CLR 103 at [51]-[52] (*per curiam*).

⁵⁶ In *Ayoub v Lombard Insurance Co (Aust) Pty Ltd* (1989) 97 FLR 284, Rogers CJ at Common Law said that, in determining what facts were "relevant" within the meaning of s 21, the old test of materiality was to be applied and what is relevant to the decision of the insurer is determined having regard to a prudent insurer acting reasonably: at 296.

⁵⁷ *CGU Insurance Limited v Porthouse* [2008] HCA 30; 235 CLR 103 at [51]-[52] (*per curiam*). In *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* [2003] HCA 25; 214 CLR 514, Gummow and Hayne JJ said, at [70]: "Under the Act, attention is shifted from the prudent insurer to the particular insurer. It is that insurer's decision which, as we have said, is the fulcrum about which the section turns."

⁵⁸ *CGU Insurance Limited v Porthouse* [2008] HCA 30; 235 CLR 103 at [53] (*per curiam*).

“*relevant*” to the insurer’s decision to accept the risk within the meaning of s 21.⁵⁹ However, the question of whether the matter was “*relevant*” to Calliden Insurance is distinct from the question whether Stealth Enterprises knew or a reasonable person in the circumstances could be expected to know that it was relevant to the insurer’s decision to accept the risk.⁶⁰ It is the latter question, which focusses not on the mind of the insurer but rather on what the insured knew or could be expected to know, that must be answered for the purposes of s 21.

67 Secondly, the subject matter and scope of the insurer’s questions to the insured will be important to the assessment of whether a reasonable insured could be expected to know that a matter was relevant to the insurer. Meagher JA said:

“There were no questions in the proposal directed to the identity of associates of the insured or its directors. Instead the proposal focussed on whether the owner, or directors of a corporate owner, had been charged with or convicted of any criminal offence in the last five years. **If it was relevant to the insurer to know of the fact of any general association between the insured or its directors and any particular activity or organisation, a reasonable person might reasonably have expected that there would have been questions addressed to that subject.**”⁶¹ (emphasis added)

68 In addition, Meagher JA and Sackville AJA noted that a reasonable person would take into account that the insurer’s business model was to target “adult industries”, including brothels.⁶² Given this insurer’s familiarity with the risks associated with the adult industry, an insured could reasonably expect it to know of dangers associated with the use of premises as a brothel, including arson, standover tactics, fights and dissatisfied customers, and that people with criminal connections, including members of bkie gangs, were likely to be involved in the use of the premises.⁶³ Accordingly, the Court of Appeal held that an insured could not be expected to know that the matter of the

⁵⁹ At [34].

⁶⁰ At [34], [50] per Meagher JA.

⁶¹ At [53].

⁶² At [52], [81].

⁶³ At [52].

association with the Comancheros would justify any different and more adverse underwriting assessment.⁶⁴

- 69 In reaching this conclusion, Ward JA said that she had “*had some hesitation*” and Sackville AJA said that, “[*a*]t first blush this may seem a surprising conclusion”.⁶⁵ However, the Court made it clear that the outcome depended on the particular circumstances of the case, including the fact that the policy was targeted at brothels and the insurer specialised in this industry, and the absence of any inquiry on the part of the insurer as to any association with outlaw motorcycle gangs.
- 70 Thirdly, s 21 directs the inquiry to what the insured *knows*. There are two levels to this inquiry. The first level is whether the matter in question was known to the insured. In *ABN AMRO Bank NV v Bathurst Regional Council* [2014] FCAFC 65; 224 FCR 1 Jacobson, Gilmour and Gordon JJ said that, without actual knowledge of a matter, there can be no breach of the insured’s duty of disclosure.⁶⁶ The term “*actual knowledge*” is not used in s 21. Their Honours reviewed the relevant authorities to conclude that s 21 does not permit an inquiry into whether the insured *ought* to have known a matter.⁶⁷
- 71 The use of the terminology of “*actual knowledge*” has not been without judicial criticism. In *Commercial Union Assurance Co of Australia Ltd v Beard* (1999) 47 NSWLR 735; [1999] NSWCA 422, Davies AJA, Meagher JA and Foster AJA agreeing said that the terms “*known*” and “*knows*” are used in their common law sense and “*it would be wrong to import the word ‘actually’ into a provision such as s 21*”.⁶⁸ However, in *GIO General Limited v Wallace* [2001] NSWCA 299; (2001) ANZ Ins Cas 61-506, Heydon JA, Priestley and

⁶⁴ At [55].

