Insurance Contracts Bill 2013 - Submission

1. Introduction

1.1 I was involved in the consultation process for the Bill with stakeholders and through IRAG. I support the policy approach in the Bill.

1.2 I have concerns about the drafting. In my view, it creates unnecessary complications which, if passed in its current form will create cost, frustration and waste of resources in interpretation both for the:

(a) drafting and preparation of insurance contract documentation; and

(b) resolution of disputes.

1.3 It would lead to increased costs for consumers.

1.4 I am a lawyer, academic and director in insurance. I am currently co-authoring, with Michael Kirby and Professor Robert Merkin, the next edition of Sutton on Insurance Law, the leading Australian text on the subject. I set out my credentials in the attached note – Annexure A.

1.5 My submission is limited to a number of sections of the Act, set out in the following paragraphs.

2. Utmost Good Faith – sections 13 and 14

2.1 Cameron Milne thought that a breach of the duty of utmost good faith should, particularly in the claims-handling context, constitute a breach of the ICA and be actionable by ASIC – see the analysis in Annexures B and C.

2.2 Please see the drafting issues in Annexure C. the Bill's additions to section 13 make a nonsense of important parts of the Act. Some more precise drafting is required. The problems with the Bill are ignored by the EM.

3. Unbundling – sections 10, 9 and 27A

3.1 The issue was raised by the Cameron/Milne Report. It is mostly about insurance contracts some terms or parts of which are within the ICA under section 9 but some terms or parts are without the ICA. Workers' comp was the main example.

3.2 The Cameron/Milne Report does contain some passages which suggest it might be a wider problem This nuance has been taken up enthusiastically by

a defendant law firm and it now has an exaggerated authority and importance in the life industry. The issue is used to suggest, for example, that when a husband's life policy is avoided because of his misrepresentation or non-disclosure, his wife loses her cover too. And that an insurer can avoid a contract with multiple covers and benefits only if the misrepresentation or non-disclosure affected all of the covers and benefits. I doubt that the ICA has either of these effects. The better view is that the EM is wrong on this point in para 1.106 although the misconception is now so wide-spread that a clarifying amendment may be worthwhile.

3.3 While there is a case for an ICA amendment on the issue on para 3.1, the case is less strong for the issue in para 3.2. On the other hand some clarity might help both customers and the industry. I attach a short note on the wider background to the issue – Annexure B – see the shaded part.

3.4 Looking more closely at the ICA, it is clear that section 10, the proposed sections 9(1A)-(1C) and the proposed section 27A are each dealing with 3 different parts of the one central issue – how does the ICA apply to hybrid contracts?:

(a) where one contract (not proposed contract ?) is partly insurance and partly not insurance – the ICA applies to the insurance part – section 10;

(b) where one **insurance** contract is partly a type of insurance that is within section 9 and partly without section 9 – the ICA applies to the part within section 9 – section 9(1A)-(1C); and

(c) where one **insurance contract** has more than one cover or life insured (on underwriting see below) - the ICA applies to each cover and life – section 27A. This feature is also the subject of the Corporations Act, section 764 (1A) and (1)(d).

3.5 I think the reference in section 27A(3) to underwriting is a mistake. Underwriting as a process is either irrelevant or dealt with adequately under Part IV. Underwriting as definitional of a type of cover is also irrelevant to its characterisation as bundled, hybrid or severable. Therefore, I think that section 27A(3) should be omitted entirely.

3.6 An important issue is that while sections 9 and 10 apply to the whole of the ICA, section 27A applies only to misrepresentation or non-disclosure

remedies under Div 3, Part IV but surely it must apply at least to the whole of Part IV. It also would need to apply to Part VII on cancellation because the same principle would apply in Part VII and the two parts are linked. And if the point in para 3.2 above has merit, it would also apply to sections 35/37, and Part VIII would need to be thought through carefully so that the subrogation elements were not lost or became circular. Finally, if an unfair contract terms amending Bill comes through, it will impact here (as well as many other parts of the ICA). I think that the relevant amendments should apply to the whole ICA.

3.7 A subsidiary issue is that the drafting of these 4 provisions should be consistent. I am concerned about the vagueness or inaccuracy of : 'separate','single','comprised' and 'form' in the current bill. The ICA uses 'enter into' rather than 'form' and the usage should remain consistent and therefore "enter into". While 'kind of cover' is newish, it is a common and well understood term.

3.8 I therefore suggest that the current section 10 is the basis for any amendments as follows – the new text is in green:

Section 10

1. A reference in this Act to a contract of insurance includes a reference to a contract that would ordinarily be regarded as a contract of insurance although some of its provisions are not by way of insurance.

2. A reference in this Act to a contract of insurance includes a reference to:

   (a) a contract that includes provisions by way of insurance in so far as those provisions are concerned, although the contract would not ordinarily be regarded as a contract of insurance;

   (b) the provisions of a contract of insurance, which provisions would, if the provisions constituted a contract of insurance, be a contract of insurance to which this Act applies.

3. Where a provision, included:

   (a) in a contract that would not ordinarily be regarded as a contract of insurance;

(b) in a contract of insurance is not a provision to which section 10(2)(b) applies,

affects the operation of a contract of insurance to which this Act applies, that provision shall, for the purposes of this Act, be regarded as a provision included in the contract of insurance.

4. If a contract of insurance provides 2 or more kinds of cover or provides cover in relation to 2 or more lives insured, this Act applies to that contract of insurance in relation to each of those kinds of cover or life insured, as if the contract provided only that kind of cover or provided cover only in relation to one life insured.

4.1 Overall, on this approach:

(a) section 9(1)(f) remains;

(b) section 9(1A)-(1C) is now in section 10 (2) and(3).

(c) section 27A is now section 10 (4)

Most importantly, these concepts apply consistently throughout the ICA Act.

4.2 The concepts that are based in the IC Act use IC Act terminology and the concepts that are based in the Corporations Act use Corporations Act terminology. Consistency of language leads to more certain outcomes.

4.3 The problems with the Bill are ignored by the EM.

5. **Section 29**

5.1 Section 29 relevantly imposes the 3 year rule on life insurance products. Its effect is that if a non-disclosure or mis-representation is not discovered within 3 years of the policy issue, it can be avoided only if there is proven fraud. This rule is against the interests of customers and life insurers. There was a consensus in the consultation process that it should be removed. The analysis on which this consensus was based is set out in Annexure D.

5.2 The Bill's drafting to achieve this purpose is flawed in its introduction of sections 29 (7) and (8). They are unnecessary, unfair and impractical.

5.3 The changes to section 29 remove the 3 year rule. They make section 29 on life insurance congruent with section 28 for general insurance – both sections have the same causes and should have the same solutions. There is no need for a reasonable and prudent insurer test as the Bill proposes. There is no

such test under section 28. Its only secure place in the common law is as a test for the action of an insurer which is avoiding a contract - no longer a part of Australian law under the ICA. The idea features nowhere else in the ICA. The plural reference to "insurers" in this context would require the insurer which has been misled, to compare its position with two other entities. The search for 'similar contracts' is difficult and not required of general insurers where this scheme has been operating successfully for nearly 30 years. The reference to 'underwriters' in the EM, para 1.118 is particularly unhelpful because it is completely inconsistent with the Bill's proposed section. The impracticalities could destroy the change the benefit is designed to bring.

5.4 These strange and inconsistent limitations on the section are omitted from the EM.

6. **Section 59A**

6.1 ***Issue*** The ICA to date has no cancellation grounds for life insurance. It seems sensible that here should be some. The Bill makes the ICA a complete code for cancellation of life insurance contracts but allows only cancellation for fraud. There is no right to cancel for any of the grounds permitted for general insurance. There is no clear right to cancel for the non-payment of premium – the Life Insurance Act 1995, section 210 raises no salvation here because it probably applies to investment life contracts only. This problem is confirmed by the drafting of the new section 29(10). The EM in para 1.123 is wrong on this point. It is also wrong on *Walton's case* in para 1.124: it does not stand for any such principle and it has no such effect. See Annexure E. A life insurer often issues a policy which can provide multiple benefits in multiple circumstances. It is not the case that they pay only on death. What are appropriate grounds for cancellation of a life insurance contract ? The submission is that they should be similar to the grounds for general insurance. It would follow that the harsh and unfair exception in section 59A (2)-(5) (there is no equivalent for general insurance contracts) should also be removed. The problems with the Bill are ignored by the EM.

