INSURANCE COUNCIL OF AUSTRALIA

FOURTH INSURANCE COUNCIL OF AUSTRALIA LUNCHEON

SYDNEY, 22 FEBRUARY 1977

REFORMING INSURANCE LAW

Hon Justice M D Kirby

February 1977

INSURANCE COUNCIL OF AUSTRALIA

FOURTH INSURANCE COUNCIL OF AUSTRALIA LUNCHEON

SYDNEY, 22 FEBRUARY, 1977

REFORMING INSURANCE LAW

The Honourable Mr. Justice M.D. Kirby *
Chairman of the Law Reform Commission

THE LAW REFORM COMMISSION

1. I must start by thanking the Insurance Council of Australia for this invitation to address you at an important stage in the life of the Law Reform Commission. I propose to take this opportunity to tell you something about the Commission, its work and methods and the Reference we have now received from the Attorney-General concerning insurance contracts.[1] I then propose to discuss with you some of the special implications of the Reference that may be of interest to you and the insurance industry generally.

2. The Law Reform Commission Act was passed in 1973. It established for the first time a Law Reform Commission for the Commonwealth.[2] State bodies to reform the law had been established for many years. The growth of the Commonwealth's interest in areas of private law, indeed the growth of Commonwealth legislation, made it appropriate to establish a federal law reform commission. The Commission's function, in matters referred to it by the Attorney-General, Mr. Ellicott, is to review, modernize and simplify the law. Our responsibility extends to the review of laws within the competence of the Commonwealth Parliament. This includes Territorial laws. In the present context, as I will show, it includes a great area of unexplored territory involving the Commonwealth's power over insurance.

3. What is the reason for a law reform commission? Why not get on with the job in the Departments of State? Nowadays, Parliaments are intensely busy. They need assistance in matters that are extremely technical or extremely comple: Where the ventilation of ideas for reform is desirable, so that they will be refined and perfected before they hit the Parliamentary table, one course that governments can adopt is to assign the task to the Law Reform Commission. This is because we go about our work in a special way. Expert consultants are

appointed to sit at the table with the Commissioners, assisting towards the formulation of policy. I have no doubt that in the Reference which we have now received concerning insurance contracts, a number of suitable consultants from all aspects of the insurance industry will be appointed by Mr. Ellcott to help us in our task. We can offer no fees for this service. What is offered is the opportunity to contribute to the formulation of national legislation. In the References we have had to date, we have found that busy men and women will set aside other obligations to assist us as consultants. I am sure that it will be so in this case. We have already commenced discussion with the Insurance Council of Australia with a view to securing the nomination of appropriate persons. As well, we call for submissions. We secure information from Australian offices overseas concerning developments that are taking place in the law beyond our horizon. We will set forward tentative views in a working paper. We will conduct public sittings in all parts of the country to allow these tentative proposals to be tested in the forum of the Australian community. We will then draft any legislation that is required. Only then will we report to the Attorney-General and the Parliament.

4. This course, though a thorough one, need not be a tardy one. The Commission has shown that it can respond quickly and effectively in complex areas of the law. We have before us at the moment important tasks upon subjects as varied as bankruptcy reform, the protection of privacy, the revision of defamation laws, the provision of laws dealing with human tissue transplants, the incorporation of Aboriginal customary law into the Australian legal system and diminution of technical rules which bar access to the courts on the part of our citizens. It is a mixed bag of interesting, challenging, relevant work. Nor is the Commission just a scholarly study group. The Attorney-General has already announced action to implement the Commission's first reports. Therefore, as we stand at the threshold of the Insurance Contracts Reference, it is vital that the Commission receives the support and assistance of the Australian insurance industry. I have a healthy and proper regard for its place in the Australian community and for the service it has done and is continuing to do for this country.

5. Can I include a personal note? As an Articled Clerk for three years I did relentless battle against the insurers on behalf of my Master's Clients. I learnt a few things in the process. As a Solicitor for six years I acted for some of the biggest insurers in Australia. At the Bar I sold my favours evenly. I have an understanding of the approach most insurers take in this country to legal problems. Anyone who has acted for insurers will know that,

whatever the law may say on a point, honour and a strong sense of obligation are living forces in the daily life of insurance companies.

THE INSURANCE REFERENCE

6. In his Reference to the Commission, the Attorney-General has posed a number of specific and some general questions for answer. I do not propose to spell out the Terms of Reference. Copies are available. Put shortly, our task is to examine whether the present law of insurance in this country does strike a fair balance between the interests of the insurer and the interests of the insured. We are required to report upon whether legislative or other measures are necessary to ensure such a fair balance. We are specifically excluded from marine insurance, workers' compensation and compulsory third party insurance. Otherwise, within the Commonwealth Constitution, our brief is a wide one.