⁶⁵ At [77], [81].

⁶⁶ At [1685]-[1686].

⁶⁷ At [1677]-[1686].

⁶⁸ At [37].

Hodgson JJA agreeing, said that if the primary judge erred in adding the word “*actual*” it was a “*harmless error*”.⁶⁹

72 The second level of the inquiry is whether the insured knew or a reasonable person in the circumstances could be expected to know that the matter was relevant to the insurer’s decision to accept the risk. In *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* [2003] HCA 25; 214 CLR 514, McHugh, Kirby and Callinan JJ said:

“The word ‘knows’ is a strong word. It means considerably more than ‘believes’ or ‘suspects’ or even ‘strongly suspects’.”⁷⁰

In *Stealth Enterprises v Calliden*, Meagher JA said that it is not enough to show that a reasonable person could be expected merely to have a suspicion that the information might be relevant to the insurer’s decision.⁷¹

The insurer must prove actual knowledge of the matter, and actual or constructive knowledge of its relevance.⁷²

73 The fourth matter relates to the remedies for breach of the insured’s duty of disclosure. At this stage, the inquiry shifts to what the insurer would have done had the matter been disclosed. The insurer faces a challenging evidentiary hurdle in this respect. When an insurer relies on s 28(3) of the *Insurance Contracts Act* to reduce its liability in respect of a claim which it says is affected by non-disclosure or misrepresentation, it must prove, on the balance of probabilities, that the position would have been different had the disclosure been made or misrepresentation not made.⁷³ If the insurer wishes to reduce its liability to nil, it must establish that it would not have issued any

⁶⁹ For further discussion, see Rob Merkin QC, “What does an assured ‘know’ for the purpose of pre-contractual disclosure?” (2016) 27 *Insurance Law Journal* 157.

⁷⁰ At [30].

⁷¹ At [35]-[54].

⁷² *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* [2003] HCA 25; 214 CLR 514 at [30] (McHugh, Kirby and Callinan JJ).

⁷³ *Prepaid Services Pty Ltd & Ors v Atradius Credit Insurance NV* [2013] NSWCA 252; (2013) 302 ALR 732 at [71] (Meagher JA, Macfarlan and Emmett JJA agreeing).

policy to the insureds which would have covered the claim the subject of the dispute. The reason that this is a challenging evidentiary hurdle is that “*the hypothesis upon which the reduction of liability is based is not an historical fact*”.⁷⁴

74 In *Stealth Enterprises v Calliden*, the insurer gave evidence, through two senior underwriters employed by the insurer, that it would not have accepted the risk if the fact of the association with the Comancheros was disclosed. This evidence was accepted at first instance but called into question on appeal. The underwriter gave no contemporaneous documentary evidence, such as file notes, memos, letters, reports or internal guidelines, which supported her evidence that there was concern about association with motorcycle gangs.⁷⁵

75 Justice Sackville, with whom Meagher and Ward JJA agreed, warned of the dangers of evidence as to likely conduct in hypothetical situations where the evidence is given through the “*prism of hindsight*”.⁷⁶ His Honour said that “[e]vidence of this kind needs to be assessed not simply on the basis of the credit of the witness but also by reference to the objective probabilities”.

76 The insurer also had evidentiary problems in relation to the second non-disclosure, which related to Stealth Enterprises’ lapsed registration as a brothel. The insurer’s underwriter gave evidence that it would not have renewed the policy had it been aware of the fact of Stealth Enterprises’ lapsed registration.⁷⁷ However, Stealth Enterprises contended that, had it disclosed the failure to register, the insurer would have raised this as an issue, and Stealth Enterprises would have attended to registration and procured

⁷⁴ *Prepaid Services Pty Ltd & Ors v Atradius Credit Insurance NV* [2013] NSWCA 252; (2013) 302 ALR 732 at [71] (Meagher JA, Macfarlan and Emmett JJA agreeing).