6.2 ***Avoidance and cancellation*** The first step in the analysis is a clear distinction between avoidance and cancellation.

6.3 Avoidance is a remedy for **pre-contractual** conduct causing flaws in the negotiation process – for insurance this is mostly disclosure and

representation. There are some other pre-contractual conduct circumstances which also found avoidance like unconscionable conduct .There is a line of authority that holds that avoidance can apply when there is fraud.

6.4 Cancellation, or better known at common law as termination, is a remedy for **conduct during the contract** which breaches a promise or term of the insurance contract. It is to be distinguished from termination by expiry, dealt with under the ICA by section 58. At common law, the remedy arose traditionally only if the term breached was a warranty (there is some terminological complexity because a condition was known in insurance law as a warranty and vice-versa) not an ordinary term and this classification was based on an analysis of the text of the contract itself . Since, the common law has developed the doctrine of innominate term which allows a court to judge whether the remedy is available not just by an analysis of the text of the contract itself but by looking at the consequences of the breach and other factors.

6.5 ***Section 31***.In the ICA, Part IV allows avoidance for misrepresentation or non-disclosure only in some cases – fraud (sections 28(2) and 29 (2)) - and otherwise applies a proportional reduction in liability for the relevant claim; the assumption is that these issues arise only at claim time. Section 31 allows a court to order payment of some of the claim even when the misrepresentation or non-disclosure is fraudulent – thus only if section 28(2) or 29 (2) apply - and enables reinstatement of the contract for that purpose only. Section 31(4) expressly limits the reinstatement by saying that the contract is not generally reinstated and remains avoided. Section 31 does not deal with and is irrelevant to cancellation. It is possible that section 31 could apply to enable a particular claim to be paid but the insurer could cancel the contract, where it is a general insurance contract, under section 60 (1)(b) or (c). The commercial and policy position is that while it is reasonable for an accrued right to claim be discharged by the insurer, even proportionately except in a case of fraud, the insurer could still limit its exposure to a defaulting insured by cancelling the contract so that the insurer did not have continuing liability for insured events or conditions in the future.

6.6 ***Section 56.*** Section 56 precludes avoidance for a fraudulent claim – see para 7.3 above. It allows a court to order a proportional payment on a fraudulent claim. Section 56 does not deal with and is irrelevant to cancellation. It is

possible that section 56 could apply to enable a particular claim to be paid but the insurer could cancel the contract, where it is a general insurance contract, under section 60 (1)(a),(d) or (e). The commercial and policy position is the same as for section 31.

6.7 ***Sections 60 and 54.*** Section 60 is confined to cancellation of general insurance contracts. It works with sections 31 and 56 on mis-representation, non-disclosure and fraud as set out above – sections 60(1)(b),© and (e). There is some difficulty with section 60(1)(a) and (d); these are in effect breaches of the insurance contract. Section 54 also deals with a breach of contract. It superficially seems odd to allow the payment of a claim under section 54 even where a breach of contract is involved but then to allow an insurer to cancel the contract for the same breach. The oddity is normalised by the analysis that section 54 does not deal with breaches alone, it deals with a wide range of conduct that might disentitle an insured to a claim payment. Non-compliance with the policy is not necessarily a breach eg a claim must be submitted within 30 days after the event but it also falls under section 54. It may be argued that 60(1)(d) applies to non compliance and it should be limited to breach Further, section 54 deals only with the consequences of a claim. Thus, it is consistent with the scheme of Part IV (including section 31) and section 56 of preserving claim rights so that the consequences of the insured's default or non-compliance are proportional to the adversity to the insurer's interests and a 'just and equitable test is applied. But section 54, like 31 and 56, through section 60, allow the cancellation of a contract for the breach. The commercial and policy position for section 54 is the same as for sections 31 and 56. This analysis also avoids the pitfall of threading the law on conditions, warranties and innominate terms through section 54.But it does highlight that section 60(1)(a) and (d) can apply no matter how severe or light the breach; if that is a flaw it must be cured throughout the ICA, not just in sections 54 and 60.

6.8 ***Cameron/Milne.*** This issue was not the subject of comment from Cameron/Milne which focused on the effect of section 54 on claims made and claims notified liability policies. Cameron/Milne touched recommended that the powers under section 31 and 56 could be excised by a tribunal as well as a court and recommended the extension of section 31 to innocent non-disclosure or misrepresentation (Paras 7.46-8.30); it did not deal with the interaction of section 60 and the above sections.

6.9 Cameron/Milne considered but rejected the introduction of a section 59A (paras 7.46-7.59) for life insurance .The FSC originally indicated it would be content with the deletion of all but the fraud ground for cancellation. The reasoning leading to this concession was that life policies usually have only one claim (death, TPD and terminal illness) but there are examples of multiple claims for traumas and disability for IP policies.

ANNEXURE B

A SHORT HISTORY OF THE INSURANCE CONTRACTS ACT 1984 (ICA)

The history of consumer protection regulation for insurance can be said to begin with the work of Justice Kirby and the ALRC in 1980. Before that date, consumer regulation in the insurance industry was sporadic and not coherent. While the Life Insurance Act, 1945 and the Insurance Act 1973, on general insurance, were principally prudential regulatory legislation, they did contain some provisions which affected the insurance contract itself. The Trade Practices Act, 1975 contained important provisions on misleading and deceptive conduct affecting the sale of insurance products and the conduct of insurers and their agents. But there was no comprehensive legislation on the insurance contract itself nor the conduct of insurance agents and brokers.

The Law Reform Commission under Justice Kirby in 1980 published its report on Insurance Agents and Brokers which recommended that insurers should be responsible for their agents but not for brokers. And in 1982 Justice Kirby's ALRC report on insurance contracts was published which recommended the Insurance Contracts Act with four main purposes or types of sections.

The ICA 1984

The first type are provisions which deal with pre-contract issues: insurable interest[1] and conduct[2]. A fundamental feature of these provisions is the limitation of an insurer's remedies for an insured's conduct. Importantly, the effect of a misrepresentation or non-disclosure was to be proportionate to the prejudice to the insurer, not the loss of the whole contract no matter how venial the sin nor how disconnected from the loss. Secondly, the Act set out standard terms of cover, which could be discarded by the insurer giving notice of the difference to the customer. The third types are provisions which explicitly or implicitly add or subtract terms in the insurance contract, or give them limited effect in certain circumstances. There are some limitations and prohibitions on the legal effect of certain common terms of the insurance contract. Some modify the general law so that the insurance contract operates differently. Some require notification of a term for it to be effective under ICA[3]. Importantly, the effect of a breach of the contract was also to be proportionate to the prejudice to the

[1] Part III.
[2] Part IV
[3] They are found in ICA Parts V-VIII.

insurer, not the loss of the whole benefit and contract no matter how mortal the sin nor how disconnected from the loss. The fourth type of provisions are those which require the insurer to give information, notices or reasons on a subject[4].

Cameron/Milne and Section 54

The 1990's saw some amendments to the ICA. Then Alan Cameron and Nancy Milne (Cameron/Milne) were appointed in September 2003 to conduct a general review of the ICA. There was a focus, following the HIH collapse, on section 54 in the context of reform of the indemnity insurance market amongst a package of measures including professional standards legislation, proportionate liability, amendments to the Trade Practices Act 1975 and consideration of ICA, section 54. There was a concern that its operation to excuse the late notification of claims and the late notification of circumstances for 'claims made' and 'claims made and notified' insurance contracts was a contributing factor, for long tail insurance in discouraging insurers from offering claims made insurance in Australian and increasing costs and reducing the breath of cover in claims made insurance. Cameron/Milne reported on section 54 in October 2003. They recommended that section 54 be amended so that it did not apply to failures to notify circumstances. They also recommended that an extended reporting period be available for the late notification of circumstances and that insurers should notify insureds before a policy expired, of the necessity of making such notifications. The Review produced the 2004 Bill which has not been passed.

