NSW Law Reform Commission

REPORT 34 (1983) - COMMUNITY LAW REFORM PROGRAM: SECOND REPORT - INSURANCE CONTRACTS: NON-DISCLOSURE AND MISREPRESENTATION

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Terms of Reference and Participants

Terms of Reference

Pursuant to section 10 of the Law Reform Commission Act, 1967*, I HEREBY REFER* to the Law Reform Commission the following matters for inquiry and report to me:

(3) *Insurance Contracts - Non-disclosure and Misrepresentation*

To review section 18 of the Insurance Act, 1902 in the light of the common law relating to disclosure, non-disclosure and misrepresentation of fact in contracts of insurance.

(4) Any matter incidental to the foregoing matters or any of them.

F.J. WALKER,

Attorney General.

28 July, 1982.

New South Wales

Law Reform Commission

The Honourable D.P. Landa, L.L.B., M.L.C., Attorney General for New South Wales.

COMMUNITY LAW REFORM PROGRAM

Attached to this document is the report of this Commission pursuant to the reference from you dated 28 July, 1982 and headed Insurance Contracts Non-disclosure and Misrepresentation

Ronald Sackville

Chairman.

Russell Scott

Deputy Chairman.

J.R.T. Wood

Commissioner.

February, 1983.

New South Wales Law Reform Commission

The Law Reform Commission is constituted by the Law Reform Commission Act, 1967. The Commissioners are:

Chairman

Professor Ronald Sackville

Deputy Chairman

Mr. Russell Scott

Full-time Commissioners

Mr. Denis Gressier

Mr. J.R.T. Wood, Q.C.

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This is the First Report of the Commission under the Community Law Reform Program. Its short citation is L.R.C. 34.

Participants

Commission Members:

For the purpose of the reference the Chairman, in accordance with section 12A of the Law Reform Commission Act, 1967 created a Division comprising the following members of the Commission:

Professor Ronald Sackville (Chairman)

Mr. Russell Scott (Deputy Chairman - in charge of this reference)

Mr. J.R.T. Wood, Q.C.

Consultant to the Commission:

Mr. J.E.H. Brownie, Q.C.

Secretary:

Mr. Bruce Buchanan

Research:

Ms. Ruth Jones

Ms. Helen Mills

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Mrs. Zoya Wynnyk

REPORT 34 (1983) - COMMUNITY LAW REFORM PROGRAM: SECOND REPORT - INSURANCE CONTRACTS: NON-DISCLOSURE AND MISREPRESENTATION

Summary of Recommendations

The recommendations in this report may be summarised as follows:

1. Legislation should be enacted to remedy a defect in section 18 of the Insurance Act 1902 (N.S.W.). The defect is that the section cannot be applied to relieve an insured person from the consequences of a breach of the common law duty to disclose material facts to an insurer when making an insurance proposal or renewing a policy. There is good reason to think that section 18 was intended to afford relief in such cases.

2. Section 18 could also be deficient in that it seems not to empower the court to excuse a failure by an insured to observe a "basis of contract" clause.

3. The most convenient way of overcoming these defects and to achieve harmony in the law is to enact general legislation following the form of sections 137 and 138 of the Consumer Credit Act, 1981. This legislation overcomes the specific defects and also achieves a fair accommodation between the interests of insurers and the expectations of honest and careful insured persons in relation to non-disclosure and misrepresentation by insured persons.

4. The precise language of sections 137 and 138 should be followed, except for two amendments to section 137 which will clarify the interpretation of that section but not alter the meaning which we think should be given to the section in its current form, and one amendment to section 138.

5. The legislation following the form of sections 137 and 138 should exclude contracts of insurance or provisions in such contracts answering the following descriptions:

> a life policy as defined by section 4 of the Life Insurance Act 1945 (Cth);
>
> a contract of marine insurance as defined by section 7 of the Marine Insurance Act 1909 (Cth);
>
> a third-party policy as defined by the Motor Vehicles (Third Party Insurance) Act 1942 (N.S.W.);
>
> a policy of insurance or indemnity under the Workers Compensation Act 1926 (N.S.W.) for the full amount of the liability of an employer under that Act to all workers employed by him;
>
> a policy of indemnity insurance effected pursuant to and in compliance with the provisions of section 70A of the Legal Practitioners Act 1898 (N.S.W.).

6. Subject to paragraph 5, the new legislation should be of general application and preferably should replace sections 137 and 138 of the Consumer Credit Act, 1981. If, however, it is considered undesirable to repeal these sections so soon after their enactment, the new legislation could simply exclude a contract of insurance subject to section 137 or 138 of the Consumer Credit Act, 1981.

7. Repeal of section 18 of the Insurance Act, 1902 is not desirable or necessary.

Draft legislation reflecting the Commissions recommendations is submitted with this report.

REPORT 34 (1983) - COMMUNITY LAW REFORM PROGRAM: SECOND REPORT - INSURANCE CONTRACTS: NON-DISCLOSURE AND MISREPRESENTATION

Chapter 1. Community Law Reform Program and This Reference

1.1 This is the first report of the Community Law Reform Program. The Program was established by the Attorney General by letter dated 24 May, 1982 addressed to the Chairman of the Commission The letter included the following statement:

> This letter may therefore be taken as an authority to the Commission in its discretion to give preliminary consideration to proposals for law reform made to it by members of the legal profession and the community at large. The purpose of preliminary consideration will be to bring to my attention matters that warrant my making a reference to the Commission under s.10 of the Law Reform Commission Act, 1967.

1.2 The Commission wrote on 9 June, 1982 seeking its first Community Law Reform references. By letter dated 28 July, 1982 the Attorney General referred three matters to the Commission the third of which is the subject of this report. The Commissions duty to inquire and report is prescribed in the following terms:

> *Insurance Contracts - Non-disclosure and Misrepresentation*
>
> To review section 18 of the Insurance Act, 1902 in the light of the common law relating to disclosure, non-disclosure and misrepresentation of fact in contracts of insurance.[1]

The background of the Community Law Reform Program is described in greater detail in the Commissions Annual Report for 1982.

1.3 The immediate reason for the Commission giving preliminary consideration to the subject matter of this report was the decision of the Supreme Court in *Kolokythas & Anor. v The Federation Insurance Limited*[2] in October, 1980. In this case Mr. Justice Rogers, who is a part-time member of the Commission drew attention to an apparent defect in section 18 of the Insurance Act, 1902 which was enacted in 1974 to lessen the harshness of certain common law principles peculiar to insurance. Section 18 provides as follows:

> (1) In any proceedings taken in a court in respect of a difference or dispute arising out of a contract of insurance, if it appears to the court that a failure by the insured to observe or perform a term or condition of the contract of insurance may reasonably be excused on the ground that the insurer was not prejudiced by the failure, the court may order that the failure be excused.
>
> (2) Where an order of the nature referred to in subsection (1) has been made, the rights and liabilities of all persons in respect of the contract of insurance concerned shall be determined as if the failure the subject of the order had not occurred.

The facts of *Kolokythas* and the defect referred to are described in Chapter 2.

1.4 We record our thanks to Parliamentary Counsel Mr. D.R. Murphy for his assistance and advice on the form and content of the draft legislation submitted with this report in Appendix 1.

FOOTNOTES

1. For the full terms of reference see p.2 above.

2. [1980] 2 N.S.W.L.R. 663.

Chapter 2. The Issues for Reform - Illustrations - Recent Cases

Kolokythas & Anor. v. The Federation Insurance Limited[1]

2.1 In this case the owners of four shops in a Sydney suburb applied to an insurance company for fire insurance. The owners completed a proposal seeking cover for four individual lock-up shops contained in one building. The proposal was dated 18 May, 1978. On 14 May, 1978 planning consents, given five years earlier by the local planning authority in relation to two of the shops, expired. This meant that four days before the date of the proposal, it became unlawful to carry on the businesses that were being carried on in those two shops. The proposal did not refer to the expiry of planning consents. Nor had the insurer asked questions in the proposal form about planning consent The proposal was accepted and an insurance policy was issued. During the currency of the policy on 5 October, 1978 the premises caught fire and were substantially damaged. The owners claimed under the policy the full amount of the cover of $50,000 together with an amount of $6,600 in respect of loss of rental (the policy including a loss of rent cover).

2.2 The insurance company refused to pay the claim and the owners sued for recovery under the policy. The proposal contained the following provision:

> I hereby declare that the Answers given above are in every respect true, and that I have not withheld any information likely to affect the acceptance of this Proposal; . . . and I agree that the Proposal and Declaration shall be the Basis of the Contract between the Company and myself and shall be taken as part of the Policy ...

2.3 The court held that:

> the common law duty on the part of the person proposing insurance “to disclose all material facts” is separate from the provisions and requirements of both the proposal and the consequent insurance contract or policy. This is so even if the declaration in the proposal is made part of the contract of insurance. The duty cannot be described as, or as arising out of, a “term or condition of the contract of insurance”;
>
> section 18 of the Insurance Act, 1902 applies only when “a term or condition of the contract of insurance” is not observed or performed. The section neither refers to nor applies to the common law duty of disclosure and therefore has no application to a failure to discharge that duty. The result is that the court has no power to give relief against such a failure;
>
> it was a “material fact” that two of the shops in this case were used on the date of the insurance proposal for purposes which conflicted with local government planning laws and were, in the words of the judge, “ impermissible” under that law. The judge concluded that the fact was “material” after hearing evidence that the absence of town planning permission could provide a strong temptation to some people to bring about a loss deliberately, for example, by fire, so as to acquire benefits under the policy. He pointed out that this temptation could be even stronger where (as in this case) the policy provided cover against loss of rent The insurer was entitled to full disclosure of facts which could lead to a loss of this kind;
>
> the owners had breached their common law duty by not disclosing that material fact when making the proposal. The insurer was therefore entitled to avoid the policy and section *18* could not be applied to excuse the breach by the insured as it was only concerned with non-

observance or non-performance of terms or conditions of the contract of insurance. Consequently, the claim by the insured failed.

Bazouni v. Sun Alliance Insurance Limited[2]

2.4 This case also involved fire damage to a shop. The owner was a middle-aged Lebanese lady who had lived in Australia for twelve years at the time of the hearing in March 1981. In 1973 she bought a shop with an adjacent dwelling in a Sydney suburb. In 1977 a burglary occurred at the premises and the insurer paid under the relevant policy a sum of $500. In the same year that insurer decided to discontinue the insurance and advised the owner accordingly. The owner was unable at any time, including the time of the hearing, to speak or read English to any extent. After withdrawal of the insurance in 1977 the owner and her daughter went to the office of another insurance company and completed a proposal for fire insurance. At the foot of the proposal form was a form of declaration in the following terms:

> No insurer has declined to insure me, refused renewal or cancelled any policy of insurance.

2.5 The owner signed and made the declaration. The insurance policy was duly issued and contained a provision stating that

> the insured has made to the company named above... a written proposal which it is agreed shall be the basis of this contract and be considered as incorporated herein ...

2.6 The owner, did not make any disclosure to the new insurer at any stage of the withdrawal of cover by the previous insurer. A fire occurred on the premises almost two years later. The owner made a claim upon the insurance company and some months later, after making inquiries, the insurance company discovered that the former insurer had cancelled the earlier policy. The new insurer thereupon avoided the policy and refused to pay the claim of the owner for damage caused by the fire.

2.7 In the Supreme Court Mr. Justice Yeldham held that the insurance company "must succeed by reason of the plaintiff's non-disclosure of the act of the prior insurer in declining to continue the insurance cover...". That refusal was a "material matter". The judge expressed agreement with the decision in *Kolokythas* to the effect that section 18(1) of the Insurance Act 1902 does not apply to breach of the common law duty of disclosure and held that there had been a breach on the part of the owner of her common law duty to disclose material facts.

