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TRAVELLING SECTION 54 WITH A WESTERN AUSTRALIAN ROAD MAP

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Introduction

1 The *Insurance Contracts Act 1984* (Cth) came into force thirty years ago – on 1 January 1986. Section 54(1) has proven to be an important, if not the most important, reform among the many changes made by the Act to the law governing insurance contracts. It provides the principal protection for an insured where conduct by the insured or anyone else, that occurs after the insurance contract was entered into, provides a reason for the insurer to refuse to pay the claim.

2 The insurer is prevented from denying liability to indemnify. It is restricted to a remedy of reducing its liability to the extent that it proves it has been prejudiced.

3 The first important Western Australian decision on s54 was decided twenty years ago. In the two decades that have followed three more significant Western Australian decisions have emerged; most recently in February of this year.

4 An understanding of these cases provides the foundation for a sound working knowledge of the operation of s54(1). I will discuss each of them and make brief reference to two other High Court cases.

5 I will start with the content of s54.

1986 – Section 54

6 Section 54 is enacted in these terms:

> **54 Insurer may not refuse to pay claims in certain circumstances**
>
> (1) Subject to this section, where the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of which subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.
>
> (2) Subject to the succeeding provisions of this section, where the act could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay the claim.
>
> (3) Where the insured proves that no part of the loss that gave rise to the claim was caused by the act, the insurer may not refuse to pay the claim by reason only of the act.
>
> (4) Where the insured proves that some part of the loss that gave rise to the claim was not caused by the act, the insurer may not refuse to pay the claim, so far as it concerns that part of the loss, by reason only of the act.

(5) Where:

(a) the act was necessary to protect the safety of a person or to preserve property; or

(b) it was not reasonably possible for the insured or other person not to do the act;

the insurer may not refuse to pay the claim by reason only of the act.

(6) A reference in this section to an act includes a reference to:

(a) an omission; and

(b) an act or omission that has the effect of altering the state or condition of the subject-matter of the contract or of allowing the state or condition of that subject-matter to alter.

7 Section 54(1) prevents an insurer from denying liability if these conditions are satisfied:

7.1 The insured has made a claim;

7.2 An identified act or omission occurred after the insurance contract was entered into;

7.3 By reason of that act or omission the effect of the contract of insurance would, but for the section, be that the insurer may refuse to pay the claim, either in whole or in part;

7.4 The act or omission was not one that could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract.

8 Where those conditions have been satisfied the insurer may not refuse to pay the claim by reason only of the act or omission but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.

9 Subsections (3), (4), and (5) are additional ameliorative provisions.

1996 – first case

Kelly v New Zealand Insurance Co Ltd
(1996) 130 FLR 97; (1996) 9 ANZIC 61-317

Issue

10 Was the insured's failure to increase limits of indemnity under a house contents policy (by specifying to the insurer items and values for items of fine art, paintings, works of art, antiques or curios) a relevant omission for the purposes of s54?

Background

11 The insured was an antiques dealer who carried on his business on Stirling Highway in Nedlands. For many years he insured his house and contents with New Zealand Insurance.

12 The definition of "contents" included as item 5 "fine art, paintings, works of art, antiques or curios". For these items there were particular limits of indemnity of $1,000 for any one article up to a maximum of $5,000 for a claim, unless an item had been specified to the insurer.

13 In October 1986 a representative of the insurer wrote to the insured and drew his attention to the indemnity limits for item 5 items. The letter advised the insured that it may be beneficial to make a list of the items that were over the $1,000 limit and supply it to the insurer when increasing the amount of contents cover. The letter pointed out that it cost no more to specify an item.

14 Early in 1988 the insured increased the cover value on contents from $330,000 to $500,000. The insured did not provide a list of house contents that were within item 5. The insurer accepted an additional premium and

forwarded a revised policy schedule for the balance of the policy period to 1 January 1989. Presumably, given the size over the overall limit of cover, many items fell within item 5 as "fine art, paintings, works of art, antiques or curios".

15 A burglary occurred at the insured's home. He claimed more than $200,000 most of which was for items that fell within item 5.

Decision

16 The court held that the insured was bound by the limits of indemnity and that his failure to specify items was not an omission for the purposes of s54. The court drew a distinction between an omission that entitled the insurer to refuse to pay a claim and the exercise by the insured of the right to elect not to expand the scope of cover.