Cameron/Milne and the ICA

Cameron/Milne then reported on the balance of the ICA in June 2004. I concentrate on a number of areas: scope, including 'unbundling'; codes of practice; utmost good faith; mis-representation and non-disclosure in life insurance ;standard cover; and third party beneficiaries.

Scope and 'unbundling'

Cameron Milne recommended 'unbundling' in two very specific contexts and ways[5]. Firstly, workers' compensation insurance contracts should be excluded in their entirety from the ICA even if the contracts contained cover for employers'' common law liability for employment related personal injury[6]. Secondly, ICA, section 9, dealing with types of insurance contracts that are excluded from the

[4] Parts IX and X and sprinkled in Parts V-VIII.
[5] Paras. 1.14-1.26 –
[6] Recommendation 1.3.

ICA, should apply to each part of the insurance contract as if it were a separate contract[7].

This recommendation has then extended by some legal views to mean also that a reference in the ICA to a contract of insurance means only the whole policy or suite of policies issued to an insured but does not mean each contract within the policy or document. This is a misreading of the ICA and the applicable common law on separate interests under an insurance contract. There is a separate question about the application of the ICA to each 'kind of cover' in the contract. The starting point is that the law treats an arrangement as capable of being a contract if there is certainty on four main terms: parties, period, premium and performance (risk and benefit). The law then applies rules about how the interests of one or more parties to a contract are calibrated by applying the relatively clear principles about what constitutes a joint or composite contract and what are the consequences of that characterization for the rights and obligations of each party. The different question here, about how the ICA and some sections of it, apply to parts of a contract or a 'kind of cover'[8], is to some extent novel.

One approach would be that the ICA and its sections should apply to a contract and that only where a policy or document can be severed into two or more contracts, should the ICA apply to each contract. On this basis, the ICA does not need amendment to achieve this purpose. The Cameron/Milne Report refers, on this approach, correctly and conclusively to the subject policies as 'composite' and the law on their operation is sufficiently clear so as to make extravagant amendments to the ICA unnecessary[9]. It would follow that the Insurance Contracts Amendment and Bill, 2010, sections 9(1A),(1B) and (1C) and 27A may render other parts of the ICA hazardous as well as being more complex than necessary for their purpose.

The other approach would be that the ICA and its sections should apply to any 'kind of cover' under a contract. The common law gives a less reliable guide on this issue. The concept of 'severing one term or part of a contract from the rest is usually in the context of a contract that is in part illegal, for example an unlawfully onerous restrictive covenant on future employment. On this

[7] Recommendation 1.4; compare recommendation 7.1
[8] compare Corporations Act, 2001, sections 764(1A) and (1)(d).
[9] para. 1.1; but compare para. 7.36-7.39 and Chapter 9.

approach, amendment to the ICA is necessary to achieve this because the concept is novel and the ICA's application is otherwise unpredictable.

A practical example makes the point. A policyowner who is the life insured buys a life, TPD and trauma product – first product. The same person buys a separate disability income product from the same company at the same time – second product. The parties and period are the same. The premium for the life and TPD is the one amount because both are underwritten together and on the same basis. The premium for trauma and disability income are calculated separately from the others and from each other. The same applies to underwriting and terms. A misrepresentation or non-disclosure by the insured has a different impact on each of the four risks. The ICA applies separately to the first product and to the second product which means that the impact is product specific. The ICA also applies separately to the life/TPD and the trauma covers in the first product because each is a separate contract, which means that the impact is product specific. But the ICA arguably applies to the life/TPD as a whole because each is merely a separate risk and benefit or cover. The practical result may be that if one part is affected by a misrepresentation or non-disclosure ,the whole contract is affected and the policyowner who is the life insured is at risk of having the contract avoided or both the benefits reduced.

Codes of Practice

Cameron/Milne recommended[10] that best practice guidelines on claim handling processes should be deployed and included in the relevant industry Codes[11]. The GI Code contains a section with detailed terms on claims handling on a one size fits all basis. The challenge for the Independent Review is to develop clear, simple and practical recommendations on this subject which balance workable specific detail and good guidance.

Utmost Good Faith

Cameron Milne thought that a breach of the duty of utmost good faith should, particularly in the claims-handling context, constitute a breach of the ICA and be actionable by ASIC. The report recommended that a breach of the duty of utmost good faith should be both a breach of an implied contractual term and a breach of the IC Act, although the breach of the IC Act would not be an offence and

[10] Recommendation 1.1.
[11] paras. 1.2-1.9

would attract no penalty[12]. That recommendation is linked to but separate from the subject recommendation and is not the subject of this note.

The focus of the first extract of the report was on claims handling and on contract terms implied by the ICA – see below. The focus of the second extract of the report was on whether the ICA dealt adequately with unfairness in insurance contracts. Cameron Milne thought that some breaches of the ICA might constitute a breach of the utmost good faith duty and gave the example of section 40. The report did not develop the idea or the practicalities of its implementation. The Report recommended that section 14 should be amended so that it applies to provisions that implied or imposed by the IC Act[13] . I refer to the recommendation as inserting an ICA-UGF remedy. Cameron Milne were clearly not recommending this type of change to the utmost good faith duty although it is consistent with the terms of recommendation 6.1.

The approach of providing that a breach of the ICA 'contract terms' could constitute a breach of the utmost good faith duty gives rise to the question of whether a useful purpose would be served by so doing. These sections already have their own consequences or remedy. They remove certain 'unfair' terms from contracts, require notice of others and make some void. The insurer's contractual rights are excluded or limited. It might seem unnecessary to give an additional remedy. There are a number of aspects which need further consideration. If an insurer presents a contract which does not take account of the ICA position on these terms, an insured might be misled into thinking that the insurer's rights are as stated in the 'non-complying contract'. There might be an argument that inserting an ICA-UGF remedy would allow the insured a right in damages to compensate for any additional costs and expenses, eg legal costs, in proving the insured's position in the face of an ill-informed insurer. There might be a contrary arguments: firstly, that the insured has rights against the insurer for misleading conduct already under the ASIC Act[14]; secondly, the insured has access to IDR, EDR and informed advocates who can rectify these matters; and thirdly that the combination of Code of Practice compliance and the powers of ASIC under the ICA are better methods of rectifying any such non-compliance than an inserting an ICA-UGF remedy.

[12] recommendation 1.2.
[13] recommendation 6.1.
[14] see sections 12BB,12BB(1)(i) and 12DA.

Another relevant type of ICA provisions are those which require the insurer to give information, notices or reasons on a subject[15]: notices, information and reasons. Cameron Milne were recommending a change to the utmost good faith duty for these types of section. Some of these have their own remedy or sanction, for example, a failure to supply a notice under sections 35,36,37,39,40[16],44 and 58 mean that the relevant term is ineffective, thus excluding or limiting the insurer's rights.

Some already include or are remedies: sections 52,54,55,63,69 and 76A:it would not make sense to have an ICA-UGF remedy apply to any of these. Some are merely mechanical or ancillary: sections 70,71 and 77; it would not make sense to have an ICA-UGF remedy apply to any of these. Some are penalty provisions: sections 41,74 and 75; it would be possible to have an ICA-UGF remedy apply to each of these. There is only one other and it does not have its own remedy: section 72 - the legibility standard.

The preliminary conclusion is that it would be viable for the ICA to be amended to insert an ICA-UGF remedy provision for:

a breach of a 'contract terms' section of the ICA can amount to a breach of the utmost good faith duty – see para 1.3 above;

a breach of a 'communication term' section of the ICA can amount to a breach of the utmost good faith duty – see paragraph 1.4 above.

The preliminary conclusion is that it would not be viable for the ICA to be amended to insert an ICA-UGF remedy provision for:

a breach of a 'pre-contract conduct' provision - see paragraph 1.2;

a breach of a remedy, mechanical or ancillary provision – see paragraph 1.5 above.

1.8 On this basis the terms of the proposed section 13(2) of the Insurance Contracts Amendment Bill 2010, would need reconsideration.