7. Some of the specific questions can be stated to indicate the sort of issue that is before us.

* Do terms and conditions presently found in insurance contracts operate unfairly?
* Should some terms be mandatory in contracts of insurance?
* Should some terms be prohibited?
* Is the practice of incorporating statements made in the proposal into the contract, equitable as between the parties?
* Should insurers be required in every case to supply a person with written information of his rights and obligations under the proposed contract?
* Do arbitration clauses operate unfairly?
* Do the principles of the law of agency operate unfairly?

Then, in case there was any question left out of this list, the Attorney-General has asked us to look at "any other related matters".

THE COMMONWEALTH'S CONSTITUTIONAL POWER: AN AUSTRALIAN LAW OF INSURANCE

8. I have said that we are specifically excluded from certain areas of insurance. The Terms of Reference do not really require us to deal with the general regulation of insurance business. The focus of the Reference is upon insurance contracts. It is for this reason that we are at present collecting a wealth of contract forms from every insurer in the Commonwealth. The material

is enormous. The variety of contract forms and of provisions within them, is significant. I hope shortly, with the approval of the Attorney-General, to appoint a person with long experience in the industry to assist the Commission in the analysis of the contracts and their terms. Obviously, this is the starting point of the Commission's work. It is a laborious task. It has to be done.

9. The more significant limitation upon us is one with which every federal officer must learn to live. I refer to the limits upon the Commonwealth' power to enact laws in respect of insurance. But these limits are not narrow. Section 51 (xiv) of the Commonwealth Constitution provides that the Commonwealth shall have power to make laws with respect to -

> "Insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned".

The decisions of the High Court of Australia have suggested that the insurance power of the Commonwealth is extremely wide.[3] Not only is the whole relation of insurer and insured apparently within the scope of the power, it also extends to providing for the enforcement of contractual obligations and for the enforcemer of further obligations beyond the contract. The power to make laws with respect to insurance supports a wide range of legislation governing the conduct of insurance business. The Commonwealth also has a wide power to enact legislation incidental to the insurance power, if need be.[4] Even the apparently absolute protections afforded by Section 92 of the Constitution to trade, commerce and int course have not been able to withstand regulation of insurance business.[5]

10. Is it not curious, in these circumstances, that the great body of law relating to insurance in Australia is not found in an Australian statute? To this day, the bulk of the private law of insurance in our country is to be discovered not in the Public Acts of the Parliaments of the Commonwealth or the States but in English text books and a jumble of confusing cases. I say "English' text books, without a hint of xenophobia, a charge to which I plead not guilty. The fact remains that the Founding Fathers may have had doubts about some things. Our Constitution may even be less than perfect. But they had no doubts that the National Parliament should be empowered (the State insurers apart in intrastate business) to enact general laws of the greatest detail in respect of insurance. We all know that this has not been done. One writer recently asked why the law of Insurance "should continue to rest mainly on a jumble of unjust precedents".[6] It is the task of the Law Reform Commission to now address itself to that law, in respect of insurance contracts at least. Armed with

wide constitutional powers, we may help the Parliament to develop an indigenous Australian approach to the law of insurance contracts. Ought that law to remain the preserve of the initiated few with access to MacGillivray's text[7] and Ivamy's book?[8] This Reference provides the occasion for the answer to that question.

POSSIBLE APPROACHES: APPROVAL OF POLICIES?

11. Looking at insurance contracts, in the light of the questions posed by the Attorney-General, it must be admitted that there is an initial question of approach to be decided here. No one realizes better than a lawyer, the value of precedents that have been tried and tested. It is certainly uncomfortab to face the notion that old fashioned language and unfair conditions that have survived for decades, even centuries, must now be reviewed. It is not five years since lawyers in N.S.W., using the English Pleading Book of the 1840s asserted that plaintiffs had "suffered great pain of body and of mind" and had been "otherwise greatly damnified". If lawyers can be weaned from familiar, comfortable language of this kind, surely the insurance industry can do likewise.