⁷⁵ At [86]-[88].

⁷⁶ At [87].

⁷⁷ At [68].

insurance thereafter, such that the insurer would have been on risk regardless of whether the failure to register was disclosed or not.⁷⁸

77 Stealth Enterprises did not adduce any evidence in support of the proposition that it would have attended to registration. Accordingly, the primary judge held that it was not open to infer that Stealth Enterprises would have done so. The Court of Appeal held that this was erroneous, because Stealth Enterprises did not bear any legal or evidentiary onus of establishing what the insurer's position would have been if the lapse of registration was disclosed.⁷⁹ Instead, the Court of Appeal held that there was evidence from which the Court might reasonably and sensibly infer that, had there been disclosure, the insurer would have been on risk at the time of the fire because Stealth Enterprises would have remedied the problem of its registration.⁸⁰ At the least, it was not open to conclude otherwise.⁸¹

78 Accordingly, the insurer failed to prove that, had Stealth Enterprise disclosed that the brothel's registration had lapsed, the insurer would not have been on risk at the time of the fire. This quite clearly demonstrates the difficulties for insurers in proving a hypothetical scenario. The outcome would almost certainly have been different under the common law.

79 In the result, the insurer was ordered to pay Stealth Enterprises an amount representing the value of its claim under the insurance policy.⁸²

80 I have said that Part IV of the Act is a code, which replaces the common law. That does not deny that the fundamental concept of pre-contractual disclosure continues to be a defining feature of Australian consumer law. The *Insurance Contracts Amendment Act 2013* (Cth) introduced a number a changes to the duty of disclosure, which came into effect on 28 December 2015. One

⁷⁸ At [67].

⁷⁹ At [70].

⁸⁰ At [72].

⁸¹ At [72].

⁸² On 14 September 2017, the High Court dismissed the insurer's special leave application.

change was to include two non-exhaustive factors to be considered in determining whether a reasonable person in the circumstances could be expected to know that a matter was relevant to the decision of the insurer to accept the risk and on what terms. Those factors are the nature and extent of the insurance cover to be provided and the class of persons who would ordinarily be expected to apply for insurance cover of that kind: ss 21(1)(b)(i) and (ii).

81 The Explanatory Memorandum to the 2013 Amendment notes that consideration was given to the abolition of the duty of disclosure in favour of a requirement to answer specific questions honestly and fully. The perceived advantage of abolishing the duty of disclosure was that it would lead to fewer disputes in that the field of inquiry would be limited to the answers given to questions posed by the insurer, and would alleviate the current obligation on the part of the insured to consider what matters are “*relevant*” to the insurer. While this option was favoured by some stakeholders, it was rejected because of the risk that it would prove impractical, particularly in the context of large commercial insurance where insurers would be required to construct lengthy and complex specific questions to ensure that all relevant information was obtained.⁸³ There was also concern that this could prove to be burdensome to insureds if they are required to answer these extensive questions.

82 There are also inherent difficulties with the concept of “*relevance*” as that term is used in s 21 of the *Insurance Contracts Act*. There is no formula for what will be relevant to an insurer, and this is particularly so where insurance markets, the nature of insurance products and the risks to which they are directed are rapidly changing. Pre-contractual disclosure is about enabling insurers to accurately assess and quantify the particular risk to which the insurance product is directed. In emerging areas of insurance, the insurers themselves may not know what is relevant, and certainly the consumer may

⁸³ Explanatory Memorandum to the *Insurance Contracts Amendment Act 2013* (Cth), at pp. 70-72.

have difficulty. One example is insuring against cybersecurity risk.⁸⁴ It is difficult to define and understand the nature of cybersecurity risk and the matters that are relevant to the assessment of that risk, particularly in circumstances where methods of hacking and understandings of what amounts to adequate cybersecurity protection are rapidly changing.

83 I raise these points because, in 2012, the United Kingdom adopted the pathway that was eventually rejected by the Australian Parliament when the duty of disclosure was abolished in favour of a duty to answer express questions honestly and with reasonable care in relation to consumer insurance contracts: *Consumer Insurance (Disclosure and Representations) Act 2012* (UK), s 2. It is too early to see what impact that has had on the industry in general and insurance litigation in particular.