Accordingly, the owner is case failed. Although the court's decision was that breach of the common law duty was sufficient to determine the matter, the judge also said that even if section 18(1) could be invoked he "would not be prepared to hold that the insurer was not prejudiced by the relevant non-disclosure". As well as the common law duty of disclosure, this case presented a question arising from the incorporation into the insurance contract of the provisions of the proposal, but the court did not need to deal with that question its decision resting solely on the non-disclosure point.

Later Decisions

2.8 We have been advised that an appeal from the judgment of the Supreme Court in *Kolokythas* was abandoned. After the decision in *Bazouni* and another case[3] following *Kolokythas,* Mr. Justice Rogers announced that the judges normally sitting in the commercial list proposed to follow the principle established by *Kolokythas* unless and until that decision was overruled by the Court of Appeal or other superior court.[4] To date there has been no such contrary decision.

Comment

2.9 These decisions have had the effect of exposing possible areas where liability might be avoided by insurers upon technical grounds that are beyond the reach of section 18 of the Insurance Act 1902. Two aspects need to be considered. The first is that the section has no application to the common law duty to

disclose material facts and therefore gives no power to the courts to inquire whether the failure of an insured person to fulfil that duty ought to be excused.

2.10 Secondly, both *Kolokythas* and *Bazouni* involved a written provision of a kind that has come to be described as a “basis of contract” clause. In *Kolokythas* the provision appeared in the proposal and in *Bazouni* in the policy. A “basis of contract” clause provides that the proponent warrants the truth of his or her answers; or agrees that the truth of those answers will be a condition precedent to the validity of the contract; or acknowledges that should any answer not be true the insurer will be entitled to deny a claim or cancel the policy. Such a clause is effective only if contained in the policy, it is insufficient for it to appear in the proposal alone, unless the proposal itself is incorporated in the contract.[5] If, however, the clause is effective, the consequence is that any inaccuracy in the proposal relieves the insurer from liability under the policy, even though the answer given by the insured is innocent, worthy of excuse, not “material” and unrelated both to the risks insured against and to the loss giving rise to the dispute.[6] In other words, the insurer need not establish materiality, or even knowledge of the inaccuracy on the part of the insured, to rely on an incorrect answer in order to resist the insured’s claim. Thus, in the leading case of *Dawsons Ltd. v. Bonnin,*[7] there had been an unimportant misstatement by the insured relating to the place where a motor vehicle would be garaged. The House of Lords found that the misstatement was not material, but because of the basis of contract clause the insurer could avoid liability under the policy.

2.11 It would seem that the power of the court under section 18 to excuse a failure by the insured “to observe or perform a term or condition of the contract of insurance” does not extend to a “basis of contract clause”. This is because an incorrect answer in a proposal which is subject to a basis of contract clause, probably cannot be described as constituting a failure by the insured “to observe or perform” a term or condition of the contract.[8] The error is more accurately regarded as a failure by the insured correctly to complete a proposal, which is made the basis of the contract than a breach of a term or condition. The error may more properly be categorised as a failure on the part of the insured correctly to complete a proposal which is made the basis of the contract, than a breach of a term or condition.

2.12 The harsh effects that can flow from the common law rules relating to non-disclosure and misrepresentation and from the use of basis of contract clauses, have been criticised.[9] In our view legislation is required to overcome the problems exposed by the judgments in *Kolokythas* and *Bazouni.* As we explain later, we think the most appropriate course of action is to extend provisions in the Consumer Credit Act, 1981, which apply to certain insurance transactions, to insurance generally. This extension should be subject to certain exceptions discussed in Appendix II.

FOOTNOTES

1. [1980] 2 N.S.W.L.R 663.

2. 17 March 1981, Supreme Court of New South Wales (Yeldham J.),

3. *Chapman v. Greater Midwest Insurance Pty. Ltd.* [1981] 1 N.S.W.L.R. 479, in which Yeldham J. again stated that he agreed with the decision and reasoning of Rogers J. In *Kolokythas*, in relation to the common law duty of disclosure and the terms of s.18 of the Insurance Act, 1902.

4. *Sarina v. G.R.E. Insurance Ltd.,* 29 April 1981, Supreme Court of New South Wales (Rogers J.).

5. *Deaves v. C.M.L Fire & General Insurance Co. Ltd.* (1979) 143 C.L.R. 24.

6. *Thomson v. Weems* (1884) 9 App.Cas. 671; *Condogianis v. Guardian Assurance Co. Ltd.* [1921] 2 A.C. 125; *Deaves v. C.M.L Fire and General Insurance Co. Ltd.* (1979) 143 C.L.R. 24.

7. [1922] 2 A.C. 413.

8. See the doubts expressed in R. Else-Mitchell and R Parsons, *Hire-Purchase Law* (4th ed. 1968), p.143, in relation to s.21 of the Hire-Purchase Act, 1960:

> It is straining words to say that an insured has failed to "observe or perform" a condition that his statements are true if it should prove that in some particular they are untrue.

9. See, for example, G.H. Treitel, *The Law of Contract* (5th ed. 1979), p.300; J.G. Starke and P.F.P. Higgins, Cheshire and *Fifoot's Law of Contract* (3rd Australian ed. 1974), pp.293-294; *MacGillivray & Parkington on Insurance Law* (7th ed. 1981), paras 607-705, 723, 737 and 755; K.C.T. Sutton *Insurance Law in Australia and New Zealand* (ed. 1980), paras 2.70, 2.71.

Chapter 3. The Source of the Problem

Common Law

3.1 The source of the problem is the effect of the common law rules relating to non disclosure and misrepresentation by a person making a proposal for insurance (the proponent). These rules are concerned to ensure that a person seeking insurance provides accurately to the insurer all relevant information that will enable the insurer to assess the risk to be covered and to set an appropriate premium. Breach of the rules can have drastic results for the proponent. The insurance contract can be avoided by the insurer retrospectively from the commencement of the insurance cover, not just from the moment of avoidance. Non-compliance with the rules can therefore lead to a claim being defeated even when the breach of common law duty is only discovered after a loss has occurred and a claim has been made. There will have been a total failure of consideration the insurer never having been “at risk”. Premiums paid will normally be repayable by the insurer, but after a loss has been suffered this is likely to provide small comfort to the insured.

The Duty of Disclosure, and Materiality

3.2 The common law duty of disclosure requires that a person making a proposal for insurance must disclose to the insurer before the insurance contract is concluded “every material circumstance” known to that person. There are decisions suggesting that this duty extends not only to circumstances and facts which the proponent actually knows but also to those which he ought reasonably to know in the ordinary course of business and to beliefs or fears held by the insured even though they are baseless.[1] A “material”, circumstance or fact has been defined as one “which would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk”.[2]

3.3 The obligation upon the proponent is to *volunteer* to the insurer information about all facts that are material. Failure of the insurer to ask a particular question or refer to a particular topic in the proposal does not excuse the proponent from the duty to volunteer information on that topic, if it is material.

3.4 The duty is extensive in time and requires disclosure to be made beyond the date of completion of the proposal, that is, up to the time of making the contract of insurance. Any change in circumstances that is “material” prior to completion of the contract must be disclosed. The duty of disclosure, including the duty to disclose changes of circumstances, also applies upon *renewal* of an insurance contract and, to a more limited extent upon variation (for example, if the sum insured is increased).[3] It appears to be common practice on the part of insurers to renew and, if requested, vary insurance policies without drawing to the attention of the insured person the continuation of this duty, and often without completion of a fresh proposal.

3.5 The duty of disclosure extends to circumstances that affect the “physical hazard”, for example, physical characteristics of a building proposed for fire insurance which might make it more vulnerable or more likely to catch fire. It also extends to facts affecting the “moral hazard”; that is, any matter going to the honesty and personal characteristics of the insured person that might increase the risk of loss. The following examples of “moral hazard” have been given by text writers:

> ... in relation to motor insurance it is important to know that the proposer has had convictions for motoring offences recorded against him and it is irrelevant to show that in other cases policies have been issued by the same insurers even with knowledge of such convictions. The age of the person who is to drive may also be material. It is material to disclose that the insured under a burglary policy, a trades combined insurance policy, an all risks insurance policy or a fire policy has a criminal record.[4]

A wide variety of circumstances have been held to be “material”.[5]

3.6 It does not help an insured person that he or she did not know that circumstances not disclosed were material or even that he or she honestly and reasonably believed that those circumstances were not material.[6] In this way, the duty of disclosure has outstripped the doctrine of good faith upon which it was based.

3.7 The test of materiality is not concerned with the question whether the particular insurer regarded the circumstances as material but whether a prudent insurer would have done so. This can occasionally provide injustice to an insurer,[7] but the rule operates more frequently in favour of insurers and against the interests of insured persons.

Misrepresentation

3.8 The common law principle relating to non-disclosure is concerned with the duty of a proponent for insurance to *volunteer* material information. The common law principle dealing with misrepresentation concerns that person’s duty to respond accurately to questions put to him by the insurer. The requirement that the matter misrepresented be material to the risk applies equally to misrepresentation as to disclosure.[8] However, with misrepresentation, it must be shown that the misrepresentation actually induced the insurer to enter the contract. An honest but mistaken representation on a matter of opinion will not permit the insurer to avoid the policy on the ground of misrepresentation.

Basis of Contract Clauses

3.9 The difficulties confronting insurers in obtaining relief on the ground of misrepresentation have often been met by basis of contract clauses, the operation of which has been described in paragraph 2.10 above. The fact that the use of these clauses has attracted considerable criticism[9]) has not prevented their widespread use. We suspect that few policyholders are aware of the effect of these clauses and, in particular, of the reliance insurers may place on them to avoid making payments under a policy.

FOOTNOTES

1. *Godfrey v. Britannic Assurance Co.* [1963] 2 Lloyds Rep. 515; *Khoury v. Government Insurance Office* [1982] 2 A.N.Z Insurance Cases 60-478.

2. Marine Insurance Act 1906 (U.K.), s.18(2), regarded as restating the common law. Section 24(2) of the Marine Insurance Act 1909 (Cth) is in identical terms; see also *Marene Knitting Mills Pty. Ltd. v. Greater Pacific General Insurance Ltd.* (1976) 11 A.L.R. 167, where the Privy Council laid to rest for Australian purposes any remaining controversy on the question, and *Lambert v. Co-operative Insurance Society Ltd.* [1975] 2 Lloyds Rep. 485.

3. *Lambert v. Co-operative Insurance Society Ltd.* [1975] 2 Lloyds Rep. 485.

4. *Halsbury’s Laws of England* (4th ed. 1978), vol.25, para. 369.

5. See, for example, the illustrations collected in K.C.T. Sutton, *Insurance Law in Australia and New Zealand* (1980), para. 3.77, and by *MacGillivray and Parkington on Insurance Law* (7th ed. 1981), paras 648-672.

6. *Lambert v. Co-operative Insurance Society Ltd.* [1975] 2 Lloyds Rep. 485.

7. *Babatsikos v. Car Owners’ Mutual Insurance Co. Ltd.* [1970] V.R. 297.

8. *MacGillivray and Parkington,* note 5 above, para.582.

9. See cases collected by K.C.T. Sutton note 5 above, paras 2.70, 2.71; Western Australia Law Reform Committee, *Motor Vehicle Insurance* (Working Paper, Project No.10, 1972), para.27; *Joel v. Law Union and Crown Insurance Co.* [1908] 2 K.B. 863, at p.885; *MacKay v. London General Insurance Co. Ltd.* (1935) 51 Ll.L Rep. 201.