17 In addition, Kennedy J held that it was not a case of the insurer refusing to pay the claim by reason of an act or omission on his part. Rather item 5 fixed the measure of indemnity granted.

1997 and 2001 – High Court

18 The decision in ***Kelly*** might now be viewed as qualified by ***Antico v Heath Fielding Australia Pty Ltd*** [1997] HCA 35; (1997) 188 CLR 652. In ***Antico*** a majority of the High Court held that insured's failure to exercise a right choice or liberty under the contract of insurance may be an omission for the purposes of s54.

19 ***Antico*** established that section 54 takes as its starting point nothing more than the existence of a claim and of a contract the effect of which is that the insurer may refuse to pay that claim by reason of some act which the insured (or someone else) has done or omitted to do after the contract was entered into: ***Maxwell v Highway Hauliers Pty Ltd*** [2014] HCA 33 [21]; (2014) 88 ALJR 841.

20 According to the plurality in ***FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd*** [2001] HCA 38; (2001) 204 CLR 641 at 659 [40], s54(1) directs attention to the effect of the contract of insurance on the claim on the insurer which the insured has *in fact* made. Section 54 does not operate to relieve the insured of restrictions or limitations that are inherent in [the] claim: at 656 [41].

2001 – second case

Moltoni Corporation Pty Ltd v QBE Insurance
[2001] HCA 73; (2001) 205 CLR 149

Issue

21 Was the insurer prejudiced by the insured's late notification of a claim by an injured employee against his employer?

Background

22 The policy was a workers' compensation policy. One aspect of the decision of the High Court was that the common law cover provided by the policy was subject to the operation of the *Insurance Contracts Act*.

23 Moltoni was insured against legal liability to pay damages for personal injury sustained by an employee if the injury was one in respect of which the employee was entitled to recover both compensation under the *Workers' Compensation and Rehabilitation Act* and damages independently of the Act. It was a condition of the policy that the insured give notice to the insurer of any personal injury suffered by an employee as soon as practicable after information as to its happening, or any incapacity resulting from it, came to the employer's knowledge. Due observance and fulfilment of the conditions of the policy were stated to be a condition precedent to liability.

24 An employee was injured and sought to recover (and ultimately recovered) damages from the employer. The employer did not notify the insurer about the incident that gave rise to the injury until about 17 months after it occurred. The insurer denied liability to indemnify and alleged that it had been prejudiced by the breach of the condition.

Decision

25 The High Court held that where an insurer would not have gone off risk if the relevant act or omission had not occurred, for s54(1) to be engaged the prejudice suffered by the insurer must be capable of being expressed in monetary terms and proved by the insurer on the balance of probabilities by reference to what would have happened if that act or omission had not occurred. The trial Judge was not persuaded by the evidence of what its representative witness said it would have done. In those circumstances the

insurer did not establish that its liability to the insured should be reduced by any amount.

26 It is not sufficient for the insurer to show that it lost an opportunity to reduce its liability. It was necessary to prove, to the requisite standard of proof, what would have been done.

Law reform

27 Subsequent legislative changes have removed common law cover under a workers' compensation policy from the ambit of the Act. The *Insurance Contracts Amendment Act 2013* (Cth), applies to contracts that were entered into or renewed after 28 June 2013. The classes of insurance to which the *Insurance Contracts Act* does not apply were extended to include contracts entered into for the purposes of a law that relates to workers' compensation and to provide cover for an employer's common law liability to pay damages for employment related personal injury: s9(1)(f).

2014 – third case

Maxwell v Highway Hauliers Pty Ltd
[2014] HCA 33; (2014) 88 ALJR 841

Issue

28 Was compliance with a requirement that drivers attain a minimum score on a specified (PAQS) test an aspect of cover that fell outside s54?

Background

29 The insured, Highway Hauliers, owned a fleet of vehicles that included prime movers and trailers known as "B Doubles" used in interstate freight transport.

It was insured for loss, damage or liability occurring to or in respect of the vehicles during the period from 29 April 2004 to 30 April 2005.

30 An indorsement to the contract of insurance provided:

> "No indemnity is provided under this policy of Insurance when Your Vehicle/s are being operated by drivers of B Doubles … unless the driver … has a PAQS driver profile score of at least 36, or an equivalent program approved by Us".