Principles governing the interpretation of insurance contracts

84 The primary duty of the court is to uphold the contract between the parties as properly construed.⁸⁵ I wish to reiterate some of the fundamental principles guiding the construction of insurance contracts. These were recently summarised by Allsop CJ and Gleeson J in *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)* [2016] FCAFC 15; 239 FCR 12.⁸⁶

“... the policy is to be given a businesslike interpretation, paying attention to the language used by the parties in its ordinary meaning, and to the commercial, and where relevant, the social purpose and object of the contract, in the context of the surrounding circumstances, including the market or commercial context in which the parties are operating, by assessing

⁸⁴ See KPMG, *General Insurance Industry Review 2016* (October 2016, <https://home.kpmg.com/content/dam/kpmg/au/pdf/2016/general-insurance-industry-review-2016.pdf>).

⁸⁵ *McCann v Switzerland Insurance* [2000] HCA 65; 203 CLR 579 at [74] (Kirby J); *Cody v J H Nelson Pty Ltd* (1947) 74 CLR 629 at 639 (Starke J); *Visy Paper Pty Ltd v Glass Granulates Pty Ltd* [2014] NSWSC 1387 at [38], [49] (Sackar J).

⁸⁶ Chief Justice Gleeson’s statement in *McCann v Switzerland Insurance* [2000] HCA 65; 203 CLR 579 at [22] is often cited: “A policy of insurance, even one required by statute, is a commercial contract and should be given a businesslike interpretation. Interpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure.”

how a reasonable person in the position of the parties would have understood the language. Preference is to be given to a construction supplying a congruent operation to the various components of the whole.”⁸⁷

- 85 Insurance contracts are commercial contracts, and so the principles of construction of commercial contracts apply.⁸⁸ There are, however, some characteristics of insurance contracts which bear on their interpretation. In the above extract, Allsop CJ and Gleeson J make reference to the “*social purpose and object of the contract*”. A contract of insurance has the object or purpose of sharing the risk of, or spreading the loss from, a contingency and thus can be said to have a “*social purpose*” in the sense that it will form part of the organisation of society through the rights and obligations created in it.⁸⁹
- 86 The language of “*social purpose*” as a concept in the construction of insurance contracts reflects what underpins the purpose of insurance law. As I observed at the outset, the spreading of risk has been central to economic and social activity for centuries.
- 87 The recent decision in *Chubb Insurance Company of Australia Ltd v Robinson* (2016) 239 FCR 300; [2016] FCAFC 17 (*Chubb Insurance*), clarified two matters in respect of the construction of exclusion clauses. The first is that there is no general rule that an exclusion clause in a policy is construed so as to carve out an area of cover that maps cleanly to the insuring clause in another insurance policy; for example, the scope of a professional liability exclusion clause need not be interpreted to fit neatly with scope of a

⁸⁷ At [42].

⁸⁸ *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)* [2016] FCAFC 15; 239 FCR 12 at [42] (Allsop CJ and Gleeson J). The settled position in New South Wales is that the identification of ambiguity is not a precondition to examining legitimate surrounding circumstances: *Newey v Westpac Banking Corporation* [2014] NSWCA 319 at [17], [23] and [86] citing *Franklins Pty Ltd v Metcash Trading Ltd* (2009) 76 NSWLR 603 at [14]-[18] and [305]; *Mainteck Services Pty Ltd v Stein Heurtey SA* (2014) 89 NSWLR 633 at [72]-[86] citing *Woodside Energy Ltd v Electricity Generation Corporation* [2014] HCA 7; 251 CLR 640 at [35] (French CJ, Hayne, Crennan and Kiefel JJ) and *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104. See also *Chubb Insurance Company of Australia Ltd v Robinson* (2016) 239 FCR 300; [2016] FCAFC 17 at [103]-[104].

⁸⁹ *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)* [2016] FCAFC 15; 239 FCR 12 at [38], [44] (Allsop CJ and Gleeson J).

professional indemnity insurance policy. The second is that the *contra proferentum* principle is a rule of last resort, to be used only in the event of unresolvable ambiguity.