Chapter 4. Legislative Reform in New South Wales

Insurance Act, 1902

4.1 Section 18 of the Insurance Act, 1902, the terms of which are set out in paragraph 1.3, became law on 13 December, 1974. The Parliamentary debates leading to the enactment of section 18 suggests that some members considered that the section would resolve many of the problems created by the common law rules relating to non-disclosure and misrepresentation discussed earlier.

4.2 In the Second Reading speech in the Legislative Assembly, the Minister of Justice, the Hon J.C. Maddison stated the broad purpose of the legislation as follows:

> [N]ew provisions are being inserted which will enable the court to excuse any failure by an insured person to observe or perform a term or condition of a contract of insurance where the insurer has not been prejudiced by the failure. Until now this provision has been limited to insurance relating to goods the subject of a hire purchase agreement It is now to apply generally. It is designed, of course, to prevent advantage being taken of a mere technicality.

The Minister made no direct mention of basis of contract clauses, the examples given being confined to breach of contractual provisions arising after the contract had been made.[1] In the Legislative Council, the Second Reading speech added little to the statements made in the lower House.[2] However, some members examined the scope of the legislation in relation to the problems experienced when proponents for insurance complete proposals. A Government member, the Hon. T.S. McKay, said:

> ... I believe that probably the greatest advance in the consumers' interests is in relation to contracts of insurance... [N]o longer will an inaccuracy in a contract of insurance that does not prejudice the insurer void the contract In other words, there is to be a departure from the old legal principle of the utmost good faith or *uberrima fides.* This is a great step towards closer and fairer contracts between the parties. An insurer will not escape liability to pay the insured if the insured has given an incorrect answer in the proposal to a non-material question. Too much use has been made of this loophole by unscrupulous companies at the expense of innocent parties.[3]

Speaking for the Opposition, the Hon D.P. Landa, commended the Bill:

> The insurance provisions of the Bill are essentially good, and we support them, especially the power of the court to excuse failure by non-observance of a non-prejudicial disclosure. This point has often been seized upon by uncharitable insurance companies. They take the point that full disclosure has not been made and, insisting on the principle of full bona fides in an insurance policy, they refuse to pay out on a claim, notwithstanding that the non-disclosure has nothing whatsoever to do with the risk undertaken
>
> Provided that the insurance company is not prejudiced, we support the Government's intentions in this regard to allow the court to overrule these company moves to seize upon that technical loophole. All of us in this House from time to time have had some contact with someone who has had a claim refused because of these technical loopholes. One company for a time specialized in taking policies where it knew a person had failed to disclose a relevant fact knowing that in the end it would not have to pay out on any claim.[4]

4.3 The legislative history of section 18 of the Insurance Act, 1902 is as follows:

The Hire-Purchase Act, 1960 (N.S.W.) introduced new provisions relating to goods comprised in hire-purchase agreements. Section 21 gave relief to hirers under hire-purchase agreements in relation to insurance contracts. The terms of section 21(1) were identical to those later employed by section 18 of the Insurance Act, 1902:

> In any proceedings taken in any court in respect of any difference or dispute arising out of a contract of insurance if it appears to the court that a failure by the insured or the hirer under the hire-purchase agreement concerned to observe or perform a term or condition of the contract of insurance may reasonably be excused on the ground that the insurer was not prejudiced by the failure, the court may ... order that the failure be excused.

Provisions of this kind were also adopted in the legislation of other States.[5]

The Commercial Transactions (Miscellaneous Provisions) Act 1974 (N.S.W.) amended various Acts including the Hire-Purchase Act, 1960 (although section 21 remained intact) and the Life, Fire, and Marine Insurance Act, 1902. The latter Act was renamed the Insurance Act, 1902 and a new Part VI was inserted which included section 18.[6] This section followed the language of section 21 of the Hire-Purchase Act 1960, but is of general application in New South Wales. The terms of section 18 which are still in force, have already been set out in paragraph 1.3 above.

Contracts Review Act, 1980

4.4 The Contracts Review Act, 1980 offers relief to persons affected by “unjust contracts”. The Supreme Court and the District Court are given extensive powers to avoid, vary, and otherwise control any contract or provision of a contract found “to have been unjust in the circumstances relating to the contract at the time it was made” (section 7). Subject to limited exceptions, the Act does not extend to contracts “entered into in the course of or for the purpose of a trade, business or profession” (section 6(2)). Section 9 of the Act provides criteria whereby the courts may determine “whether a contract or a provision of a contract is unjust”. These include, among other things, the following:

> (d) whether or not any provisions of the contract impose conditions which are unreasonably difficult to comply with or not reasonably necessary for the protection of the legitimate interests of any party to the contract; ...
>
> (f) the relative economic circumstances, educational background and literacy of [the parties to the contract].

The Act seems to apply to an insurance policy entered into by a private citizen although it contains no specific reference to contracts of insurance. There have been as yet few decisions invoking the powers conferred by the Act.[7] Accordingly, the extent of its scope and operation in practice remain to be seen. Nonetheless, the Act should not be disregarded as a measure capable of affording relief to an insured person adversely affected by a basis of contract clause or the provisions of an insurance contract which may be unjust. However, in our view it should not be regarded as the principal means of overcoming the deficiencies in section 18 of the Insurance Act, 1902. Rather, it should be seen as a source of additional assistance to insured persons in circumstances not covered by the Insurance Act, 1902 or other legislation specifically concerned with contracts of insurance.

Consumer Credit Act, 1981

4.5 The Consumer Credit Act, 1981 has reformed the law in relation to some contracts of insurance. The Act is not of general application but relates only to “regulated contracts” and “regulated mortgages”, defined in the Act Generally speaking, these are credit sale contracts and certain types of consumer loan contracts. The Consumer Credit Act, 1981 received the Royal Assent on 30 December, 1981 but

has not yet commenced.[8] Sections 137 and 138 of the Credit Act 1981 of Victoria are identical with sections 137 and 138 of the Consumer Credit Act, 1981 of New South Wales.

4.6 **Section 137** provides that a contract of insurance within its reach is not void or unenforceable:

(a) by reason only of a false or misleading statement made in or in connection with the contract or a proposal, offer or document that led to the entering into, reinstating or renewing of the contract unless the statement was material to the insurer in relation to the contract of insurance and

(i) the statement was fraudulent; or

(ii) the insured knew or ought reasonably to have known that the statement was material to the insurer in relation to the contract of insurance; or

(b) by reason only of an omission of matter from the contract or a proposal, offer or document that led to the entering into, reinstating or renewing of the contract unless the matter omitted was material to the insurer in relation to the contract of insurance and

(i) the omission was deliberate; or

(ii) the insured knew or ought reasonably to have known that matter material to the insurer in relation to the contract of insurance had been omitted.

Section 138 provides that where by or under the provisions of a contract of insurance within its reach:

(a) the circumstances in which the insurer is bound to indemnify the insured are so defined as to exclude or limit the liability of the insurer to indemnify the insured on the happening of particular events or on the existence of particular circumstances; and

(b) the liability of the insurer has been so defined because the happening of those events or the existence of those circumstances was in the view of the insurer likely to increase the risk of loss occurring,

the insured shall not be disentitled to be indemnified by the insurer by reason only of those provisions of the contract of insurance if, on the balance of probability (the onus of proof being upon the insured) the loss in respect of which the insured seeks to be indemnified was not caused or contributed to by the happening of those events or the existence of those circumstances.

This section has its origin in the Insurance Law Reform Act 1977 (N.Z.), section 11, referred to in paragraph 5.5 below.

Effect of Sections 137 and 138 of Consumer Credit Act, 1981

4.7 Sections 137 and 138 substantially modify the effect of the common law and existing rules relating to non-disclosure, misrepresentation, basis of the contract clauses, and clauses excluding or limiting liability.

4.8 The common law allows no exception to the rule that failure to disclose a material fact entitles an insurer to avoid the policy *ab initio*. Section 18 of the Insurance Act, as we have explained, has been held to be inapplicable to the common law duty of disclosure, since it is concerned only with failure on the part of an insurer to observe or perform a term or condition of the contract of insurance. Further, the test of absence of prejudice to the insurer which it provides presents a practical difficulty. A court may find it difficult to hold that there has been no prejudice where there has been a material non-disclosure. Section 18 does not require the “prejudice” to be substantial. It follows that an insurer who sustains any prejudice from a failure to observe or perform a term of the contract of insurance would have an argument that the power to excuse, conferred by the section could not be exercised. Since a material fact is one which a prudent insurer would wish to know in deciding whether to accept the risk or in

determining the appropriate premium, there would be few cases of, say, failure to disclose a material fact (assuming the failure to be within section 18) where the insurer would not suffer some prejudice.

4.9 We believe that the potential for an unfair application of the rigid common law rules, and the inadequacy of section 18 of the Insurance Act, 1902 to cope with the problem can be overcome by extending generally the operation section 137(a) of the Consumer Credit, 1981. That section is specifically directed to omissions from proposals, offers or documents leading to the making of a contract of insurance. The section is not confined to cases where there is a breach of a contractual term or condition. It is therefore capable of applying to a breach by the insured of the common law duty of disclosure.

4.10 In order for an insurer to rely on material non-disclosure to refuse liability for a claim under a policy to which the Act applies, two tests must be satisfied:

> the non-disclosure must be of matter which is material to that insurer in relation to the contract in question; and
>
> the non-disclosure (omission) must have either been deliberate, or the insured must have known or ought reasonably to have known that the matter omitted was material to the insurer in relation to the contract

4.11 The section does not sweep away the concept of materiality, but the first test focuses upon the omission of matter which is material *to the actual insurer concerned.* “Material” in this context relates to matter which that insurer considers relevant in deciding whether or not to accept any particular risk offered f or insurance, and in rating it for premium purposes. The second test satisfies the legitimate interests of insurers by excluding from relief undeserving proponents for insurance who either deliberately omit information material to the insurer, or who actually know or ought reasonably to know that matter material to the insurer has been omitted. It also accommodates the legitimate expectations of honest and careful proponents for insurance, by protecting an innocent person who could not reasonably be expected to have known that matter material to the insurer had been omitted.

4.12 We turn next to misrepresentation by the insured in the proposal or offer for insurance. So far as a misstatement or misrepresentation maybe fraudulent no occasion for relief arises, and the legislative reform we suggest would not provide any relief. The area of concern is with innocent and immaterial misstatements made in the proposal, which are made the basis of the contract or which are accompanied by warranties as to their accuracy. For the reasons already mentioned it seems that section 18 does not provide any relief in such a case.

4.13 We are of the view that an insured who has made such an innocent and immaterial misstatement should be able to obtain relief from the court Section 137(a) is capable of providing that remedy. There is no foundation for suggesting that it cannot apply where the insurer employs a basis of contract provision and we think it fair that the section should apply in such a case. Again, the legitimate needs of the insurer are protected, since the section focuses upon statements which are material to the actual insurer in respect of the contract of insurance in question. If the misstatement is not material in that sense, the policy should be enforced. The insurer is also protected in that the section is not available to the undeserving proponent for insurance who has made the false or misleading statement fraudulently or who knows or ought reasonably to have known that the statement was material to the insurer in relation to the actual contract.

4.14 The section goes further than section *84* of the Life Insurance Act, 1945 (Cth) and section 25 of the Instruments Act 1958 (Vic.) referred to in paragraphs 5.1 and 5.3, below, in that it is not confined to misrepresentations in written form.