31 Two of the insured's B Doubles were damaged in separate accidents in 2004 and 2005. Other vehicles were damaged. Neither driver had undertaken a PAQS test. The insured made claims for accidental damage to the vehicles, liability to a third party and legal costs.

32 The insurers refused to pay each claim and said that there was "an absence of relevant cover … by virtue of the fact that the vehicle was being driven by an untested driver".

33 The insurers' liability turned on whether s54 operated to preclude the insurers from denying liability except to the extent to which their interests had been prejudiced. The insurers argued that s54 did not apply. Their argument was that the drivers had a characteristic that removed the accidents from the scope of cover. They asserted that this was a restriction or limitation inherent in the claim.

34 At trial two important concessions were made:

34.1 The drivers' failure to have a PAQS score of 36 could not reasonably be regarded as being capable of causing or contributing to any loss;

34.2 Insurers' interests were not prejudiced.

Decision

35 The insured's claim for indemnity was successful at trial and on an appeal by the insurers. The dispute went to the High Court.

36 The High Court found that no difference was to be drawn between a term framed as:

36.1 An obligation of the insured (eg. "the insured is under an obligation to keep the motor vehicle in a road worthy condition");

36.2 A continuing warranty of the insured (eg. "the insured warrants that he will keep the motor vehicle in a roadworthy condition");

36.3 A temporal exclusion from cover (eg. "this cover will not apply while the motor vehicle is un-roadworthy"); or

36.4 A limitation on the defined risk (eg. "this contract provides cover for the motor vehicle while it is roadworthy").

37 A restriction or limitation that was inherent in the claim that the insured in fact had made was one that must necessarily be acknowledged in the making of a claim having regard to the type of insurance under which that claim is made:

37.1 Under a "claims made and notified" policy it is a demand made on the insured by a third party during the period of cover;

37.2 Under a "discovery" contract it is an occurrence of which the insured became aware during the period of cover;

37.3 Under an "occurrence based" contract it is an event which occurred during the period of cover.

38 Each insured vehicle was being operated at the time of the accident by an untested driver. There was an omission of the insured to ensure that each vehicle was operated by a driver who had undertaken a PAQS test. Section 54(1) applied to that omission.

Rejection of Queensland decision

39 In the Queensland decision ***Johnson v Triple C Furniture & Electrical Pty Ltd*** [2012] 2 Qd R 337 the insured was indemnified for amounts which it became liable in respect of accidental injuries to passengers whilst on board an aircraft. The policy contained a temporal exclusion expressed in terms that "this policy does NOT apply whilst the aircraft … is operated in breach of [air safety regulations]". The Queensland Court of Appeal accepted an argument that s54(1) was not engaged. The High Court disagreed and said that the Queensland decision on this point should not be followed. The temporal exclusion did not qualify the "claim" that was made.

2016 – fourth case

Allianz Australian Insurance Ltd v Inglis
[2016] WASCA 25

Issue

40 Was an exclusion for legal liability for injury to "any person who normally lives with you" founded on an "act" and hence controlled by s54?

Background

41 The plaintiff, Georgia Inglis, was seriously injured when she was run over by a ride-on lawn mower driven by Stephen Sweeney at the home of Stephen's

parents, Daniel and Elaine. Stephen was 11 years old. Georgia was 10.

42 Georgia commenced proceedings for damages against Stephen and his parents. The Sweeneys in turn claimed indemnity or contribution from Georgia's brother James (who was 12 at the time of the accident) and their father Stuart Inglis. For this contribution claim Stuart and James sought indemnity under a home insurance policy with Allianz. Allianz denied indemnity.

43 Allianz agreed to cover the insured's legal liability for payment of compensation in respect of bodily injury occurring during the period of insurance which is caused by an accident occurring anywhere in Australia. There was an exclusion for legal liability for injury to "any person who normally lives with you".

Decision

44 The claim for indemnity succeeded at trial but was lost on appeal.

45 The Court of Appeal rejected arguments, by notice of contention, by the respondents Daniel and Stuart Inglis that the exclusion only applied in the case of an injury to a person who was not covered by the policy and did not cover a claim for indemnity or contribution under the *Law Reform (Contributory Negligence and Tortfeasors' Contribution) Act 1947*. The central question was whether there was a relevant "act" that engaged s54.