12. The present Reference, however, goes beyond mere matters of language. Many of the doctrines of insurance law have lately come under trenchant criticism Some of these doctrines originated in the eighteenth century and no longer serve a useful social function.[9] I shall refer to one or two of them shortly. But fir there is an important issue that is clearly raised as to the approach the law sho have to the matters that are now before us. Let it be assumed that the Commissio at the end of its inquiry, came to the conclusion that there were some terms that should be mandatory in contracts of insurance, others that should be prohibited and still others that operate unfairly and should be regulated. What is the correct approach to regulation of such matters? I can think of three approaches at least. The first is self regulation. I do want to emphasize the importance which the Commission attaches to self regulation. Facing the growing tide of legislation which daily emanates from our Parliaments, law reformers (and Parliamentarians themselves) everywhere cry out, like Canute, for a halt to the flood. Is it appropriate or feasible to leave the regulation of contracts to self discipline? Can some mechanism be established by which the industry itself polices unfair practices? It will be important to have the views of insurers and of the industry upon this question.

13. If some legislation is appropriate, it could take one of two forms. A statute could spell out provisions in relation to some insurance contract

terms at least, giving guidance as to standards of fairness and providing means to uphold the legislative will against the terms of any offending contract.[10]

14. But the legislation could also provide for the administrative control of the terms of insurance contracts. This method has been adopted overseas. As early as 1870, administrative agencies were established in the United States to control the terms of insurance policies.[11] Their regulatory functions have steadily increased. Germany, in 1901 established an insurance supervision body. More recently, France has developed a comprehensive system of insurance regulatio Sometimes, these administrative agencies lay down general rules. They have the advantage over statute for the mobility to act more speedily and flexibly to cope with the changing circumstances of the insurance market. Sometimes, however, specific power is conferred on an agency to prescribe "reasonable conditions" and to alter standard conditions in insurance contracts. The Wisconsin Department of Insurance, for example, has broad powers to prescribe or prohibit particular policy terms.[14] In Israel, a *Standard Contracts Law* was passed in 1964.[15] It requires the approval of a Board for any "restrictive term" in insurance and other contracts.

15. I am alive to the fear of the dead hand of bureaucracy upon the vital, living insurance market. But the proposal for general regulation of some terms at least of non-life insurance contracts in Australia has a precedent in this country. It is Section 77 of the *Life Insurance Act* 1945 (Cwth). This section requires the submission of proposals and policies ordinarily used to the Commissioner for approval. The power is rarely used. Only policies issued by newly established companies have been submitted to this scrutiny. New policie or policies existing before 1945 are not, as a matter of practice, required for scrutiny. The Act applies only to life insurance policies. But bearing in mind American, European and Israeli developments in the law, would it be appropriate to suggest the establishment of a properly expert agency (perhaps one in which the industry itself was represented) to test Australian insurance policies against clearly established criteria designed to balance fairly the interests of the insurer, the insured and society. I express no concluded view on the subject. I invite assistance on the fundamental question of the approach the law should have to this issue. There is, of course, a fourth approach. It is to do nothing and to leave it to the market place to sort out the fair from the unfair contracts. This assumes that all contracting parties are of equal capacity to judge their own interests and to understand their contractual rights. It is somewhat unreal in a world of printed forms and fine print. The "jumble

of unjust precedents" may require action. It will be important for us all to consider the form which the action should take.

SPECIFIC ISSUES

Whose Agent?

16. We all know that many insurance contracts are negotiated through agents nominated by the insurer. The practice has proved on occasions to be directly relevant to the liability of the insurer. A proponent who obtains his insurance through such an intermediary is apt to assume that a true and complete disclosure of facts to the agent is disclosure to the insurer. Australian authority probably establishes the contrary. At any rate, in relation to the filling out of a proposal form it seems clear that the agent is not the agent of the company but of the proposer. If the agent carelessly or deliberately falsifies information, distorting oral instructions, the insured may be left without legal redress. Can there be a better case to illustrate this than the *Jumna Kahn* case.[16] The insured was illiterate. He went to the local office of the insurance company to secure insurance of his house and belongings against fire. At the suggestion of the agent, he signed a proposal form. The agent said he would "fix everything up". The agent, without asking the insured any questions, filled in the form. He inserted an untrue answer to one question. The policy was issued on the basis of the proposal. The house was destroyed by fire. When the insured sued upon the policy, the jury returned a verdict for him. The High Court, however, set aside the verdict. The company was not responsible for the statement. The agent was an agent to receive proposals, not to fill them in. The High Court admitted that it was a hard case for this illiterate insured. It consoled him by suggesting that he might have an action against the agent.