4.15 We are of the view that section 137(a) is adequate in itself to excuse misrepresentations in basis of the contract policies. However, in appropriate circumstances, section 138 might also be called in aid.

4.16 Section 138 empowers a court to permit an insured person to remain indemnified in the face of a clause in an insurance contract which specifically excludes or limits the liability of the insurer. Assume,

for example, that a basis of contract clause in afire insurance policy gives the insurer the right to avoid the contract if *any* statement made by the insured in the proposal, including statements unrelated to the risk insured (such as the insured's prior health history), are not correct. If the building covered by the policy is destroyed by fire and the insurer seeks to avoid liability on the ground that the insured s proposal had failed to reveal a minor illness suffered some years earlier, section 138 would preserve the insured's right to indemnity.

4.17 The concern of section 138 is with provisions in insurance contracts which exclude or limit the liability of insurers to give indemnity, and may be compared with section 11 of the Insurance Law Reform Act, 1977 (N.Z.), referred to in paragraph 5.5, below. Again a reasonable accommodation between the competing interests of insurers and insured is achieved. Exemption clauses and limitation clauses can still be invoked by insurers, where the loss is caused or contributed to by the happening of the events or circumstances to which the clauses are directed. In such circumstances, the insured may be taken to have had ample warning of their possible application. There is therefore no unfairness in the insurer relying on those clauses, so long as there is a true nexus with the loss. However, where there is no connection between the loss and an event or circumstance triggering an exclusion or limitation there will usually be no good reason to refuse indemnity to the insured. Except for the special circumstances discussed in paragraphs 7.3 3 and 7.34, to allow the insurer to rely on such a clause to decline liability is, in our view, an unjustified inroad into the legitimate expectations of the insured, and an unnecessary and unfair addition to the armour of the insurer.

Section 137 and Kolokythas

4.18 It is of interest to consider how the question in *Kolokythas*[9] might have been approached if a statutory provision in terms of section 137 had been applicable. It would be necessary for the court to determine, first, whether the insurers failure to disclose that planning consents had expired "was material to the insurer in relation to the contract of insurance". At this stage the concept of materiality is subjectively determined in relation to the particular insurer. If the insurer could show materiality in this sense (as seems likely), it would then be necessary for the court to decide whether the insured had deliberately omitted to supply the information or, alternatively, knew or ought reasonably to have known that matter material to the insurer had been omitted. if the insurer could satisfy the court on the balance of probabilities (assuming that the section places the onus on the insurer) as to either of these matters it would be able to rely on the non-disclosure as a defence to the claims. Proof that the insured had deliberately omitted information, or knew that material matter had been omitted, would, of course, require an investigation of the insured s state of mind at the relevant time. If the insurer could not prove deliberate omission or knowledge by the insured, the outcome of the case would depend upon whether the insured ought reasonably to have known that material matter had been omitted. In this respect it seems that the court would be required to apply an objective standard against a matrix of facts which would include matters personal to the insured. Thus in assessing what the insured should reasonably have known, it seems likely that the court would take into account such factors as the kind of insurance provided under the policy, the previous experience of the insured in relation to such policies, the insured s business sophistication (or lack of it), explanations and warnings in the proposal form, the insured's appreciation of the information regarded by the insurer as material, and legitimate expectations as to what ordinary insured persons might be assumed to know in relation to the requirements of insurers. Ultimately, therefore, the decision would depend upon the courts assessment of the facts, although in the case of an insured with significant business experience, the insurer might be expected to be in a strong position.

Section 137 and Bazouni

4.19 *Bazouni*[10] was different in degree from *Kolokythas,* in that it involved not merely non-disclosure of a fact but a misrepresentation. The insured signed a proposal which included a false declaration that no insurer had cancelled any policy of insurance previously held by her. The insured also failed to disclose the cancellation. This was clearly material to the insurer in relation to the contract of insurance. Assuming that a statutory provision in the terms of section 137 had been applicable, both of its subsections would have been attracted. This would have meant that if the insured had been innocent of fraudulent intent and deliberate omission (for example, because she did not understand the statement in

the proposal, or her duty of disclosure), the insurer would have been able to resist the claims only by proving that the insured knew or ought reasonably to have known that the misrepresentation was material, or knew or ought reasonably to have known that the matter was material to the insurer but had been omitted.

4.20 It is unlikely that the insured, a migrant with little command of the English language, had actual knowledge that the misstatement was material to the insurer, or that there had been an omission of matter material to the insurer. Accordingly, the case would probably have turned on the question whether the insured ought reasonably to have known those matters. The section could be interpreted as excluding from consideration circumstances (such as language difficulties) personal to the insured. But in our view the section permits a determination based on a matrix of facts and circumstances, including matter personal to the insured and matters within the reasonably expected contemplation and understanding of average proponents of insurance of the kind in question. No doubt an insurer could argue that ordinary good sense would suggest that a new insurer would wish to be informed that another insurer had recently refused to renew the insurance, at least where reasons were given (although this is not the position in marine insurance).[11] We do not see any difficulty in leaving it to the courts to decide the issue in any given case.

Section 137 and Lambert v. Co-operative Insurance Society Limited[12]

4.21 We next illustrate the possible application of section 137 to a case decided by the English Court of Appeal. In April, 1963 the plaintiff signed a proposal form for an all risks insurance policy to cover her own and her husband's jewellery. No questions were asked and the plaintiff gave no information about any previous convictions. The plaintiffs husband, to her knowledge, had been convicted some years earlier of receiving 1,730 cigarettes, knowing them to have been stolen. He had been fined 25*.* The insurer was unaware of the conviction and issued the policy, a condition of which provided that the policy would be treated as void should there be an omission to state any fact material for estimating the risk. The policy was renewed each year, the last renewal being in March 1972. In December, 1971*,* the plaintiffs husband was convicted of two further offences of dishonesty and sentenced to imprisonment for 15 months. This was not disclosed to the insurer. In April, 1972 the plaintiff made a claim for the value of seven items of the insured jewellery which were either lost or stolen The insurers repudiated the claim on the ground of the non-disclosure of the first conviction of the plaintiff's husband before the contract was concluded, and on the further ground of the failure to disclose the second set of convictions when the policy was last renewed. The insurer succeeded before the trial judge and the Court of Appeal dismissed the appeal.

4.22 The only witness called for the insurer, its branch manager, said that while the company would have wished to know in 1963 of the first conviction and would have given it careful consideration, probably the policy would have been issued just the same. However, he did say that he would not have invited renewal had he known of the 1971 convictions. The plaintiff contended that the duty was to disclose only what a reasonable insured would consider material, this being the test recommended by the Law Reform Committee in its 1957 report.[13] This test was rejected both by the trial judge and the Court of Appeal although the former took the view that had it been the appropriate test the case would have been decided the other way. In the Court of Appeal Mr. Justice MacKenna expressed his

> personal regret that the Committee's recommendation has not been implemented. The present case shows the unsatisfactory state of the law. Mrs. Lambert is unlikely to have thought that it was necessary to disclose the distressing fact of her husband's recent conviction when she was renewing the policy on her little store of jewellery. She is not an underwriter and has presumably no experience in these matters. The defendant company would act decently if, having established the point of principle, they were to pay her. It might be thought a heartless thing if they did not, but that is their business, not mine.[14]

4.23 We think that section *137* could operate to relieve the insured in a case such as this, although we recognise that there could be different views as to whether or not a reasonable insured should expect that an insurer will wish to know that a spouse has been convicted of dishonesty. In the absence of any specific questions concerning convictions of persons other than the proponent, the observations of the

Court of Appeal in Lambert support the argument that the insured ought not reasonably to have known that matter material to the insurer had been omitted. if, as we suggest in paragraph 7.28, the court should take into account the circumstances of the insured in determining whether his or her conduct was reasonable, the argument that section 137 can be applied to the facts of Lambert so as to relieve the insured is stronger.

Section 137 and Preece v. The State Insurance General Manager[15]

4.24 We next pose as an example the facts of a recent New Zealand case. The insurer had issued a motor vehicle policy following completion of a proposal. One question in the proposal asked "Has the vehicle or its engine been modified in any way since manufacture?" The answer supplied was "Yes. Replace and install standard 2000 cc." In fact in order to accommodate the larger engine, a new gearbox and a new exhaust manifold had also been supplied. There was expert evidence to the effect that such additional modifications were essential, and should have been expected by anyone familiar with motor engineering. In addition wide rear rims with radial tyres had been fitted.

4.25 A claim was made under the policy following damage to the vehicle when it skidded off a gravel road. The fitting of the gearbox, manifold, wheels and tyres was found to have had nothing to do with the accident. The insurer declined to indemnify the insured on the basis that the answer in the proposal had not disclosed "extensive modifications" and that as a consequence it was entitled to avoid the policy. The misstatement was excused under the New Zealand Act on the basis that it was not "substantially incorrect", nor " material", within the meaning of these expressions as defined by the Act. For the purposes of the discussion we shall add a further fact which so far as the report shows was not present, namely that the truth of the answers given was warranted, and that the proposal was made the basis of the policy.

4.26 We consider that section 137 could be applied to excuse the misrepresentation and non-disclosure, and to overcome the basis of the policy provision We assume, as was found, that the answer given was misleading, being an incomplete answer affecting the truth of the statement made, and we further assume that the incomplete answer was not made fraudulently or deliberately. in these circumstances if there was no basis for finding actual knowledge that the additional information not supplied was material to the insurer, a strong case could be made that the alterations were not of a kind which a proponent for insurance ought reasonably to have known were material to the insurer. It would be necessary to consider the significance of the modifications which were consequential upon the disclosed installation of a larger engine, and the fitting of radial tyres on wheels of a common variety. Again this is a matter which we consider could best be left to the court to determine objectively having regard to any explanations or warnings given by the insurer, the expectations of ordinary proponents for insurance, and any particular knowledge or prior experience of the proponent in question.

Sections 137 and 138 - Some Conclusions

4.27 It can be argued that the tests specified by section 137, which include a combination of subjective and objective matters, may lead to uncertainty. There is some force in this argument, since the statutory language requires an assessment to be made of the insured's state of mind, or the knowledge that he or she ought reasonably to have had in relation to the contract of insurance. However, one answer is that such uncertainty is not an unreasonable price to be paid to avoid the harshness inherent in the common law, which may achieve certainty at the cost of unfairness to an innocent insured. We take the view that the changes effected by section 137 (and those adopted by section 138) achieve a fair accommodation between the respective interests of the insured and the insurer and constitute a marked improvement upon the common law rules and the provisions of section 18 of the Insurance Act, 1902. We return to this question in Chapter *7.*

FOOTNOTES

1. N.S.W. Parl. Deb. (Leg. Ass.), 8 October, 1974, pp. 1699-1706, esp. p.1705.

2. N.S.W. Parl. Deb. (Leg. Council), 20 November, 1974, p. 2975.

3. *Ibid.,* pp. 2982-2983.

4. Ibid., pp. 2980-2981.

5. See, for example, Hire Purchase Act 1959 (Vic.), s.21 (1) and statutes cited in R. Else-Mitchell and R Parsons, *Hire-Purchase Law* (4th ed. 1968), p.142.

6. Commercial Transactions (Miscellaneous Provisions) Act. 1974 (N.S.W.), s.6.

7. See, for example, *Partyka v. Wilkie* [1982] ASC 55-213, Supreme Court of New South Wales (Needham J.).

8. Commencement will be delayed, we understand, until certain administrative arrangements are completed which involve contemporaneous commencement between the States of New South Wales and Victoria.