Life Insurance Misrepresentation and Non-disclosure

Cameron/Milne recommended a range of changes to and for ICA section 29 which provides for the insurer's remedies in life insurance for mis-representation

[15] Parts IX and X and sprinkled in Parts V-VIII.
[16] note that this was the Cameron Milne example.

and non-disclosure[17]. The section is in dire need of reconsideration [see attached note].

Standard Cover[18]

Cameron/Milne recommended that the test under ICA sections 35 and 37 to ' clearly inform' the person should become a test on the basis of ' clear concise and effective' presentation of information[19] and that a Product Disclosure Statement could be used for the purpose with the ICA giving appropriate remedies for a failure to make the required disclosure[20].

Cameron/Milne also recommended that the categories of standard cover should be updated and modernized after consultation with stakeholders[21].

Third Party Beneficiaries and Life Insured[22]

Cameron/Milne also recommended that third party beneficiaries, of an insurance contract to which the ICA applied, should have the same obligations (disclosure[23] and subrogation[24]) and rights (utmost good faith[25]; give and receive[26] notices; subrogation[27]), as an insured under the ICA. Any ICA amendment will need to distinguish carefully between the rights of the policyowner and the impact on them by the rights, and the exercise of those rights, of the third party beneficiary.

Gender and Natural Disasters

Gender specific language and references were removed in 2008[28]. After the natural disasters of 2010 and 2011, and on the recommendation of a number of reviews, commissions and reports, the Insurance Contracts Amendment Act 2012 was passed to insert a standard definition of flood and to provide for key facts statements to be a part of the disclosure and sales process for general insurance. ICA, section 37 was amended[29] to provide that the standard definition of flood would apply to prescribed contracts entered into and events occurring after the

[17] Chapter 7 and recommendations 7.1-7.5; compare para 9.7.
[18] Chapter 5.
[19] Recommendation 5.1.
[20] Recommendation 5.3 and 5.4.
[21] Recommendation 5.2.
[22] Chapter 10.
[23] Recommendation 4.4
[24] Recommendations 10.1 and 11.2.
[25] Recommendation 10.1.
[26] Recommendations 4.5,10.1.
[27] Recommendation 10.1 and 11.2.

[28] Statute Law Revision Act, 2008.
[29] Inserting sections 37A-37E.

transition period. An insurer must 'clearly inform'[30] an insured if the contract does not provide standard defined flood cover. Section 37D provides that if an insurance contract does offer flood cover then it does so on the terms of the standard definition and there is no 'opt out' by notifying the insured. An insurer must supply a key facts statement with the content and in the circumstances prescribed by the regulations[31]; the supply of a key facts statement does not, of itself, discharge the obligation to clearly inform the insured of a matter[32].

[30] But see above the view that the test should be ' clear, concise and effective'.
[31] Sections 33A-33D.
[32] section 33D.

ANNEXURE C

Breach of the ICA and Utmost Good Faith

1. Background

1.1 Before the ICA, the utmost good faith duty was limited in content, time and remedy. Its content was limited to the duty to disclose – there are some exceptions but they are not relevant for present purposes. It ended, on the better view, when the contract was entered into. The remedy was avoidance, not damages.

1.2 The ALRC wanted utmost good faith to be a flexible doctrine, with fairness based content, running throughout and for the duration of the contract, and damages would be a remedy for its breach.

1.3 The ICA achieved two of these three purposes on time and remedy, but it is objectively fair to say that it has not become the flexible fairness based doctrine that the ALRC envisaged.

1.4 Cameron Milne thought that a breach of the duty of utmost good faith should, particularly in the claims-handling context, constitute a breach of the ICA and be actionable by ASIC – see below Appendix , para 1.8. The report recommended that a breach of the duty of utmost good faith should be both a breach of an implied contractual term and a breach of the IC Act, although the breach of the IC Act would not be an offence and would attract no penalty (recommendation 1.2). That recommendation is linked to but separate from the subject recommendation and is not the subject of this note.

1.5 The focus of the first extract of the report (see attached parts) was on claims handling and on contract terms implied by the ICA – see below. The focus of the second extract of the report was on whether the ICA dealt adequately with unfairness in insurance contracts. Cameron Milne thought that some breaches of the ICA might constitute a breach of the utmost good faith duty and gave the example of section 40 – see below Appendix , paragraph 6.15. The report did not develop the idea or the practicalities of its implementation. The Report recommended that section 14 should be amended so that it applies to provisions that implied or imposed by the IC Act (recommendation 6.1). I refer to the recommendation as inserting an ICA-UGF remedy.

1.6 The proposal is being reconsidered in the current round of discussions about amendments to the ICA. This note comments on the proposal.

1.7 It is necessary to consider the structure of the ICA in order to evaluate the proposal.

2. ICA Structure and Pre-Contract Provisions

2.1 It is helpful to divide the ICA into three types of provisions, leaving aside the parts of the ICA that deal with ASIC, definitions and application (Parts I and IA, section 55A).

2.2 The first type are provisions which deal with pre-contract issues: insurable interest (Part III) and conduct (Part IV). A fundamental feature of these provisions is the limitation of an insurer's remedies for an insured's conduct. These parts do not say anything about an insured's remedies for an insurer's breach of disclosure obligations and there are some complex interactions with the provisions of the FSR legislation here.

2.3 Cameron Milne were clearly not recommending this type of change to the utmost good faith duty although it is consistent with the terms of recommendation 6.1.

2.4 It is not now viable for a breach of any provision in Part IV to constitute a breach of the utmost good faith duty. For the insurer's remedies it would be fundamentally inconsistent with one of the major features of the ICA reforms. For the insured's remedies, it would open an area of the utmost complexity which would need careful consideration.

3. ICA Contract Terms

3.1 The second types are provisions which explicitly or implicitly add or subtract terms in the insurance contract, or give them limited effect in certain circumstances. Some modify the general law so that the insurance contract operates differently. Some require notification of a term for it to be effective under ICA. They are found in ICA Parts V-VIII. They are listed and summarized in the Table in the Appendix in the first two columns under the headings 'Void' and 'Affect''.

3.2 There is an argument that as a matter of principle, the proper construction of the ICA is that some types of breach of or failure to comply with one of these provisions can constitute a breach of the utmost good faith duty. A sketch of the argument would be:

(a) the utmost good faith duty is an implied term of the insurance contract;

(b) the ICA makes certain sections terms of the insurance contract;

(c) some breaches of the insurance contract can be breaches of utmost good faith duty;

(d) that should be the case whether the breached term is a term of the insurance contract as an express term or a term implied by the ICA.

3.3 The argument has been accepted for fraudulent claims. There is a strong line of authority that the making of a fraudulent claim is a breach of the utmost good faith duty. A fraudulent claim involves breach of an express or implied contractual term as well as a breach of the general law prohibition on fraud.

3.4 The central difficulty is that, on first principles, not all breaches of a term of a contract, and so by extension, of the ICA, would be a breach of the utmost good faith duty. There are a number of case law guides about the nature of utmost good faith. They all involve at least honesty to a high degree. I also think that the 'faith' part of the phrase asks us to look into the mind of the person affected by the relevant conduct to assess whether the person has been misled. This would be an important qualification to import into any amendment to the ICA on this issue.

3.5 The issue is not discussed in either *Sutton* or in *Kelly and Ball*, the two leading text books. I am not aware that the issue has been the subject of judicial consideration.

3.6 Cameron Milne were recommending this type of change to the utmost good faith duty.

3.7 The approach of providing that a breach of the ICA 'contract terms' could constitute a breach of the utmost good faith duty gives rise to the question of whether a useful purpose would be served by so doing. These sections already have their own consequences or remedy. They remove certain 'unfair' terms from contracts, require notice of others and

make some void. The insurer's contractual rights are excluded or limited. It might seem unnecessary to give an additional remedy. There are a number of aspects which need further consideration. If an insurer presents a contract which does not take account of the ICA position on these terms, an insured might be misled into thinking that the insurer's rights are as stated in the 'non-complying contract'. There might be an argument that inserting an ICA-UGF remedy would allow the insured a right in damages to compensate for any additional costs and expenses, eg legal costs, in proving the insured's position in the face of an ill-informed insurer. There might be a contrary arguments: firstly, that the insured has rights against the insurer for misleading conduct already under the ASIC Act – see sections 12BB,12BB(1)(i) and 12DA; secondly, the insured has access to IDR, EDR and informed advocates who can rectify these matters; and thirdly that the combination of Code of Practice compliance and the powers of ASIC under the ICA are better methods of rectifying any such non-compliance than an inserting an ICA-UGF remedy.