46 The Court was satisfied that the fact that a person normally lives with an insured does not constitute an "act" within the meaning of s54(1).

47 The principal reasons of the Court of Appeal were delivered by McLure P. According to her Honour where the ultimate fact (did the claimant normally live with the insured at the relevant time) depends on the drawing of an inference from the conduct of all relevant persons over an extended period and does not depend on there being any act on the relevant day, the ultimate fact is not (for the purposes of s54) an "act of the insured or some other person". It is properly characterised as a state of affairs or description of a relationship. It was analogous to another exclusion (1)(c) where the actions of both parties will inform and determine whether the relationship of employer and employee exists.

48 In separate reasons for decision Mitchell J observed that s54(1) will not operate unless "the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim … by reason of some act of the insured or of some other person". Section 54 operates by reference to the effect of the contract of insurance on the claim that the insured has in fact made. In considering its application to a particular case, close attention must be given to the claim which the insured has made, the effect of the contract of insurance between the parties, and the reason of the insurer's refusal to pay that claim.

49 According to Mitchell J to identify Georgia (incorrectly described in his reasons as "Georgina") as a person who normally lived with the insured is to describe the character of her relationship with the insured rather than her

conduct. It followed that the policy did not have the effect, but for s54, that Allianz may refuse to pay Stuart and James Inglis' claim "by reason of some act of the insured or some other person". That condition for the operation of s54(1) was not satisfied.

Other Allianz arguments were rejected

50 Allianz raised a number of arguments that were rejected.

51 First, it argued that the fact that Georgia was normally living with the insured "could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract" for the purposes of s54(2). This argument was only raised on appeal.

52 The argument was built on a number of components – first, loss for the purposes of s54(2) is financial loss by reason of incurring legal liability; secondly, an act within the subsection is something that would give rise to a duty of care or something that would make an accident more likely to occur; third, persons who normally live in the insured's home are most likely to suffer an injury in the home because of regular and frequent interaction; and fourth, an insured is more likely to owe a duty of care to a person who normally lives with the insured.

53 McLure P held that if the fact that Georgia was normally living with the insured is an act for the purposes of s54 then on the date of the accident Georgia was normally living with the insured that would be an act that occurred after the policy was entered into for the purposes of s54(1). The fact

that a claimant normally lives with the insured may increase the risk of a financial loss in respect of which cover is provided but it is incapable of satisfying the causation requirements for legal liability. If there was an "act" the increasing risk of financial loss may arguably constitute prejudice for the purposes of s54(1) but it did not bring the act within s54(2).

54 Secondly, Allianz sought to raise the kind of argument that was comprehensively rejected by the High Court in ***Highway Hauliers***. Allianz submitted that the reason for refusal to pay the claim was not an act or omission of the insured or some other person but because the policy did not extend to the claim. It was, so the argument went, a restriction or limitation that was inherent in the claim that the insured had in fact made.

55 This argument was rejected by the Court of Appeal. The inherent restrictions or limitations were that there was legal liability for bodily injury that occurred during the period of insurance and was caused by an accident within the geographical area covered by the policy.

Conclusions about s54(1)

56 Four lessons may be learned from this survey of four Western Australian cases.

57 First, section 54(1) focuses attention on the claim that has been made.

58 It does not operate to relieve the insured of restrictions or limitations that are inherent in that claim. As to what constitutes such a restriction or limitation:

58.1 Under a “claims made and notified” policy it is a demand made on the insured by a third party during the period of cover;

58.2 Under a “discovery” contract it is an occurrence of which the insured became aware during the period of cover;

58.3 Under an “occurrence based” contract it is an event which occurred during the period of cover.

59 Secondly, there must be an identified act or omission.

60 The insured’s failure to exercise a right choice or liberty under the contract of insurance may be an omission.

61 A collection of facts that includes the conduct of a number of people over a period of time might be better characterised as the description of a relationship or a state of affairs rather than an act or omission.

62 Thirdly, the identified act or omission must be the reason for the insurer’s refusal to pay the claim.

63 Fourthly, the insurer must prove the prejudice that it has suffered and its value.

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