- 88 The insurance policy the subject of the dispute in *Chubb Insurance* was a directors and officers (D&O) policy, which provided broad cover in respect of wrongful acts or omissions committed by executives while acting in their capacity as executives. It contained an exclusion clause in respect of professional services, which excluded any loss which was occasioned by an act or omission “*in the rendering of [...] any professional services to a third party*”. Reed Constructions Australia Pty Limited (Reed), a building contractor, was the insured under the policy, and the appellant, Chubb Insurance Company of Australia Ltd (Chubb), was the insurer. Reed’s business was the construction of medium to large buildings and other construction projects.
- 89 Reed entered into a design and construct contract with a third party in respect of a development in St Kilda. Under that contract, one of Reed’s executives was required to swear a statutory declaration in support of progress claims submitted to the third party. The respondent to the appeal, Mr Robinson, made a statutory declaration in support of one of Reed’s progress claims. At the time, Mr Robinson was the Chief Operating Officer of Reed and accordingly he was an officer for the purposes of the D&O policy. Reed went into liquidation, and the third party brought proceedings against Mr Robinson, claiming that Reed was not lawfully entitled to the progress claim. Mr Robinson denied liability, but brought a cross-claim against Chubb seeking indemnity from Chubb in respect of any liability which he might ultimately be found to have to the third party.
- 90 The issue was whether Mr Robinson’s conduct in making the statutory declaration fell within the professional services exclusion clause in the policy.

91 Chubb submitted that the exclusion of loss in respect of professional services should be interpreted consistently with the insuring clauses in professional indemnity insurance policies.⁹⁰ Its argument was that the professional indemnity carve out was intended to fit neatly with the commonly understood scope of cover usually provided in professional indemnity policies. The Full Court rejected this approach. It held that other policies, such as the professional indemnity policy held by Reed or a typical policy in the market, were of no relevance to construing the D&O policy under examination.⁹¹ The Full Court did suggest that if Reed had taken out a professional indemnity policy with Chubb, then the scope of that cover might have been relevant to the interpretation of the exclusion clause.⁹² Ultimately, the primary duty of the court is to construe the clause according to the principles outlined above, not by reference to external texts. The Court concluded:

“We do not agree that, in every case, the scope of an exclusion in respect of professional services in a D&O policy must correspond with the scope of cover provided by the commonly used insuring clause in policies which provide professional indemnity cover. That is far too general a statement and ignores the importance of the principles explained by the High Court in [*Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500] and in [*Selected Seeds Pty Ltd v QBEMM Pty Ltd* (2010) 242 CLR 336].”⁹³

92 One consequence of this position is that insurers and insureds should not assume that separate policies do not overlap. Insureds should also be careful not to assume that a particular risk will come within a suite of policies and not “*slip between the cracks*”.

93 Chubb also submitted that the primary judge erred by applying the *contra proferentem* rule to the exclusion clause where no ambiguity had been demonstrated.⁹⁴ It said that her Honour applied the rule as a first point of reference rather than a last resort. There is a misconception that the

⁹⁰ At [115], [121].

⁹¹ At [122].

⁹² At [122].

⁹³ At [124].

⁹⁴ At [112].

approach to the construction of a contract of insurance is that it should be construed in a manner favourable to the insured, with the corollary that an exclusion clause is to be read narrowly.⁹⁵ In *Chubb Insurance*, the Full Court made it clear that this is not the law in Australia.⁹⁶

- 94 The Full Court clarified that the *contra proferentem* rule does not articulate a general approach to the construction of exclusion clauses. Rather, as Kirby J said in *McCann v Switzerland Insurance* [2000] HCA 65; 203 CLR 579:

“Courts now generally regard the *contra proferentem* rule (as it is called) as one of last resort because it is widely accepted that it is preferable that judges should struggle with the words actually used as applied to the unique circumstances of the case and reach their own conclusions by reference to the logic of the matter, rather than by using mechanical formulae.”⁹⁷