9. See paras 2.1-2.3 above.

10. See paras. 2.4-2.7 above.

11. E.R. Hardy Ivamy, *Marine Insurance* (3rd ed. 1979), p.60.

12. [1975] 2 Lloyd’s Rep. 485.

13. Law Reform Committee, *Conditions and Exceptions in Insurance Policies* (Fifth Report Cmnd. 62, 1957), para. 14(1).

14. [1975] 2 Lloyd’ s Rep. 485, at p.491. Cf *Regina Fur Co. Ltd. v. Bossom* [1957] 2 Lloyd’s Rep. 466, where Pearson J. accepted as material a single conviction for receiving stolen property more than 20 years before the insurance was taken out.

15. [1982] 2 A.N.Z. Insurance Cases 60-493.

Chapter 5. Legislative Reform Outside New South Wales

Life Insurance Act 1945 (Cth)

5.1 Section 84 of the Life Insurance Act 1945 (Cth), which governs life insurance contracts throughout Australia to the exclusion of State law provides as follows:

> A policy shall not be avoided by reason only of any incorrect statement (other than a statement as to the age of the life insured) made in any proposal or other document on the faith of which the policy was issued or reinstated by the company unless the statement
>
> (a) was fraudulently untrue; or
>
> (b) being a statement material in relation to the risk of the company under the policy, was made within the period of three years immediately preceding the date on which the policy is sought to be avoided or the date of the death of the life insured, whichever is the earlier.

5.2 Section 83(1) of the same Act provides:

> A policy is not avoided by reason only of a misstatement of the age of the life insured.

Under section 83(2) the insurer is entitled to the benefit of a principle of proportionality in place of the remedy of avoidance.

Instruments Act 1958 (Vic)

5.3 The Instruments Act 1958 (Vic.) contains provisions to similar effect as those of section 84 of the Commonwealth Act. Section 25 of the Victorian Act provides:

> No contract of insurance (other than a contract of life insurance) shall be avoided by reason only of any incorrect statement made by the proponent in any proposal or other document on the faith of which such contract was entered into revived or renewed by the insurer unless the statement so made was fraudulently untrue or material in relation to the risk of the insurer under the contract.

5.4 These provisions are clearly intended to modify the common law. Two significant limitations upon their effect should be noted:

- each relates to “incorrect statements” and does not extend to nondisclosure;
- they have effect only in relation to statements in documents and do not deal with oral statements. This may be particularly important in the case of temporary insurance, for example, by way of cover note, which is often arranged orally.

Accepting these limitations, it remains plain that the provisions have the capacity to nullify basis of contract clauses. Section 25 of the Instruments Act, 1958 could have the effect in an appropriate case of preventing the insurer from avoiding the policy and, in addition, not giving the insurer consequential relief either by way of additional premium or reduction in the extent of its liability.

New Zealand

5.5 The Insurance Law Reform Act 1977 contains a number of relevant provisions:

section 5(1) provides as follows.

> A contract of insurance shall not be avoided by reason only of any statement made in any proposal or other document on the faith of which the contract was entered into, reinstated, or renewed by the insurer unless the statement
>
> (a) Was substantially incorrect; and
>
> (b) Was material.

section 6 defines the terms “substantially incorrect” and “material”:

> (1) [A] statement is substantially incorrect only if the difference between what is stated and what is actually correct would have been considered material by a prudent insurer.
>
> (2) [A] statement is material only if that statement would have influenced the judgment of a prudent insurer in fixing the premium or in determining whether he would have taken or continued the risk upon substantially the same terms.

section 11 forbids exclusions in terms similar to those employed in section 138 of the Consumer Credit Act 1981 (N.S.W.). Section 11 provides.

> Where -
>
> > (a) By the provisions of a contract of insurance the circumstances in which the insurer is bound to indemnify the insured against loss are so defined as to exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances; and
> >
> > (b) In the view of the Court or arbitrator determining the claim of the insured the liability of the insurer has been so defined because the happening of such events or the existence of such circumstances was in the view of the insurer likely to increase the risk of such loss occurring -
>
> the insured shall not be disentitled to be indemnified by the insurer by reason only of such provisions of the contract of insurance if the insured proves on the balance of probability that the loss in respect of which the insured seeks to be indemnified was not caused or contributed to by the happening of such events or the existence of such circumstances.

These provisions were enacted following the Report of the Contracts and Commercial Law Reform Committee on *Aspects of Insurance Law (1975).*

5.6 Broadly speaking, section *5* of the New Zealand Act is subject to the same criticisms as section 25 of the Instruments Act 1958 (Vic.) and section 84 of the Life Insurance Act 1945 (Cth). Section 11 of the New Zealand Act is comparable to section 138 of the Consumer Credit Act 1981 (see paragraph 4.6*,* above) and provides a source of relief to insured persons where the description in an insurance policy of the ambit of the risk or the operation of a provision in that policy would operate to deprive the insured of indemnity for reasons that in essence have nothing to do with the risk actually run or the true cause of the loss suffered.

Conclusion

5.7 It can be seen that legislative steps have been taken outside New South Wales to soften the impact on insured persons of the rigid rules of common law. An accommodation has been sought to be achieved between the competing interests. On the one hand, the object has been to retain the essential concept of materiality and to protect insurers from deliberate or fraudulent misconduct on the part of proponents for insurance. The other purpose has been to protect insured persons from the consequences of material misstatements or innocent non-disclosures, where it is reasonable to do so. They have also been protected from contractual provisions which might allow the insurer to limit or

exclude liability on the basis of events or circumstances having no relevance to the loss for which indemnity is sought. We think that this general approach is justified and should be followed in New South Wales.

Chapter 6. Law Reform Recommendations by Others

6.1 It is not intended in this report to list comprehensively all suggestions for law reform made in relation to the common law rules the subject of this report. However, since similar problems have been encountered in other common law jurisdictions we refer to a limited number of such proposals.

England

6.2 In October, 1980 the report of the Law Commission of England entitled Insurance Law - Non-Disclosure and Breach of Warranty"[1] was presented to Parliament. The report concluded that the law of non-disclosure and of warranties was deficient in important respects:

> The creation of various warranties as to past or present fact by the operation of a "basis of the contract" clause on answers in a proposal form constitutes a major mischief in the present law ...[2]
>
> Where the insured has committed a breach of warranty which consists, wholly or in part, of the making of a non-fraudulent misrepresentation, the insurer should not be entitled to rely on the misrepresentation as such but should be confined to his rights and remedies (if any) for breach of warranty...[3]
>
> There should be no change in the law relating to fraudulent misrepresentation ...[4]

6.3 The report of the Law Commission recommends that the duty of disclosure be modified so that a proponent should be required to disclose a fact material to the risk, if it is either known to the proponent or is one which he or she can be assumed to know, or if it is one which a reasonable person in his or her position would disclose to his insurer having regard to the nature and extent of the insurance and the circumstances in which it is sought It can be seen that these recommendations include the significant suggestion that the test of materiality should be made dependent on the perceptions of the reasonable insured rather than the prudent insurer. This would mean that a proponent would not be in breach of the duty of disclosure unless he or she had, in failing to disclose relevant information, fallen below the standard of a reasonable person in the position of the insured. These recommendations of the Law Commission bear a distinct similarity to the principles embodied in section 137 of the Consumer Credit Act 1981. The Law Commission points out that this change in the law would not of itself provide sufficient protection for an insured person but would do so if combined with a clear and explicit warning to the insured at the time of completing the proposal.[5] The report also recommends that copies of completed proposal forms be supplied to insured persons. Similar recommendations are made in relation to renewals.

6.4 The Law Commission also considered the possibility of recommending the introduction of the "proportionality principle". This principle, which has been introduced in certain European countries, involves a reduction in the amount for which an insurer is liable proportionate to the premium that the policy holder should have paid if he or she had declared the risk correctly, as compared with the premium which he or she in fact paid. The Law Commission after careful analysis of the operation of the proportionality principle in practice, rejected it.[6]

The Australian Law Reform Commission

6.5 The Australian Law Reform Commission (ALRC) received a major reference entitled "Insurance Contracts" in 1976 requiring it to report, *inter alia,* upon the adequacy of the law governing all contracts of insurance (with the exception of marine insurance, workers' compensation and compulsory third party

insurance). The report of the ALRC[7] was presented to the Commonwealth Parliament on 14 December, 1982, but prior to presentation we had the benefit of examining it in draft form.[8]

6.6 The ALRC is also of the view that reform is called for on the subjects here under discussion. Its report supports the following reforms:

Non-disclosure:

a statutory statement of the extent of the duty of disclosure, limiting that duty to facts which the insured knows or a person in his circumstances ought to know to be relevant to the insurer;

the imposition upon insurers of a duty to advise proponents of the nature and effect of their duty of disclosure;

Misrepresentation:

the imposition of a duty not to misrepresent facts which the insured knows or a person in his circumstances ought to know to be relevant to the insurer;

a failure to answer a question set out in a proposal form, or an obviously incomplete or an irrelevant answer, not of itself to amount to misrepresentation;

Basis of *contract clauses:*

warranties of existing fact to cease to have effect as warranties and to be treated as representations subject to the usual rules concerning misrepresentation;

Remedies:

abolition of the right to avoid the contract for innocent non-disclosure or misrepresentation, and the substitution of a right to damages;

maintenance of the right to avoid the contract for fraudulent non-disclosure or misrepresentation subject to the court's discretion to award damages instead.

6.7 The ALRC favours the concept of an exclusive code, that is, the introduction of statutory provisions which will exclude all other rights. Our recommendations are consistent with those presented by the ALRC. The implementation of our recommendations will therefore not prejudice the revision of the general law of insurance in accordance with the ALRC's recommendations.

FOOTNOTES

1. Law Commission, *Insurance Law - Non-Disclosure and Breach* of *Warranty* (Cmnd. 8064, 1980, Law Corm. No. 104). See also Law Reform Committee. *Conditions and Exceptions in Insurance Policies* (Fifth Report, Cmnd. 62, 1957).

2. Law Commission, note 1 above, para 10.39.

3. *Ibid.,* para. 10.42.

4. *Ibid.,* para. 10.44.

5. *Ibid.,* para. 4.60.

6. *Ibid.,* paras 4.2-4.17.

7. *Insurance Contracts* (1982, ALRC 20).

8. We wish to record that we are greatly indebted to the Australian Law Reform Commission and, in particular, to the Commissioner in Charge of the reference, Professor David St. L Kelly, for generous advice and providing the fruits of their research for our consideration.

Chapter 7. Reform in Relation to Non-Disclosure, Misrepresentation and Basis of Contract Clauses

Our Approach

7.1 The general issues posed by the subject matter of this report are not easily resolved. The difficulty is to achieve reform in the interests of insured persons, yet preserve a fair balance between insurer and insured. The law must try to achieve an accommodation between the clear entitlement of the insurer to have enough information adequately to assess the risk and, on the other hand, the need to protect an innocent insured who may suffer a catastrophic loss because of an inadvertent omission or misrepresentation.

7.2 Reforms in New South Wales and elsewhere in recent years have been directed towards modification of some of the strict duties which are imposed on the insured by the common law or by the contract of insurance itself. One approach has been to give the courts power to excuse a breach by the insured of a term or condition of a contract of insurance which does not prejudice an insurer (section 18 of the Insurance Act, 1902), although this provision has not provided relief in all circumstances where it might be thought appropriate. Another approach has been to provide that an innocent misrepresentation or omission shall not render the insurance contract void or unenforceable unless the misstatement or omission was material to the insurer and the insured knew or ought reasonably to have known this (section 137 of the Consumer Credit Act, 1981). Each section approaches the problem in a rather different way, but the common purpose, broadly speaking, is to protect an innocent insured whose conduct has not been unreasonable and has not materially affected the insurer.