4. ICA Communication Terms

4.1 The third type of provisions are those which require the insurer to give information, notices or reasons on a subject (Parts IX and X and sprinkled in Parts V-VIII). They are listed and summarized in the Table in the Appendix in the third, fourth and fifth columns under the headings 'Notice', 'Information' and 'Reasons'.

4.2 Cameron Milne were recommending a change to the utmost good faith duty for these types of section.

4.3 Some of these have their own remedy or sanction, for example, a failure to supply a notice under sections 35,36,37,39,40(note that this was the Cameron Milne example),44 and 58 mean that the relevant term is ineffective, thus excluding or limiting the insurer's rights – see paragraph 3 above.

4.4 Some already include or are remedies: sections 52,54,55,63,69 and 76A:it would not make sense to have an ICA-UGF remedy apply to any of these. Some are merely mechanical or ancillary: sections 70,71 and 77; it would not make sense to have an ICA-UGF remedy apply to any of these.

4.5 Some are penalty provisions: sections 41,74 and 75; it would be possible to have an ICA-UGF remedy apply to each of these. There is only one other and it does not have its own remedy: section 72 - the legibility standard.

5. Preliminary Conclusions

5.1 The preliminary conclusion is that it would be viable for the ICA to be amended to insert a an ICA-UGF remedy provision for:

(a) a breach of a 'contract terms' section of the ICA can amount to a breach of the utmost good faith duty – see paragraph 3;

(b) a breach of a 'communication term' section of the ICA can amount to a breach of the utmost good faith duty – see paragraph 4.5 above.

5.2 The preliminary conclusion is that it would not be viable for the ICA to be amended to insert an ICA-UGF remedy provision for:

(a) a breach of a ‘pre-contract conduct’ provision - see paragraph 2;

(b) a breach of a remedy, mechanical or ancillary provision – see paragraph 4.4 above.

5.3 The test for when a breach of the relevant section is a breach of the duty of utmost good faith would need some careful drafting – see paragraph 3.4 above.

Appendix

Extract from "Review of the *Insurance Contracts Act 1984* (*Cth*): Final report on second stage: provisions other than Section 54"; Alan Cameron, Nancy Milne; Canberra, June 2004

General conduct of insurers

1.2 As stated in its long title, the IC Act regulates the terms included in insurance contracts and insurer conduct in relation to such contracts. The focus is the contractual relationship between insurers and the insured.

1.3 The duty of utmost good faith imposed in Part II of the IC Act operates as an implied term of insurance contracts. Under Part IA, the Australian Securities and Investments Commission (ASIC) can gather information from insurers about the way they conduct their business. ASIC can bring a representative action against an insurer under section 55A of the IC Act, but only in respect of insurance contracts entered into. Despite those provisions, neither the IC Act nor the regulations made under it include provisions that directly regulate insurer conduct beyond the extent to which the conduct relates to individual insurance contracts.

1.4 Conduct matters, such as claims handling and dispute resolution processes, are dealt with in the General Insurance Code of Practice developed by the Insurance Council of Australia Limited and oversighted by ASIC. [2]

1.5 ASIC's preliminary submission urged the review to consider whether the current regulatory system as a whole ensures that insurers have proper claims handling procedures in place, including the appropriate training of employees and outsourced service providers, to ensure that claims handling is dealt with in a fair, transparent and timely manner.

1.6 Given the scope of the IC Act and the terms of reference of the review, it was foreshadowed in the Issues Paper that the Review Panel did not propose to make detailed recommendations going beyond the relationship between parties. However, there are two matters connected with claims handling about which the Review Panel considers it appropriate to make recommendations.

1.7 First, the Review Panel considers that the issue of claims handling practices should, at least in the first instance, be dealt with through industry codes. Industry bodies should have an opportunity to develop codes in consultation with stakeholders that offer appropriate protection for consumers in relation to claims handling.[3]

1.8 Second, as mentioned elsewhere in this report, the Review Panel believes that the duty of utmost good faith in section 13 of the IC Act has potential to provide remedies for some of the issues relating to claims handling by insurers.[4] For example, an insurer who has caused unreasonable delay in admitting liability and paying a claim has been found to have breached the duty of utmost good faith.[5] The Review Panel agrees with the commentators who have noted that there is a significantly wider scope to use section 13 in comparable circumstances.[6] It has been suggested to the Review Panel that a breach of the duty of utmost good faith should not only be a breach of an implied term of the insurance contract — it should be a breach of the IC Act. If this was made clear, there would be no doubt that ASIC would have power to commence representative proceedings in relation to the breach. The Review Panel agrees that including a provision along these lines would be beneficial.[7]

However, the Review Panel believes that a breach of the duty should not amount to an offence, nor attract any penalty.

1.9 The possible implications of a breach of the duty for the purposes of the licensing provisions in section 920A of the *Corporations Act 2001* may require some further consideration if this proposal is implemented. The Review Panel considers that isolated breaches of the duty should not give rise to any risk of a banning order being imposed. However, the ordinary operation of the licensing regime generally should mean that repeated breaches, or very serious breaches, of the duty by an insurer might be grounds for ASIC to consider imposing conditions on an insurer's financial services licence or, in extreme cases, to ask an insurer to show cause why its licence should not be revoked.[8]

Recommendations

1.1 Best practice guidelines relating to claims handling processes by insurers should be developed and included in the relevant industry codes.

1.2 A breach of the duty of utmost good faith should be both a breach of an implied contractual term and a breach of the IC Act, although the breach of the IC Act would not be an offence and would attract no penalty.

[2] The Insurance Council of Australia Limited released a draft revision of its General Insurance Code of Practice on 8 June 2004 for public comment, available at: www.ica.com.au/codepractice.

[3] Codes of conduct may be approved by ASIC under section 1101A of the *Corporations Act 2001*.

[4] See Chapter 6, 'Remedies of insured' below.

[5] *Moss v Sun Alliance Australia Ltd* (1990) 55 SASR 145; (1990) 93 ALR 592; (1990) 99 FLR 77; (1990) 6 ANZ Ins Cas 60-967.

[6] See, for example, Bremen, J. 'Good Faith and Insurance Contracts — Obligations on Insurers' (1999) 19 (1) *Australian Bar Review* 89 at 91.

[7] The Consumers' Federation of Australia (CFA) in its submission dated June 2004 following the release of the proposals paper argued that this recommendation is required because an industry code of conduct alone will not adequately address the issue of claims handling. The reasons being, 'first, the Code is voluntary' and secondly 'the real test of any Code is whether it can be effectively enforced … Under the draft Code however, in effect the CCC (Code Compliance Committee) will only be able to address "a serious material breach or a serious systemic failure". The CCC has limited enforcement powers in relation to other breaches. And sanctions for breaches do not extend to monetary penalties or compensation to consumers who may have been affected by the conduct.'

[8] Any action taken by ASIC under section 920A of the *Corporations Act 2001* is subject to due process requirements and a decision is reviewable by the Administrative Appeals Tribunal — section 1317B.

Extract from "Review of the *Insurance Contracts Act 1984* (*Cth*): Final report on second stage: provisions other than Section 54"; Alan Cameron, Nancy Milne; Canberra, June 2004

Remedies for unfair contractual terms

6.2 Section 13 of the IC Act implies into insurance contracts a duty of the utmost good faith, owed by each party to the other, in respect of any matter arising under or in relation to the contract.

6.3 If there is a breach of the duty by the insurer that causes loss to the insured, that could found a claim for damages for a contractual breach. Further, section 14 provides that a party may not rely on a contractual term if to do so would be to fail to act with the utmost good faith.