17. Recent cases show an extension of this principle. In England,[17] a Mr. Stone took out policies of insurance. One of them covered risk of fire. A claim was made in 1967. Later that year the policy lapsed. In January 1968, a Mr. O'Shea, an Inspector, called from the insurance company. Stone was not in so he saw Mrs. Stone. He asked her if she would like to take out a new policy. He suggested it should be for a higher amount She agreed. He got out some forms and started filling them in. He gave them to her to sign. She did not

read them but signed the forms. One of the answers given, in respect of past claims made, was "none". In 1970 the plaintiff made a claim under the policy. The claim was rejected for non-disclosure of the previous fire claim. The Stones sued but the trial Judge rejected the claim on the basis of the term of the contract. In the Court of Appeal, Lord Denning suggested that an insurance company in such a case should not be permitted to rely on a printed clause which says that something has happened which has not. As long ago as 1957, the English Law Reform Committee recommended that -

> "Any person who solicits or negotiates a contract of insurance should be deemed for the purposes of the formation of the contract, to be the agent of the insurers and that the knowledge of such person should be deemed to be the knowledge of the insurers".[18]

Arbitration Clauses

18. Despite the inroads of modern statutes, many insurance policies still contain arbitration clauses. They have no direct effect on the liability of an insurer. Yet they may operate harshly against an insured in a number of ways. Generally speaking, legal aid is not available. Technically valid but unmeritorious defences may avoid the scrutiny of public trial. The costs of arbitration in Australia, if anything, exceed court trials. They have none of the merits of the swift procedures conducted in London. True it is that insurers rarely invoke these clauses today. But if this is the case, ought not the legislator to translate this practice into a rule of law? Specific legislation has been passed in New South Wales and Victoria.[19] Perhaps like provisions should now set a national standard throughout the Commonwealth. If there are merits in arbitration clauses, as they have operated in Australia, I hope that someone will enlighten me about them.

Insurable Interest

19. Every contract of insurance requires an insurable interest to support it. This principle originated to prevent gaming and wagering and to remove the temptation to destroy the insured property. It is a principle which can work results that are apparently unfair and out of harmony with modern commercial conditions. Our law looks at the formal property interests of the insured in the thing insured.[20] In the United States, the "interest" is defined in terms of "expectation of economic loss".[21]

20. Problems have arisen in the application of the universal principle where property is assigned or sold. As you know, it is a well established principle of property law that from the time of the signing of a valid and enforceable contract for the sale of land, the property, including any house on the property, is at the risk of the purchaser. He it is who has the beneficial ownership. Should the property be destroyed by fire after the date of the contract, the purchaser is not entitled either against the vendor or his insurer, to payment of any monies under a policy of insurance that the vendor has taken out. Unless the policy is assigned, no action can be maintaine upon it except between the original parties to it. Many "hard cases" have resulted from this principle. Legislation has even been passed to modify the strict common law. But "hard cases" persist. The recent *Zeil Nominees* case [22] is an illustration. In that case, the plaintiff in December 1972 purchased land and building thereon under a valid enforceable contract. The vendor had insured the property against loss by fire. In January 1973 the buildings were damaged by fire. When the contract was settled in February 1973 the vendor signed an authority addressed to the insurer authorizing the insurer to pay all monies to which the vendor would be entitled under the insurance policy. On the same day, the vendor by endorsement on the policy, transferred all his rights to the purchaser. The insurer declined indemnity. The purchaser sued the insurer and joined the vendor as a co-defendant. The Supreme Court of Victoria dismissed the claim. The High Court upheld this decision. Since the vendor had no right against the company, it naturally followed that the purchaser, as assignee of the vendor gained no right under the policy. The decision has the inexorable attraction of logic about it. But if you asked the man in the street whether this was a fair result, I doubt if many would think it was. The premium was paid. The risk was a genuine one. A loss was suffered. Is this a technical issue that is ripe for reform?

Non-disclosure

21. The insured must disclose all material facts that are within his knowledge, actual or presumed. This duty is not confined to things he actually knows. It extends to all material facts which he ought, in the ordinary course, to have known. He cannot escape the consequences of not disclosing facts, even if he did not actually know them. The inquiry is

not addressed to his innocence or ignorance. It relates to material facts which in the ordinary course he ought to have known, even if he did not.

22. There is no general duty in the law of contract upon parties to come forward to disclose facts that the other party would deem material in determining whether or not to enter the contract. Trust relationships give rise to one exception to this rule. Insurance gives rise to another. There may be reason to doubt whether the insurance rule developed to cover maritime insurance in the eighteenth century is still apt today. Various proposals for reform have been made. They range from modest recommendations of the English Law Reform Committee in 1957[23] to quite radical developments in the United States.[24] All of these will come under the close scrutiny of the Commission.