7.3 In New South Wales the difficulty has not been so much to ascertain a general legislative policy, but to ensure that the implementation of that policy is effective to achieve its purpose. The specific problem has been the deficiencies that have become apparent in section 18 of the Insurance Act, 1902 and have been identified earlier (paragraphs 2.9-2.10). We think that those deficiencies should be overcome, since otherwise there is an unintended gap in the protection afforded by the law. We think the most convenient way of overcoming the deficiencies and achieving harmony in the law is to enact general legislation following the form of sections 137 and 138 of the Consumer Credit Act, 1981.

Overcoming the Deficiencies

7.4 We have identified two deficiencies in section 18 of the Insurance Act, 1902.

> The first is that the section has been held not to apply to a breach by the insured of the common law duty of disclosure of material facts (paragraphs 2.3, 2.7, 2.9). Thus the court has no power to excuse an innocent non-disclosure in breach of the common law duty, even though the non-disclosure had no bearing on the making of the contract of insurance or the loss which ultimately occurs.
>
> The second is that section 18 may not apply where the insured breaches a “basis of contract” clause (paragraph 2. 10). Consequently the court may not be able to excuse an innocent and immaterial mis-statement in the proposal.

The power of the court under section 18 to excuse a breach by the insured of his or her duty to the insurer is therefore subject to serious limitations which in our view are capable of causing injustice.

7.5 We have also identified a further possible weakness in section 18, in that the insurer may too readily be able to show “prejudice” within the meaning of the section (paragraph 4.8).

7.6 We have explained that sections 137 and 138 of the Consumer Credit Act, 1981 substantially change the common law and the pre-existing rules relating to non-disclosure, misrepresentation and exclusion clauses (paragraphs 4.7 ff). These sections (in relation to the limited class of transactions to which they apply) overcome the defects we have identified in section 18 of the Insurance Act, 1902. Section 137(b) applies to breaches by the insured of the common law duty of disclosure (paragraph 4.9). Unless the insurer is able to satisfy the conditions specified in the subsection such a breach will not result in the insurance contract being avoided or rendered unenforceable. Sections 137 and 138 may be invoked notwithstanding that the insured has "breached" a basis of contract clause by incorrectly or insufficiently completing a proposal, where that document and the answers thereto have been made the basis of the policy (paragraphs 4.13-4.16).

7.7 The extension of sections 137 and 138 of the Consumer Credit Act, 1981 (subject to exclusions mentioned later) would therefore overcome what can be described as the threshold defects in section 18 of the Insurance Act, 1902. In addition, the sections are not subject to the limitations inherent, for example, in section 25 of the Instruments Act 1958 (Vic) (paragraph 5.4).

A Fair Accommodation?

7.8 The next question is whether section 137, in particular, reaches a fair accommodation between the interests of the insured and of the insurer. The scheme of the section has been explained (paragraphs 4.9-4.10). Section 137 substitutes a different test from that employed in section 18 of the Insurance Act 1902, for the purpose of determining whether the insurer has been so adversely affected by a misrepresentation or non-disclosure as to warrant avoidance of the insurance contract.

7.9 The provisions of section 137 have received thorough and detailed consideration and represent a Parliamentary solution to the general problem with which we are concerned. The section has been enacted in identical form in New South Wales and Victoria.[1] We understand that both Acts are likely to be proclaimed to commence within a reasonably short time. The responsible Ministers in each State have stated in Parliament that they hope other Australian States will legislate in similar terms in relation to consumer contracts generally.[2] Thus it is proper to conclude that the section has been regarded by the policy makers and Parliaments of two States as reaching a fair accommodation between the interests of insurer and insured.

7.10 Some criticisms could be levelled at the scheme of section 137. The tests an insurer must satisfy in order to avoid an insurance contract involve a combination of the insured's subjective belief and an assessment of whether the insured's failure to appreciate that material information had been misrepresented or omitted was unreasonable. In the application of these criteria, as we point out elsewhere (paragraph 4.18), a great deal will depend on the facts of each case. We think that courts will not experience undue difficulty in applying the statutory criteria, which reflect the approach recommended by the English Law Commission in 1980 (paragraph 6.3).

7.11 The tests that an insurer must meet under section 137 are significantly more stringent than the test of "prejudice" established under section 18 of the Insurance Act, 1902. For reasons explained earlier (paragraphs 4.9-4.11, 4.13), we consider that the tests in section 137 accommodate both the legitimate interests of insurers and the legitimate expectations of honest and careful proponents for insurance. We therefore do not consider that the legislative solution embodied in section 137 can be characterised as unfair to insurers.

An Incentive to Dishonesty?

7.12 A major insurance company operating in New South Wales[3] has suggested to us that we should be cautious in recommending changes in this area lest our recommendations have the effect of encouraging dishonest or unjustified insurance claims. The company points out that in recent years the incidence of general insurance claims, particularly in the fields of motor vehicle and home burglary insurance, has increased sharply. The company reports that in dollar terms claims during 1981-1982 in respect of car thefts increased by 45% over the preceding year. The increase in claims for domestic burglaries over the same period was about 64%. The company considers that these figures indicate a

significant increase in unjustified claims, including “sham burglaries”, deliberate destruction of property and inflated claims.

7.13 We accept that dishonest or unjustified claims constitute a significant problem for the insurance industry and that our recommendations should not encourage or facilitate fraudulent claims. The extension of section 137 of the Consumer Credit Act 1981 into the general insurance area would not, however, provide protection to an insured whose behaviour has been dishonest or reckless. The section by its terms does not assist a person who has withheld material information deliberately or who knows or ought to know that the information is material to the insurer.

7.14 It is true that our recommendations, if implemented, will deprive insurers of the opportunity in some cases to raise the defence of non-disclosure. it is also true that reputable insurers may choose to raise an essentially technical defence where they suspect (but perhaps cannot prove) that an insured person has acted dishonestly. (It is difficult to imagine that a reputable insurer would rely on a defence of non-disclosure, where there is no significant prejudice, unless it is believed that the insured has been dishonest.) But in our view it should be a court and not the insurer that determines the truth of allegations of fraud. Suspicions may be unfounded. Moreover, not all insurers are reputable and the general availability of technical defences of the kind discussed means that honest insured persons could be deprived of indemnity which they should receive. in addition there is always the possibility of the honest insured being deprived of indemnity by somebody whose duty it is to take technical points, for example, a liquidator.

7.15 We appreciate that to the extent that the incidence of successful insurance claims increases, the burden will fall on the general body of insurers and, through higher premiums, on the public at large. However, a substantial proportion of contracts of insurance, particularly in respect of motor vehicles, will be covered by section 137 of the Consumer Credit Act, 1981 when that section comes into force. For reasons we have already given we think it is unlikely that the reforms proposed in this report will significantly increase the incidence of insurance claims, whether fraudulent or otherwise.

Legislative Harmony

7.16 The desirability and utility of uniformity and harmony in legislation within a State and among States needs no elaboration. Any argument for adopting legislation in relation to insurance contracts generally (that is, insurance contracts other than “consumer” contracts) in substantially different terms from the Consumer Credit Act 1981 would, in our opinion, need to be strongly based and to demonstrate clear inadequacy in sections 137 and 138.

7.17 A significant development in the insurance market, that bears on the need for legislative harmony in Australia, is the growing tendency on the part of insurance companies to issue to one insured a number of different insurance policies in one “book”. For example, a person buying a house might well obtain a “book” of insurance policies. One policy will insure the house against fire, one the contents, another public liability risks, yet another his or her motor car, and so on In our view, it is important that all policies should be governed by the same set of rules. If the provisions of the Consumer Credit Act, 1981 were not to be extended to other forms of general insurance, the consequences of one non-disclosure might vary as between the policies depending on which happened to be caught by that Act. Similarly, if the extension were not made, the position of insured persons with identical policies would vary depending upon whether the items covered were subject to a consumer credit arrangement. Clearly, anomalies and complexity could be avoided if general statutory provisions in the same terms as sections 137 and 138 of the Consumer Credit Act 1981 were to be enacted.

Problems of Interpretation

7.18 We have given careful consideration to sections 137 and 138 to ensure that in the pursuit of uniformity and harmony in legislation a reforming provision is not adopted which is either inadequate or productive of difficulty in interpretation and application. In the following paragraphs we outline the matters we have taken into account and our reasons for concluding that the sections can be adopted as provisions of general application, subject to two amendments to section 137 and one to section 138.

7.19 *Voidable.* Section 137 provides that a contract of insurance within its reach is not “void or unenforceable”. A failure to disclose material matters technically renders a contract of insurance *voidable* at the option of the insurer, and not void.[4] The word “unenforceable” was no doubt used because the draftsman was looking to the consequences of the insurer’s act in avoiding the contract of insurance, rather than to the right of the insurer to avoid the contract. We recognise that an argument might be put that, if a contract is voidable and is avoided by the insurer, there is no longer any contract to enforce and it cannot therefore be described strictly as unenforceable. However, in our view, it was clearly intended that section 137 should extend to insurance contracts that would, apart from the section be voidable. Any other view would render the section wholly or substantially ineffective. We therefore consider that on a proper view the expression” unenforceable” achieves the intended result on the basis that an avoided contract is, in practical terms, unenforceable.

7.20 Nonetheless, in the interests of accuracy and to remove any doubt, we think that any new legislation should refer expressly to the concept of voidability. It is appropriate to preserve the word “void” in the new section to meet the type of contractual provision encountered in *Lambert v. Co-operative Insurance Society Ltd.,*[5] where a non-disclosure was acknowledged to render the policy “ipso *facto* void”, although there may be doubt as to whether such a provision does take effect according to its literal meaning. The new section should therefore delete the words “not void or unenforceable” from the language used by section 137(a) and substitute the phrase “not void, voidable or otherwise rendered unenforceable”.

7.21 *Omission of Matter.* We have considered whether the expression “omission of matter from the contractor a proposal, offer or document” is sufficient to bring within section 137(a) failure to disclose material facts in breach of the common law duty. A possible argument against this view is that the answer given to the questions put maybe full and correct yet there may still be a failure to disclose a material fact about which no question is asked. We consider that the answer to this argument is that unlike other legislation to which we have referred (paragraphs 5.1 and 5.3), the section is not confined to omissions from documents. In our view, on its proper interpretation, the section extends to oral “proposals” and “offers” which are subject to the common law duty of disclosure. A non-disclosure can accordingly be properly described as an “omission of matter from the contract or a proposal, offer or document”. Certainly, the mischief to which section 137 was directed, and to which the proposed section I8A is directed, concerns non-disclosure in every circumstance. Applying recognised canons of statutory interpretation we are confident that the sections would not be interpreted narrowly so as to defeat their clear intent.

7.22 *Cover Notes.* For similar reasons, we think it clear that section 137, and the proposed section 18A, apply to cover notes. They are plainly contracts of insurance and result from a proposal or offer, which commonly is made orally. No canon of construction requires the sections to be read down so as to be confined to written contracts, proposals or offers.

7.23 *Burden of Proof.* We are conscious that express provision is made in section 138 as to the party having the burden of proof, whereas section 137 makes no such provision. We have formed the view that it is unnecessary for the proposed section 18A to provide expressly for this. as the usual canons of interpretation are adequate for the purpose. We refer again to this question in paragraph 7.32.