6.4 Section 15 of the IC Act expressly excludes insurance contracts from the operation of any Act (Commonwealth, State or Territory) that provides relief in the form of judicial review of harsh or unfair contracts. It also excludes relief under other Acts for insureds from the consequences in law of making a misrepresentation, except for relief in the form of compensatory damages.

6.5 In the review that led to the introduction of the IC Act, the ALRC considered that the prospect of facing an action for breach of duty under section 14 was sufficient to encourage insurers to draft policies carefully and to act fairly in strictly enforcing policy terms. The ALRC reported that, in light of the proposed section 14, it was unnecessary for insurance contracts to be subject to a facility for judicial review of unfair contractual terms.[98] The risk of differences in such laws between jurisdictions causing difficulties was noted.[99]

6.6 The Issues Paper included an invitation to comment on whether it was appropriate for the restriction in section 15 of the IC Act to be retained and, if so, whether there were any remedies under other laws whose use should be similarly restricted in the context of insurance contracts.

6.7 Submissions were starkly divided on the ongoing need for section 15 with strongly held views being expressed both in favour and against its retention.

6.8 Those against its retention argue that:

- insurance contracts are not so different from all other contracts that they should be immune from the general law regarding unfair contracts;
- the duty of utmost good faith in sections 13 and 14 has not been sufficient to encourage insurers to act fairly in drafting policies and enforcing their terms; and
- the provisions in sections 13 and 14 and the dispute resolution bodies interpreting them can only assist individual consumers — they cannot address systemic issues and indications are that there are systemic problems with unfair terms in insurance contracts.

6.9 Those in favour of its retention unaltered argue that:

- insurance contracts are not 'immune' from general consumer protection avenues — rather they are dealt with under specific legislation which takes account of the complexities of insurance contracts and the fact that liability is reinsured, often on an

overseas market, and re-insurers will not necessarily be bound by Australian judicial review;

- insureds have adequate protection arising from the duty of utmost good faith in sections 13 and 14 and although the use of those provisions has been limited, the response should be to encourage their use, not make available a multitude of other remedies;
- external dispute resolution bodies provide a low cost and speedy means of resolving disputes in the insurance contracts framework — it is undesirable to encourage use of litigation.

6.10 One submission strongly opposed alteration of section 15 but noted that, if any change were to be made, it should be confined to mass personal (consumer) risks. The submission argued that allowing a court to re–write commercial insurance contracts would 'wreak utter havoc' in the commercial insurance environment.

6.11 One of the dispute resolution bodies suggested that this is a complex issue that should be deferred.

6.12 Following the release of the Proposals Paper the Consumers' Federation of Australia questioned the argument that section 15 be retained because of concerns about re-insurance and complexity:

'With respect, in relation to consumer contracts, this is a matter to be resolved between insurers and their re-insurers. What is of concern to individual consumers is the right to remedies in the event of unfair or unconscionable conduct by insurers.

Similar issues arise in the context of consumer mortgages, however, the financial services industry has not sought, (and nor would it obtain) exemption from such basic consumer protection principles as statutory unconscionability etc.

The Proposals Paper also notes that the complexities of insurance contracts have been suggested as a reason for the retention of section 15. However, it might equally be argued that other products (for example, superannuation products) have the same level of complexity or otherwise of insurance products does not seem to be an adequate reason to retain section 15.' [100]

6.13 The Standing Committee of Officials of Consumer Affairs (SCOCA) has appointed a Working Party to review the issue of unfair contract terms generally. The Working Party's comprehensive discussion paper[101] has been developed with a view to investigating the need for nationally consistent regulation of unfair contract terms. It includes consideration of such issues as whether business to business transactions, including insurance contracts, should be excluded from the scope of any national model.

6.14 The Review Panel considers that the arguments are finely balanced. The ALRC's concerns about the application of the laws of different jurisdictions are still valid. Similarly, the concerns about the potential for judicial review of insurance contracts to re-open carefully negotiated commercial arrangements after the event are well-founded. If a nationally consistent model for review of consumer unfair contracts is developed, the balance of consideration may shift and the issue should be revisited.

6.15 The Review Panel considers that the consequences of repealing section 15 are too uncertain to warrant taking that step. However, the Review Panel believes section 14 warrants consideration. Section 14 applies where reliance 'on a *provision of the contract* of insurance would be to fail to act with the utmost good faith …' (emphasis added). The Review Panel considers that section 14 should be amplified so that it applies in other circumstances. For example, it could provide relief where an insurer has failed to provide notice as required under subsection 40(2) or the proposed amendments to section 40. The section should also reflect clearly the fact that the rights and obligations of the parties are subject to a range of 'provisions' in the IC Act, whether they be by way of express terms of the contract or otherwise. This would include implied terms of the contract, or by way of operation of law.

6.16 The Review Panel believes that sections 13 and 14 of the IC Act, relating to the duty of utmost good faith, have potential to be utilised by insureds in connection with insurer conduct that might otherwise be dealt with under statutes dealing with unfair contracts or unconscionable conduct. This capacity will be enhanced further if the Review Panel's proposal for treating a breach of the duty of utmost good faith in Chapter 1 is adopted.

RecoSecmmendation

6.1 Section 14 of the IC Act should be amended so that it applies to provisions that are implied or imposed by the IC Act.

[98] Such as those found in, for example, the *Contracts Review Act 1980* (NSW).

[99] Australian Law Reform Commission 1982, *Insurance Contracts*, ALRC 20, AGPS, Canberra, paragraph 51.

[100] See submission on the Proposals Paper by the Consumers' Federation of Australia dated June 2004.

[101] Standing Committee of Officials of Consumer Affairs — Unfair Contract Terms Working Party 2004, *Unfair Contract Terms: A Discussion Paper*, available at: http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/web+pages/CD456F7C38F523684A256E240014EF7C?OpenDocument&L1=Publications.

Table

Void	**Affect – amend contract or general law**	**Notice**	**Information**	**Reasons**	**Remedies**	**Admin**
38(1) – interim cover not dependent on proposal	38(2) period for interim cover	35 +36– prescribed cover applies	69 - Method and timing for insurer to inform insured of ICA matters. Delay affects insurer's rights on prior claims	75 – insurer must give reasons for cancellation, non-renewal, offer of less advantageous than normal terms. **Penalty provision.**	52 terms cannot defeat the ICA	Part IA – ASIC admin of ICA and its powers
43 arbitration term in insurance contract is void		37 –unusual terms	70 – notices, information or reasons to an insured, for an individual super product, means to a life insured		54 – beyond summary !	55A – ASIC representative actions under ICA
	39 – a term limiting the insurer's liability for the insured's failure to pay	39 – a term limiting the insurer's liability for the insured's failure to pay	71 – pre-contract notice, information or reasons, except under s.58, do		55 – ICA is an exclusive code for s 54 and 55A matters	

Void	Affect – amend contract or general law	Notice	Information	Reasons	Remedies	Admin
	instalment premium must require 14 days overdue**.**	instalment premium must require 14 days overdue and be notified.	not need to be supplied if the insured has a broker. Insurer notices to insured's agent (not broker) sufficient compliance.			
		40 (1) and (2) – a term excluding or limiting the insurer's liability for a claim that is not notified to the insurer during the period of cover must be notified. **Penalty provision**	72 – notices etc must meet prescribed standards of legibility		76A director liability for certain breaches of the ICA.	
	40(3) - a		74 - Insurer must			

Void	Affect – amend contract or general law	Notice	Information	Reasons	Remedies	Admin
	notification of a circumstance during the period of cover is sufficient notice of a claim that is made after the period of cover.		supply policy documents on request. **Penalty provision.**			
	41 – if a term precludes the insured admitting or settling a claim, and the insurer does not, after a notice by the insured, admit the claim, the insurer cannot deny the claim and any admission or settlement by the insured is not a		77 – method of service of notices etc			