CONCLUSIONS

23. Sir Winston Churchill once sent a pudding back to his chef with the complaint that it lacked a theme. I resist a similar fate. What is the theme that I would leave you with today? The Attorney-General has given a challenging, important Reference to the Law Reform Commission to review the law in Australia relating to insurance contracts. We face our task without preconceptions. We will secure the assistance of the industry and others in preparing our report. We will thoroughly ventilate any suggestions for reform before they are put to the Parliament. We will not lend outselves to the criticism that we approach this task of reform with fixed ideas and a determination to impose them on the insurance industry, come what may. On the contrary, I am here today to enlist your aid in the task which Mr. Ellicott has given us.

24. The Reference provides an opportunity. Despite the wide power of the Commonwealth to legislate in respect of insurance, Australian law on this subject is not found conveniently in our statute books. All too often it is hidden away in English case books. The interests of the industry, of the community of insured and of our society require that we take a close look at the possibility of repatriating a code of Australian insurance contract law. This is a task worthy of the national law commission. It is one that can obviousl not be achieved without the fullest support and co-operation of those for whom insurance is a matter of daily bread.

25. I recognize that in insurance, flexibility, adaptability and imagination are imperative. But we all know that printed forms are the staple of the business. The question which the Law Reform Commission now faces is whether machinery should be created to scrutinize the terms and conditions appearing in those forms to make sure that they are fair and just. I have illustrated this talk with a couple of cases that appear, at first blush, to involve unfairness. I would not want the idle listener to assume that I am ignorant of the facts of life. We all know the multi-million dollar business that is going on and will continue to go in to the general satisfaction of insured and insurer alike and to the service of the community. But the law has a educative function for us all. The task of my Commission in this exercise will be to submit insurance law to new scrutiny. With the help of the insurance industry and others, we will come up with practical solutions that can recommend themselves to the Federal Parliament.

* B.A., LL.M., B.Ec.(Syd.). This is the text of an address given by Mr. Justice Kirby to the Fourth Insurance Council of Australia Luncheon, Sydney 22 February 1977.

1. The Reference was made on 9 September 1976.

2. A law reform commission for the A.C.T. was established in 1970 but completed its programme in 1976. Its functions were transferred to the Australian Law Reform Commission.

3. See *Insurance Commissioner v. Associated Dominions Assurance Society Pty. Ltd.*, (1953) 89 *C.L.R.* 78.

4. *Loc.cit.*

5. *Associated Dominions Assurance Society v. Balmford*, (1951) 84 *C.L.R.* 249.

6. R.A. Hasson, "Misrepresentation and Non-Disclosure in Life Insurance - Some Steps Forward", (1975) 38 *Mod.L.R.* 89, at p.93.

7. MacGillivray and Parkington, *Insurance Law*, London, 6th ed., 1975.

8. Ivamy, *General Principles of Insurance Law*, London, 3rd ed., 1975.

9. See, e.g., B. Harnett, "The Doctrine of Concealment: A Remnant of the Law of Insurance", (1950) *Law and Contemporary Problems* 391.

10. S.L. Kimball and W. Pfennigstorf, "Legislative Control of the Terms of Insurance Contracts: A Comparative Study", (1964) 39 *Indiana L.J.* 675.

11. Patterson, *The Insurance Commissioner of the United States*, (Harvard, 1927)

12. S.L. Kimball and W. Pfenningstorf, "Administrative Control of the Terms of Insurance Contracts: A Comparative Study, (1965) 40 *Indiana L.J.* 143.

13. *Loc.cit.*

14. *Ibid*, at p.149.

15. The text of the law will be found in [1968] *Journal of Business Law* 329.

16. *Jumna Khan v. Bankers' and Traders' Insurance Co.*, (1925) 37 *C.L.R.* 451.

17. See, *Stone v. Reliance Mutual Insurance Soc.* [1972] *Lloyds Rep.* 469.

18. Fifth Report, "Conditions and Exceptions in Insurance Policies", Cmnd.62, p.7.

19. *Commercial Transactions (Miscellaneous Provisions) Act*, 1974 (N.S.W.); *Instruments Act*, 1958 (Vic.), s.28.

20. MacGillivray and Parkington, p.3.

21. *Corpus Juris Secundum*, vol. 44, p.870.

22. *Zeil Nominees Pty. Ltd. v. V.A.C.C. Insurance Co.Ltd.*, 50 *A.L.J.R.* 219.

23. Fifth Report, p.7.

24. B. Harnett, *op.cit.*, pp.391ff.