7.24 *Contracting Out.* We next turn to a matter to which we have devoted considerable attention namely the possibility that insurers might attempt to circumvent or contract out of the legislation given that the proposed section achieves a fair accommodation of interests we consider it unlikely that reputable insurers would attempt to circumvent the legislation. We also think that the courts would be quick to frustrate any such attempt. However, we recognise the possibility that proposal forms or policy documents could be framed which for example, might endeavour to extract an acknowledgment or recognition by the insured that the subject matter of every question is material to the insurer and that the insured knows it to be so. Alternatively, insurers might use the legislation as an occasion for oppressively lengthy, or widely framed and possibly ambiguous questions, so as to cast the net of disclosure as wide as possible.

7.25 At the outset we observe that attempts by insurers to place proponents for insurance on actual or constructive notice of matters which they regard as material, or to include in proposals questions as to all pertinent matters which to them might be material, is neither reprehensible nor contrary to the interests of insured persons. If the legislation achieves the result that insurers more clearly and carefully explain to proponents for insurance what is required of them, that would be beneficial to all and might well reduce the incidence of claims disputed on the ground of non-disclosure. indeed, the purpose of the reforms recommended in this report is ultimately to prevent the *unfair* avoidance of liability. If an insurer clearly and specifically draws the attention of the insured to information that is material, *and it is material to that insurer,* then in general we see no reason why it should not be supplied, or why a failure to supply it should be excused.

7.26 We are confident that courts will not allow the legislation to be abused by devices such as deeming clauses, or declarations as to matters which would be beyond the comprehension of average proponents for insurance. It would not be difficult for the courts to conclude that complex or unfair "deeming" provisions are insufficient of themselves to give rise to knowledge or constructive knowledge of the kind referred to in the section. Similarly, it would not be difficult to read down ambiguous, vague or sweeping questions. Rather, we see the courts as considering the tests prescribed by the proposed section 18A by reference to the entire matrix of facts surrounding the insurance contract. The documents would be but one aspect of that matrix. In our view, matters personal to the insured, including his or her command of the English language, business sophistication (or lack of it) and prior experience in matters of insurance should also be taken into account. Similarly, it would be proper to take into account any misleading or inaccurate advice given by persons for whose conduct the insurer is responsible, where the advice might lead the insured to misunderstand or not to comply with the documentation supplied by the insurer for completion in addition, the knowledge and understanding of average persons would be taken into account.

7.27 We repeat that we are confident that reputable insurers are unlikely to bring to bear an approach deliberately aimed at circumventing the plain intention of the law. For insurers who do attempt to circumvent the law, we consider that the proposed section is adequate to prevent abuses. For these reasons we do not, at this stage, see need for any additional provision designed to limit or prevent practices of the kind in question. If, however, we are wrong, and abuses do occur despite the legislation, the possibility of further reform to overcome the abuses should not be dismissed.

7.28 *The Circumstances* of *the Insured.* We have expressed our view that section 137, as presently drafted, allows a court to take into account matters personal to the insured (such as education, language skills and business experience) in determining what an insured "ought reasonably to have known" (paragraphs 4.20 and 7.26). We recognise the possibility of an argument that the section adopts an objective test of the "reasonable insured", so that the court would be obliged to exclude considerations personal to the individual insured. In our view, this interpretation (if accepted) would frustrate one purpose of the section, since it would discriminate against those who, by reason of education, experience or origin, cannot reach the required standard of care. We do not consider, on the present wording of the section, that this interpretation would prevail but we recommend that in any new legislation the matter be placed beyond doubt. This recommendation is consistent with the approach of the ALRC (paragraph 6.6). This recommendation could be implemented by substituting for the phrase "the insured knew or ought reasonably to have known" the following:

> the insured knew or a reasonable man in his circumstances ought to have known ...

7.29 The recommendation in the preceding paragraph was made after taking a variety of matters into account, including a written submission from the Insurance Council of Australia Ltd. (the ICA), followed by discussion between members of the Commission and the ICA. The ICA submission consistently with our view, accepted that a proper interpretation of the words "ought reasonably to have known" in section 137, requires that considerations personal to the insured be taken into account by the courts. As stated in paragraph 7.28, we envisage the possibility of a contrary argument and recommend the elimination of all doubt by means of the phrase "a reasonable man in his circumstances ought to have known". Therefore, the Commission and the ICA are in substantial agreement on interpretation. However, we diverge on the question of desirable reform. The ICA view is that" equity would be much better served' if the test in section 137 (section 18A in the draft legislation in Appendix I) was an entirely objective one,

that employed the standard of “a prudent insured”. The effect of the ICA suggestion in relation to section 137 and section MA(2) of the draft legislation would be to delete the expression the insured knew or ought reasonably to have known” from the first, and the expression “the insured knew or a reasonable man in his circumstances ought to have known” from the second, and to substitute the expression “a reasonable insured of ordinary prudence ought to have known”.

7.30 We are unable to accept this part of the ICA submission for a number of reasons. These include the following.

> Justice is better served by the use of a test that enables the courts to take into account considerations personal to the individual insured.
>
> Our recommendations will preserve the interests of insurers in the very cases in which the ICA believes insurers should not be disadvantaged, namely, cases where (in the ICA’s words) insured persons “speaking commercially are capable of looking after themselves”. Under the test which we have recommended in paragraph 7.28, it is plain that an insured who, for example, is a knowledgeable lawyer, or a large public company, will be expected to “know” much more than a modestly-educated individual with poor command of the English language. Under the test suggested by the ICA submission the knowledgeable lawyer and the public company could be unduly advantaged in that they need only conform to the standards of “a reasonable insured of ordinary prudence”, even if one happens to be a senior barrister specialising in insurance law and the other employs insurance specialists on its staff. In summary, we believe that the interests of both insured persons and insurers will be better served by the adoption of our recommendation than by the adoption of a “reasonable insured’ criterion.
>
> The ALRC has considered this question at length and given the same answer as we have.[6] In a careful review of the recent history of insurance law reform in the United Kingdom the ALRC draws attention to the fact that the Law Commission in England in 1979 also advocated the same test in a working paper after considering and rejecting the “reasonable insured” test which had been proposed in 1957 by the English Law Reform Committee.[7]

7.31 A suggestion of the ICA that our reform proposals should be confined to domestic insurance, as distinct from commercial and company insurance, in our view lacks justification An exclusion of the kind suggested by the ICA would, for example, deprive small business and many other organisations and persons of the benefit of law reform despite the fact that the existing law may render them vulnerable to catastrophic loss even though they have acted honestly and (given their circumstances) reasonably. We can see no good reason for such an exclusion.

7.32 *Structure of Draft Legislation.* The ICA submission led us to make two amendments to our discussion draft. The first amendment was to divide our draft legislation into two sections (section 18A and section 18B) thus restoring the scheme of the Consumer Credit An 1981 with its separate sections 137 and 138. The Appendix to our original discussion draft contained only one section (section 18A) in which subsections (1) and (2) reflected section 137 and subsections (3) and (4) reflected section 138. The ICA submission drew to our attention the fact that subsections (3) and (4) made provision for the placement of the burden of proof, while subsections (1) and (2) make no such provision. In order to avoid affecting the interpretation of subsections (1) and (2) by reason of their inclusion in the same section as subsections (3) and (4), we changed the draft legislation in the manner described. As mentioned in paragraph 7.23 we are of the view that it is unnecessary for section 18A to make express provision for the placement of the burden of proof.

7.33 *Exclusion Clauses - Section 138.* The second amendment which we have made pursuant to the ICA submission relates to section 18B which provides a mechanism whereby an insured person may remain indemnified in the face of an exclusion clause (paragraphs 4.16 and 4.17). The ICA submission suggested that there could be circumstances in which the continuation of the obligation to indemnify

because of the operation of the section would be unfair to an insurer, because, at the least, the insurer would have required a greater premium at the outset had it foreseen the cancellation of the exclusion. We did not agree with the analysis by the ICA of a hypothetical case put to us in the written submission but we do agree that the terms of section 18B could be improved. In particular, we accept that there could be cases in which there may be no nexus between a loss and an exclusion clause (thus entitling the insured under the section to remain indemnified), in which the insurer, relying upon the exclusion clause, may have been influenced in setting the premium or may even have been influenced to accept the proposal. A case which comes to mind is that of an exclusion in a motor vehicle policy declining cover where the driver is unlicensed or disqualified. A vehicle driven by such a driver may be involved in an accident in circumstances entirely due to the fault of another driver. In such a case it is unlikely that the absence of a licence could be shown to have "caused or contributed to" the loss. Yet it might still be reasonable on policy grounds, for the insurer to rely on the exclusion. We believe that the proposed legislation should be able to accommodate this case and not preclude reliance on the exclusion where appropriate.

7.34 We can see a number of ways of improving the drafting of section 18B but for reasons already given in paragraphs 7.16 and 7.17, we think that it is preferable to retain as much harmony as possible in the relevant legislation. We have, however, come to the view that there is a sound basis for inclusion in section 18B of additional protection for insurers. We believe that this can best be achieved by a similar approach to that which underlies section 18 of the Insurance Act, 1902, namely, conferring on the courts a discretion under which the insurer could be relieved of the obligation to give indemnity when it is reasonable to do so. Accordingly, we have added to section 18B(1) the following words:

> unless in all the circumstances it is not reasonable for the insurer to be bound to indemnify the insured.

Retention of Section 18

7.35 To some extent section 138 overlaps section 18 of the Insurance Act, 1902. Each is designed to allow an insured person to claim and receive indemnity despite the contrary terms of a contract. Yet the two sections are expressed in different terms and are not coextensive in scope. For example, section 18 allows any failure to observe or perform any term or condition of an insurance contract to be excused by the court if the insurer is not prejudiced, while section 138 offers aid to an insured person only if the contract contains an exclusion or limitation clause. There is therefore good reason to retain section 18.

Recommendations

7.36 We therefore recommend enactment of provisions in the form of sections 137 and 138 of the Consumer Credit Act, 1981 subject to the modifications in paragraphs 7.20, 7.28 and 7.34. Our intention is that all insurance contracts governed by New South Wales law, except those contracts and policies described in paragraph 7.39 below, will be subject to the same statutory provisions when it comes to the matters dealt with by this report. The new legislation could conveniently be placed in the Insurance Act, 1902.

7.37 We have considered whether sections 137 and 138 of the Consumer Credit Act, 1981 should be repealed and replaced by the general provisions we recommend (bearing in mind that the terms of the recommended provisions are not identical). We consider this course of action to be preferable to enacting supplementary legislation, with sections 137 and 138 left intact. The replacement of sections 137 and 138 will produce uniform provisions applicable to all insurance transactions other than those expressly excluded from our recommendations (paragraph 7.39). This course of action will eliminate the doubts which might otherwise arise, as to which legislation applies to a particular policy. Difficulties might occur, for example, where a motor vehicle is. insured while subject to a consumer credit agreement and the insurance policy is continued after the credit agreement is concluded. We also see advantages in having legislation regulating insurance contracts contained, so far as possible, within a single enactment.

7.38 If the recommendation in paragraph 7.37 is unacceptable (for example, because it is thought the Consumer Credit Act, 1981 should be left undisturbed so soon after its enactment) the legislation we

recommend should exclude from its scope insurance contracts which are subject to sections 137 and 138 of the. Consumer Act, 1981. This approach would be feasible, since the legislation we propose does not differ in its effect from the sections in the Consumer Credit Act 1981.