Void	**Affect – amend contract or general law**	**Notice**	**Information**	**Reasons**	**Remedies**	**Admin**
	breach of the contract.					
	42 – provides for the maximum cover.					
	44(1) – average provision unenforceable unless notified	44(1) – average provision unenforceable unless notified				
	44(2)-(4) The effect of average clauses limited					
45 – Other insurance term **void**	76- insured can recover indemnity from any one insurer; insurers retain contribution rights.					
	46 term which excludes pre-existing defect is					

Void	Affect – amend contract or general law	Notice	Information	Reasons	Remedies	Admin
	not enforceable if insured was not aware of defect.					
	47 term which excludes pre-existing sickness or disability is not enforceable if insured was not aware of defect.					
	48,48AA, 48A - named person/beneficiary can claim on an insurance contract **– amends general law to affect the contract**					
	49 – insurer payments when two person have					

Void	Affect – amend contract or general law	Notice	Information	Reasons	Remedies	Admin
	an interest in the insured subject matter					
	50 insurance on property transfers when the property is sold – **amends the general law to affect the contract**					
	51 third party recovery against insurer in specified circumstances - **amends the general law to affect the contract**					
53 a term permitting unilateral variation by the						

Void	**Affect – amend contract or general law**	**Notice**	**Information**	**Reasons**	**Remedies**	**Admin**
insurer is **void**						
					55 no other remedies	
	56(1) – no contract avoidance for fraudulent claim					
	56(2) court may order the payment of just and equitable amount					
	57 – insurer liable for interest on unreasonably delayed claim					
	58 (3) –(6) statutory extension arises on failure to notify expiry - **amends the general law to**	58 (2) statutory extension arises on failure to **notify** expiry				

Void	Affect – amend contract or general law	Notice	Information	Reasons	Remedies	Admin
	affect the contract					
	59 notification of cancellation has effect at specified times – amends policy					
	60 circumstances in which an insurer can cancel a general policy – amends policy					
	61 – cancellation on insurer insolvency					
	62 – cancellation of instalment general insurance contracts					
					63- ICA is a code for insurer cancellation of	

Void	Affect – amend contract or general law	Notice	Information	Reasons	Remedies	Admin
					general insurance contracts	

ANNEXURE D

Misrepresentation and Non-Disclosure – Life Insurance
ICA – Section 29

1. Section 29 applies to certain non-disclosures and misrepresentations for life insurance[33]. Section 29 forms a part[34] of an exclusive code of remedies against the insurer for misrepresentation and non-disclosure for life insurance[35]. Section 29 does not apply where the insurer would have entered into the contract despite the failure or the misrepresentation[36]. The insurer must prove that it would not have entered into the same contract: either that it would not have entered into any life insurance contract[37], any life insurance contract of the same type or it would have entered into a contract on different terms, otherwise section 29 does not apply.

2. Section 29 has the effect when it applies, that if an insured person misleads the insurer (misrepresentation or non-disclosure) fraudulently in the dealings leading up to the insurer issuing the life policy[38], the insurer can avoid the contract *at any time*[39]. There is a fraudulent misrepresentation for the purposes of s 29(2) if a false representation is made knowingly or if there is a reckless indifference as to whether it is true or false.[40] The effect of avoidance for fraud is that the parties revert to their respective positions before the policy was issued: but on a fraud, the insurer does not refund the premium to the insured person[41], and the insurer has no liability for any claims.

3. Section 29 has the effect when it applies, that if an insured person misleads the insurer (misrepresentation or non-disclosure) *but is not fraudulent* in the

---

[33] *The section does not apply to the date of birth: section 29(1)(d); date of birth is under section 30; See Life Insurance Act 1945, section 83; Life Insurance (Consequential Amendments and Repeals) Act 1995 (Cth), s 5 and compare Life Insurance Act 1995 (Cth), s 264. In any event, s 83 of the Life Insurance Act 1945 (Cth) did not apply to a policy within the ambit of the Insurance Contracts Act 1984 (Cth)—see s 86A of the 1945 Act.*
[34] *subject to sections 30-32A.*
[35] *section 33 [cross refer to exclusive code part]*
[36] *section 29(1)(c); this is the same test as in section 28: the words "for the same premium and on the same terms and conditions" in section 28(1) do not seem to add meaning, nor their absence from section 29(1), subtract meaning: Davis v Westpac Life Insurance Services Ltd [2007] NSWCA 175, Schaffer* v Royal and Sun Life Assurance of Australia Ltd [2003] QCA 341; *although it might be possible to argue that the amendment to section 28 which introduced the subject words was to ensure that general insurers were not put in the same difficulties as life insurers. Entry into the contract includes its reinstatement (s 11(9)(c)) and in the case of life insurance an agreement to extend or vary the contract: s 11(9)(a).*
[37] Compare *Schaffer* v Royal and Sun Life Assurance of Australia Ltd [2003] QCA 341
[38] *Contract of life insurance; a contract of life insurance under ICA section11(1) is defined in terms of the Life Insurance Act 1995 (Cth). The definition is considered in para XX below.*
[39] *Section 29(2).*
[40] *Macquarie Bank Ltd v National Mutual Life Assoc of A'sia Ltd (1996) 40 NSWLR 543 CA; Boekenstein v Tyndall Life Insurance Co Ltd (unreported, Supreme Court, NSW, James J, No 10103/96, 17 February 1997).*

[41] *See Chapter XX and paras XXX on premium refunds*

dealings leading up to the insurer issuing the policy, the insurer can avoid the contract *only if (1) the insurer acts within 3 years of the policy issue*[42]*(the 3 year rule);and (2) the insurer proves that it would not* have been prepared "to enter into **a** contract of life insurance with the insured on **any** terms if the duty of disclosure had been complied with or the misrepresentation had not been made"[43] (the no contract rule).It is not necessary for the insurer to prove that it would have made a final decision declining the insurance at the time it actually entered into the contract[44]. It is not sufficient to ground the avoidance right that the insurer would have deferred the decision[45]. [comment] The effect of avoidance for non-fraudulent conduct is that the parties revert to their respective positions before the policy was issued: the insurer refunds the premium to the insured person and the insurer has no liability for any claims.

4. If the insurer does not avoid the contract, whether under section 29(2), 29(3) or otherwise, it may, by notice in writing given to the insured before the expiration of 3 years[46] after the contract was entered into, vary the contract by substituting for the sum insured a sum that is not less than the sum ascertained in accordance with a statutory formula. The formula has the effect that it reduces, from the time the contract was entered into[47], the sum insured[48], proportionately to the actual premium and the premium that should have been charged[49].

5. The 3 year rule and the no contract rule pose some difficulties for the structure of section 29 and raise some practical issues[50]. The 3 year rule does not apply to

---

[42] *Section 29(3).*
[43] *Section 29(3).*
[44] *Davis v Westpac Life Insurance Services Ltd [2007] NSWCA 175, Schaffer* v Royal and Sun Life Assurance of Australia Ltd [2003] QCA 341
[45] *Davis v Westpac Life Insurance Services Ltd [2007] NSWCA 175, Schaffer* v Royal and Sun Life Assurance of Australia Ltd [2003] QCA 341
[46] *Section 30 which provides for an adjustment of the sum insured for a mis-statement of age, does not contain a 3 year rule, nor does its predecessor in the Life Insurance Act, 1945, section 83.*
[47] *Section 29(6).*
[48] *See Chapter XXX, para XXX on Limits.*
[49] *See Chapter XXX, para XXX on Premium.*
[50] *Section 30; The ALRC does not touch on either . The Insurance Contracts Bill 1983, Explanatory Memorandum, paras 90-94 adopts the Life Insurance Act, 1945, section 84 approach, with the exception of widening the section's application to oral misrepresentations. The Life Insurance Act, sections 83 and 84 were omitted from the Life Insurance Act, 1995 and although the reasons do not appear in any of the 1994 Explanatory Memorandums, it is probable that the omission was because of the introduction of the ICA, sections 29 and 30.See the Insurance Contracts Amendment Bill 2010, clauses 29A and 30 and the Explanatory Memorandum 2010, paras 2.91-2.99, 3.9,3.118-3.140; It is noteworthy that the 3 year rule in the Life Insurance Act, 1995, Part 10 is now confined to investment policies. In the Life Insurance Act, 1945, section 96, a policyowner was entitled to treat a policy as paid up after 3 years and under section 100 a policy could not be forfeited for non-payment of premium after 3 years.See Review of the Insurance Contracts Act 1984, June 2004, Cameron and Milne, paras 4.25-4.27 and Chapter 7.*

general insurance because general insurance contracts usually have an annual duration but it is noteworthy that the general insurer's rights under section 28 are unlimited by time alone. The 3 year rule has its origins the Life Insurance Act 1945, section 84[51]. At that time most life insurance products were death and investment products[52] and pure risk and disability products were rare. It was regarded as objectionable for a person to lose a material investment because of misleading conduct and so the insurer's rights were limited in time so that the person could recoup and re-invest before too much time was lost.