- 95 Only when the court cannot resolve ambiguities may resort be had to the *contra proferentem* rule. It assists to remember that it is not a general rule, but rather an aid to interpretation that has developed to achieve a fair outcome in the circumstances of a particular case. The rationale for the rule was explained by Fullagar J in *Halford v Price* [1960] HCA 38; 105 CLR 23:⁹⁸

“The document on which liability depends is involved and obscure and, in my opinion, ambiguous. It is the insurers' document, prepared and delivered by the insurers. It cannot, I think, be denied that it is fairly susceptible of the construction attributed to it by the respondent, and the case seems to me to be a case par excellence for the application of the *contra proferentem* maxim. If, when the ambiguity is resolved by the application of that maxim, we miss the real intention of the insurers, they have only themselves to blame.”⁹⁹

⁹⁵ See generally Jenny Thornton, “Interpreting exclusion clauses in insurance policies: *Contra proferentem* and the High Court” (2016) 28 *Insurance Law Journal* 1.

⁹⁶ At [137].

⁹⁷ At [74].

⁹⁸ See also *Johnson v American Home Assurance Company* [1998] HCA 14; 192 CLR 266 at [19] per Kirby J: “More recently, it has been accepted that the *contra proferentem* principle may still be useful where each of the competing constructions is strongly supported by argumentation and where dictionaries and logic alone cannot readily carry the day for either party. Then, it is not unreasonable for an insured to contend that, if the insurer proffers a document which is ambiguous, it and not the insured should bear the consequences of the ambiguity because the insurer is usually in the superior position to add a word or a clause clarifying the promise of insurance which it is offering.”

⁹⁹ At [34].

The rationale for the *contra proferentem* rule helps to explain the position that it only has application where there is unresolvable ambiguity.

- 96 Ultimately, in *Chubb Insurance* the Full Court did not need to have recourse to the *contra proferentem* rule. It held that the exclusion clause did not exclude liability for any losses which might flow from Mr Robinson's statutory declaration in respect of the payment claim. It was possible to resolve any ambiguity by giving the contract a businesslike interpretation. In so doing, the Court made reference to what is sometimes referred to as the "*circumscription of cover principle*". In *Horsell International Pty Ltd v Divetwo Pty Ltd* [2013] NSWCA 368, McColl JA, with whom I agreed, said:

"In construing an exclusion clause, the court will take into account the principle that it would not give effective business operation to a contract if an exclusion clause inappropriately circumscribed the cover provided by the insuring clauses" (citations omitted).¹⁰⁰

- 97 In *Chubb Insurance*, the Full Court held:

"[T]he professional services exclusion in the present case must relate to a narrower band of activity than the work that generally comprises or supports the delivery of building and construction activities by the Reed group of companies. If this were not so, the cover provided by the D&O policy would be inappropriately circumscribed.
[...]

[T]he obvious purpose of the exclusion was to exclude activities that are truly professional in nature, such as architectural design, engineering, surveying and quantity surveying. The clause was not intended to apply to the routine activities of Reed or of its executives. The provision of progress claims under the D&C Contract were routine activities and did not constitute the rendering of a professional service to St Kilda or to anyone else."¹⁰¹

- 98 Accordingly, the Full Court held that the insurer was on risk.

¹⁰⁰ At [192].

¹⁰¹ At [149]-[152].

99 In later proceedings, Mr Robinson was held to be liable to the third party in an amount of nearly \$1.5 million.¹⁰²

Conclusion

100 The introduction of statute into the field of insurance has, so far, had a soft landing. Whilst the changes are significant they haven't altered the underlying precepts of insurance law as such. The principles of construction of insurance contracts remain, but the terms of insurance policies will need to be construed in light of the statutory provisions.

101 There is still a duty of utmost good faith and there is still an obligation of disclosure albeit their scope, extent and application have been altered and clarified in the ways discussed. The consequences of breach have been significantly altered to reflect an appropriate balance between the insured and the insurer. The presence of an effective statutory watchdog in the mix aids this balance.