7.39 Our recommendations do not apply to the following:

> a life policy as defined by section 4 of the Life insurance Act 1945 (Cth);
>
> a contract of marine insurance as defined by section 7 of the Marine Insurance Act 1909 (Cth);
>
> a third-party policy as defined by the Motor Vehicles (Third Party Insurance) Act, 1942 (N.S.W.);
>
> a policy of insurance or indemnity under the Workers' Compensation Act 1926 (N.S.W.) for the full amount of the liability of an employer under that Act;
>
> a policy of indemnity insurance effected pursuant to and in compliance with the provisions of section 70A of the Legal Practitioners Act, 1898 (N. S. W).

The reasons for these exclusions are given in Appendix II.

7.40 Should the recommendation in paragraph 7.37 not be acceptable it will be necessary to exclude from the new legislation:

> a contract of insurance subject to sections 137 and 138 of the Consumer Credit Act, 1981 (N.S.W.).

7.41 We do not consider it desirable or necessary to repeal the provisions of section 18 of the Insurance Act, 1902.

7.42 Submitted with this report in Appendix I is draft legislation which reflects our recommendations. The draft legislation is in the form of a Bill for an Act for the State of New South Wales. We draw attention to clause 2 of the Bill (to which paragraph 7.25 is relevant). The purpose of clause 2 is to allow a reasonable period between the time of enactment and the time the legislation takes full effect during which insurers may consider (and revise if they so decide) their procedures for making, renewing and reinstating insurance contracts. Three months would be ample.

7.43 In making these recommendations we have borne in mind the Commonwealth Constitution and the fact that the Commonwealth Parliament has power to make laws which would prevail over inconsistent State laws, in relation to all insurance other than State insurance.[8] However, in our view this provides no good reason for failure to introduce desirable law reform on subjects to which State laws have long applied. We therefore believe that the reforms recommended in this report are desirable. As mentioned above in paragraph 6.7, they are consistent with those presented by the ALRC.

FOOTNOTES

1. Credit Act 1981 (Vic.), s. 137.

2. N.S.W. Parl. Deb. (Leg. Council), 1 December. 1981, p.1103; Vic. Parl. Deb. (Leg. Council), 3 December, 1981, p.4137.

3. Letter dated 9 December, 1982 (N.R.M.A. Insurance Ltd.).

4. *MacGillivray and Parkington on Insurance Law* (7th ed. 1981), para. 634; *Joel v. Law Union & Crown Insurance Co.* [1908] 2 K.B. 863.

5. [1975] 2 Lloyd's Rep. 485.

6. Australian Law Reform Commission, *Insurance Contracts* (1982, ALRC 20), pp. 108-112; see also para. 6.6 above.

7. Australian Law Reform Commission, note 6 above, pp. 108-109: see also paras 4.22 and 6.3 above.

8. See App. II below, para. 1 and notes thereto.

Appendix I - Insurance (Amendment) Bill, 1983.

A BILL FOR

An Act to amend the Insurance Act, 1902, with respect to the enforceability of certain contracts of insurance.

BE it enacted by the Queen's Most Excellent Majesty, by and with the advice and consent of the Legislative Council and Legislative Assembly of New South Wales in Parliament assembled, and by the authority of the same, as follows:-

Short title.

1. This Act may be cited as the "Insurance (Amendment) Act, 1983".

Commencement.

2. (1) Sections 1 and 2 shall commence on the date of assent to this Act.

(2) Except as provided by subsection (1), this Act shall commence on such day as may be appointed by the Governor in respect thereof and as may be notified by proclamation published in the Gazette.

Amendment of Act No. 49, 1902.

3. The Insurance Act, 1902, is amended in the manner set forth in Schedule 1.

SCHEDULE 1.

AMENDMENTS TO THE INSURANCE ACT, 1902.

(1) Sections 18A, 18B -

After section 18, insert:-

Misrepresentation and non-disclosure.

18A. A contract of insurance that is entered into, reinstated or renewed after the commencement of this section is not void, voidable or otherwise rendered unenforceable -

SCHEDULE 1 - *continued.*

AMENDMENTS TO THE INSURANCE ACT, 1902 - *continued.*

(a) by reason only of a false or misleading statement made in or in connection with the contract or a proposal, offer or document that led to the entering into, reinstating or renewing of the contract unless the statement was material to the insurer in relation to the contract of insurance and -

(i) the statement was fraudulent; or

(ii) the insured knew or a reasonable man in his circumstances ought to have known that the statement was material to the insurer in relation to the contract of insurance; or

(b) by reason only of an omission of matter from the contract or a proposal, offer or document that led to the entering into, reinstating or renewing of the contract unless the matter omitted was material to the insurer in relation to the contract of insurance and -

(i) the omission was deliberate; or

(ii) the insured knew or a reasonable man in his circumstances ought to have known that matter material to the insurer in relation to the contract of insurance had been omitted.

Limitation on exclusion clauses.

18 B. (1) Where by or under the provisions of a contract of insurance entered into, reinstated or renewed after the commencement of this section -

(a) the circumstances in which the insurer is bound to indemnify the insured are so defined as to exclude or limit the liability of the insurer to indemnify the insured on the happening of particular events or on the existence of particular circumstances; and

(b) the liability of the insurer has been so defined because the happening of those events or the existence of those circumstances was in the view of the insurer likely to increase the risk of loss occurring,

the insured shall not be disentitled to be indemnified by the insurer by reason only of those provisions of the contract of insurance if, on the balance of probability, the loss in respect of which the insured seeks to be indemnified was not caused or contributed to by the happening of those events or the existence of those circumstances, unless in all the circumstances it is not reasonable for the insurer to be bound to indemnify the insured.

(2) The onus of proving for the purposes of subsection (1) that, on the balance of probability, loss in respect of which an insured seeks to be indemnified was not caused or contributed to by the happening of particular events or the existence of particular circumstances is on the insured.

(2) Section 21(2) -

At the end of section 21, insert-

(2) Without limiting subsection (1), sections 18A and 18B do not apply to or in respect of -

(a) contracts of marine insurance;

(b) contracts of life insurance; or

(c) those provisions of contracts of insurance to or in respect of which the Motor Vehicles (Third Party Insurance) Act 1942, the Workers' Compensation Act 1926, or section 70A of the Legal Practitioners Act, 1898, applies.

Appendix II - Exclusions Described in Paragraph 7.39 of Recommendations

Recommendations do not Apply to Life insurance or Marine Insurance

1. The recommendations in this report do not relate to life insurance or to marine insurance, although we mention life insurance for comparative purposes.[1] The reason is that the Australian Commonwealth Parliament has enacted national legislation on both subjects.[2] Such legislation is within the constitutional power of the Commonwealth[3] and covers the field.[4] The Life Insurance Act 1945 (Cth) provides specifically for the exclusion of the operation of named State Acts from the field of life insurance, including the Insurance Act, 1902 (N.S.W.).[5] In addition. clause 4(1) of the Insurance Regulation 1902 (N.S.W.), which was made in 1974 after the enactment of section 18 of the Insurance Act 1902, provides that "contracts of marine insurance and contracts of life insurance are exempt from all of the provisions of Part VI" (including section 18) "of the Act". Item (2) of Schedule 1 to the draft legislation in Appendix I excludes, *inter alia,* contracts of life insurance and contracts of marine insurance. We therefore envisage that amendment of clause 4(1) of the Insurance Regulation 1902 may be thought desirable so as to avoid difficulties of interpretation that might arise from similar exclusions or exemptions appearing both in the statute and in the Regulation. The decision whether or not to make such an amendment is more properly a matter for the expert attention of Parliamentary Counsel than for this Commission and, accordingly, we do no more than mention it.

2. In passing it should be noted that marine insurance extends beyond losses sustained at sea and is regarded as including, for example, ordinary insurance contracts effected by owners of boats, yachts, and dinghies normally moored or kept in inland waterways. In other words, a growing field of insurance exists that cannot be affected by the recommendations of this report, the law of New South Wales, or even the recommendations of the ALRC in its reference on insurance contracts.[6] Unlike the Life Insurance Act 1945 (Cth), which mitigates some of the rigors of the common law,[7] the Marine Insurance Act 1909 (Cth) enshrines in statutory form the traditional principles of common law that we consider to be overdue for reform.[8]

Recommendations do not Apply to Certain Other Insurance

3. Three other kinds of insurance contract are excluded from the recommendations in this report

4. The first exclusion extends to compulsory third party insurance contracts in relation to death and bodily injury caused by the drivers of motor vehicles as described in the Motor Vehicles (Third Party Insurance) Act, 1942. Section 15 of this Act provides a procedure whereby a person (that is, a third party) entitled to a judgment in respect of death or bodily injury may have direct resort to the insurer. Insurers are prohibited from raising against such persons defences based on non-disclosure, misrepresentation and breach of a term of the insurance contract, but may recover from the insured if the latter is guilty of misrepresentation, non-disclosure or breach of such a term. The Act also provides for recovery from a driver who has committed a breach of or has failed to comply with any provision of the Act. This discrete legislation has already changed the common law. Because of this and the structure of the Act, the reforms recommended in this report are not capable of direct application to it but the principles underlying our recommendations could be applied.

5. The second exclusion extends to workers' compensation insurance. Section 18 of the Workers' Compensation Act, 1926 (N.S.W.) prescribes the cover to be extended by insurance policies issued pursuant to that Act. The prescribed form of policy contains a basis of contract clause.[9] Section 18 contains peremptory provisions imposing liability upon insurers, but contains no counterpart to the provisions of the Motor Vehicles (Third Party Insurance) Act, 1942 referred to in the previous paragraph. This has led to litigation and judicial interpretation of the effect of untrue statements in insurance

proposals.[10] The result is that reform of the kind envisaged by this report could not be undertaken in relation to insurance contracts governed by the Workers' Compensation Act, 1926 without detailed study of that Act and the judicial decisions interpreting it. It is plain that the specific recommendations of this report could not safely be applied directly to workers' compensation insurance. However, as with the Motor Vehicles (Third Party Insurance) Act, 1942 the underlying principles of our recommendations could be applied by suitably drafted provisions.

6. The third exclusion from the recommendations of this report extends to solicitors' professional indemnity insurance. Section 70A of the Legal Practitioners Act, 1898 (which was enacted in 1980) has the effect of requiring a practising solicitor to be covered by indemnity insurance "the terms of which are approved ... by the Governor...". The terms currently approved require an insurer to agree not to avoid, repudiate or rescind the insurance contract upon the grounds, *inter alia*, of non-disclosure or misrepresentation. Thus the subject matter of this report has received direct recent attention in so far as professional indemnity insurance is concerned. Further reform is, in our view, not called for.

Insurance Contracts Subject to the Consumer Credit Act, 1981

7. We have given our reasons for preferring that sections 137 and 138 of the Consumer Credit Act, 1981 should be repealed and replaced by the provisions we recommend (paragraph 7.37). If this is unacceptable, a further exclusion will be required, namely, all insurance contracts subject to sections 137 and 138 of the Consumer Credit Act, 1981 (paragraphs 7.38 and 7.40).

FOOTNOTES

1. See paras 5.1-5.2 above.

2. The Life insurance Act 1945 (Cth) and the Marine Insurance Act 1909 (Cth).

3. Constitution, s.51(xiv) - "Insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned."

4. Constitution, s.109.

5. Section 8(1).

6. Marine insurance was specifically excluded from the terms of reference.

7. See paras 5.1-5.2 above.

8. See Marine Insurance Act 1909 (Cth), ss.23-27.

9. See Workers' Compensation Regulations 1926, App. 1; see para. 2.10 above.

10. See comment and cases cited in C.R Mills, *Workers' Compensation (New South Wales)* (2nd ed. 1979), pp. 361-364.