6. It is not easy to see why the 3 year rule should apply to risk products. Firstly, it means that one group of risk product customers, general and life insurance product buyers, are treated differently; it means that two different group of insurance customers, investment product and risk product buyers, are treated the same. Secondly, there is no connection between fraud and a time limit. The effect on the insurer of misrepresentation and non-disclosure is the same whether or not fraud is involved; fraud merely reflects the insured's malign intention and that intention exposes the insured to more severe remedies. The expiry of 3 years does not reduce the effect of the misleading conduct on the insurer. Thirdly, the 3 year rule is also capricious: if the misleading conduct is discovered the day *before* the 3 year mark, the conduct is actionable but if the misleading conduct is discovered the day *after* the 3 year mark, the conduct is not actionable. Fourthly, experience indicates that misleading conduct is discovered only after a claim has been made and so the rule's caprice is heightened because the period commences with policy issue not the date of claim; the predecessor section applied the 3 year rule from the date of death or the date the insurer avoided the policy and these dates would be much closer to the date of claim than policy issue[53].

---

[51] *Sutton thought that the 3 year time limit accorded with s 84 of the Life Insurance Act 1945 (now repealed) under which a policy was not to be avoided because of an incorrect statement made in any proposal or other document on the faith of which the policy was issued or reinstated unless, among other things," it was made within three years of the date on which the policy was sought to be avoided, or the date of death of the life insured, whichever was the earlier". But this 3 year rule began differently, with the avoidance or death either of which is later than contract entry.*

[52] *Whole of life or endowment policies had a surrender value which meant that when the policy ended, the insured would receive the investment contribution back, plus or minus any investment returns or losses; the policy would pay on surrender, termination or death; see the Insurance Contracts Amendment Bill 2010, clauses 29A and 30 and the Explanatory Memorandum 2010, paras 2.91-2.99, 3.9,3.118-3.140*

[53] Life Insurance Act, 1945, section 84(b): date of avoidance must, in context, mean the date the insurer avoids not the date avoidance becomes effective because otherwise the possibility of avoidance preceding death would be absurd; there is no obvious reason for the change.

7. The no contract rule also raises some difficulties, linked to the 3 year rule[54]. Section 29(1) applies to a different contract situation but section 29(3) applies only to a no contract situation. The difference is whether or not 3 years has expired. It is difficult to see why section 29(1) is on a wider basis, effectively applying to fraud only, but section 29(3) is on a narrower basis for non-fraudulent misleading conduct discovered within the 3 year rule. The practical effect is that if an insurer would have issued the policy but with a higher premium, lower sum insured or an exclusion, the insurer's remedy is limited to a reduction of the sum insured[55]; it is not possible under the ICA to otherwise vary the terms to include an exclusion or otherwise.

ANNEXURE E

1. ***Introduction.***

a. This note sets out the grounds and consequences for a cancellation of an income protection life policy for fraud.

b. An income protection policy is usually a continuous disability policy under the Life Insurance Act 1995,section 9 and therefore a contract of life insurance under the Insurance Contracts Act 1984 (ICA), section 11(6). While some income protection policies can be general insurance contracts under the ICA, this note is confined to life insurance contracts.

2. ***Life insurance contract cancellation and the ICA.***
ICA section 60 is one of the two ICA sections that affect cancellation grounds for an insurance contract. It has no application to life insurance. Section 59, which deals with cancellation notices, does apply to life insurance. Section 56 applies to life insurance with some effect on cancellation grounds.

3. ***Fraud.*** An insured can be fraudulent before the contract is entered into or during the contract:

a. If the insured is fraudulent **before** the contract is entered into, it is usually in a non-disclosure or misrepresentation. An insurer's rights on a fraudulent non-disclosure or misrepresentation include the right to avoid although the right to avoid can be subject to a court disregarding the avoidance in the stated circumstances under section 31. Avoid in the ICA means avoid from inception (section 9). The ALRC, continuing a long line of legal characterization, refers to it as 'avoid ab initio' (para 243). It is the statutory rendition of the common law right to avoid or rescind for a pre-contractual vitiating flaw. On avoidance, the parties return to the position they were in immediately before the contract was entered into, or under the ICA, before inception. The insurer is never on risk.

b. If the insured is fraudulent **after** the contract is entered into, it is usually in relation to a claim. It was always clear that fraud during a contract would entitle to the insurer to terminate the contract. There was a view that fraud

[54] It is not in the Life Insurance Act, 1945 or 1995 nor dealt with in the ALRC Report.
[55] *under section 29(6).*

during a contract would entitle the insurer to avoid; but this view is no longer available because of section 56(1). It remains clear under the ICA that for fraud during a general insurance contract, the insurer can cancel the contract (section 60(1)(e)). Cancel is not explicitly defined under the ICA. It is clear from its use and context, as well as the ALRC that it is the equivalent of the common law termination – usually in the context of breach. On cancellation, the rights of the parties in the future, but not the past, are altered. The insurer is not obliged to pay a claim for an insured event which occurs after the effective time of cancellation.

c. The difference between avoidance and cancellation is that avoidance alters past and future rights and obligations but cancellation alters only future rights and obligations.

4. ***Cancellation notice.*** The cancellation notice must be given in accordance with section 59 and it takes effect at the time provided by that section.

5. ***Walton.***

a. There seems to be a view that *Walton* restricts or precludes the insurer's right to cancel a life policy for fraud. It is difficult to see how that view arises. It is, in my view, clearly wrong. Walton took out a policy which commenced on 1 September 1994. On 17 November 2000, he suffered a heart attack and claimed that he was disabled and entitled to a monthly benefit. From 2000 to 2003 he submitted progress certificates which represented that he was disabled. The insurer thought that these were fraudulent. The insurer sent a cancellation notice on 23 April 2003. The insurer appears to have argued that the fraud entitled it to avoid the policy and, presumably, to recover the payments already made. It also argued that the fraud entitled it to cancel the policy and so to cease future payments. The court considered whether Walton was disabled under the policy.

b. The insurer first argued that it was not on risk at the time of the heart attack. The court found that the insurer could not avoid the policy ab initio (paras 37-48). The insurer was therefore on risk at the time of the heart attack. This is simple law and uncontroversial. It might have been clearer if the judge used the word 'avoid' rather than 'terminate' in paragraph 48 and had not taken an unnecessary excursion through section 54 to reach the point (unless the insured had argued that if section 54 applied, the right to cancel was lost).

c. The insurer then seems to argue that it can 'avoid in futuro'(paras 49-52). The facts and legal context suggest that the insurer is arguing that it can avoid with the effect that it is not liable for the future payments of monthly benefits. There are two objections to this approach. Firstly, cancellation operates only to the future and for future **events** (see paras 4b&c above); it does not operate to relieve the insurer of its obligations for claim payments, for an event before cancellation, running into the future. Secondly, because the insurer is not entitled to avoid under section 56(1), it may refuse to pay the claim (section 56(1)) subject to the court's powers to order payment under section 56(2). The insurer's argument would permit the insurer to achieve through the first part of section 56(1) what it could not achieve through the second part or section 56(2).

d. The judge's reasoning is not clearly expressed nor are the insurer's arguments. The text suffers from typos and some opaque choices of words and grammar. The court is essentially supporting the quotation from Sutton in para 37. But it is essential to recognize that the focus is on the rights on the subject claim, not the effect of cancellation generally or on future insured events.