102 There are undoubted advantages in having consistent laws across jurisdictions in what is a significant global industry. That is true for both sophisticated commercial underwritings and consumer insurance contracts. Significant divergence in insurance contract law in commercially interdependent jurisdictions is undesirable. The enactment of the *Insurance Act 2015* (UK) has brought insurance law in the UK closer to the law in Australia and New Zealand. Sutton suggests that one consequence of this convergence is that United Kingdom case law will become more relevant and influential to Australia.¹⁰³

103 May I say, with respect, that I hold my breath on that prediction. Australia has long developed its own jurisprudence, not only in the area of insurance law, and if principles articulated in foreign, albeit friendly jurisdictions do not suit

¹⁰² *470 St Kilda Road Pty Ltd v Robinson* [2017] FCA 597.

¹⁰³ W I B Enright, R M Merkin, *Sutton on Insurance* (4th Edition, 2015, Thomson Reuters) at [1.80].

Australian conditions we have not been afraid to say so. Rather, as I see it, given the important global reach of insurance products and policies, jurisdictions ought to be particularly sensitive to the developments in other jurisdictions. One area where it is likely that legislators will watch with interest the way in which the duty to answer express questions honestly and with reasonable care assists the better functioning of the insurance market in the United Kingdom.

- 104 Finally, one cannot leave any discussion of law in current times without a mention of new technologies. There is pressure on insurers to embrace new technologies as a way to add security and reduce cost in a challenging market characterised by high competition, low interest rates and, in some sectors, low levels of consumer trust.¹⁰⁴ Already, there has been a significant increase in investment in and implementation of what is commonly referred to as InsurTech.
- 105 Blockchain, smart contracts and instantaneous payment systems have a role to play in improving the accuracy and efficiency of payouts and individualising insurance products. These have the potential to address some of the concerns in relation to abolishing the duty of pre-contractual disclosure by altering the way in which insurance contracts are entered into and pre-contractual disclosure is conducted. Some insurance companies are already looking at ways to use blockchain as a mechanism for providing automatic payouts.¹⁰⁵ Problems of information asymmetry might be addressed by smartphone applications which allow for interactive product disclosure statements.
- 106 The challenge and interesting question for lawyers will be not only to understand the technologies but also to understand the underlying legal

¹⁰⁴ See KPMG, *General Insurance Industry Review 2016* (October 2016, <https://home.kpmg.com/content/dam/kpmg/au/pdf/2016/general-insurance-industry-review-2016.pdf>).

¹⁰⁵ See KPMG, *General Insurance Industry Review 2016* (October 2016, <https://home.kpmg.com/content/dam/kpmg/au/pdf/2016/general-insurance-industry-review-2016.pdf>).

relationships created by the technologies and how to deal with disputes as and when they arise, as they inevitably will.

- 107 Disruptive practices will also have an impact on the insurance market. Peer-to-peer insurance has already emerged in some overseas jurisdictions.¹⁰⁶ The concept of a peer-to-peer network underlies Uber and Airbnb. Peer-to-peer insurance involves a group of like-minded individuals paying “*premiums*” into a shared pool, from which claims may be made. If it comes to Australia, peer-to-peer insurance will raise regulatory issues in circumstances where there may be no “*insurer*” as that term is commonly understood and the scale of the peer-to-peer network might vary from a group of work colleagues to a group with members in multiple jurisdictions across the world.
- 108 Whilst we wait for these developments, I will conclude with the observation that so far, the impact of statute on the industry and on the law has been positive. No longer can it be said, as did Michael Kirby when he described the state of insurance contract law in 1976 that it is “*chaotic*” and “*not so much a moveable feast, as a gorgonzola*”.¹⁰⁷ But, if like the connoisseurs of cheese, you consider gorgonzola a cheese with bite – perhaps it remains an appropriate descriptor of the currently vibrant insurance market.

¹⁰⁶ KPMG, *General Insurance Industry Review 2016* (October 2016, <https://home.kpmg.com/content/dam/kpmg/au/pdf/2016/general-insurance-industry-review-2016.pdf>).

¹⁰⁷ The Hon. Michael Kirby AC CMG, “Insurance contract law reform – 30 years on” (2014) 26 *Insurance Law Journal* 1 at 3; W I B Enright and R M Merkin, *Sutton on Insurance Law* (4th Ed, 2015, Thomson Reuters) at cclviii.