THE CHARTERED INSTITUTE OF LOSS ADJUSTERS

AUSTRALASIAN DIVISION

LUNCHEON, PARK ROYAL MOTEL, CANBERRA

THURSDAY 24 SEPTEMBER 1981

LAW REFORM AND THE PAYMENT OF INSURANCE CLAIMS

The Hon. Mr. Justice M.D. Kirby
Chairman of the Australian Law Reform Commission

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INSURANCE REFERENCE

The Australian Law Reform Commission was established in 1975. Amongst the Commissioners have been some of the most distinguished lawyers in our country, including Sir Zelman Cowen (now Governor-General) and Sir Gerard Brennan (now a Justice of the High Court of Australia). The Commission works only on tasks given to it by the Federal Attorney-General. In preparing its reports, it takes a painstaking path, designed to ensure that the reforms proposed will be acted upon and will last. A team of consultants from the relevant interest groups is appointed to assist the Commissioners. Discussion papers with tentative proposals are widely circulated. Public hearings and seminars are held. There is widespread discussion in the media. At the end of the day a report is prepared with draft legislation. Many of the reports of the Commission have been accepted by Federal and State Governments. The task we are engaged in is not an academic one. It is nothing less than the revision of the Federal laws of Australia.

In late 1976, the Commission was given a major project by Attorney-General Ellicott. It was required to review the laws relating to insurance contracts in this country. Until now insurance law has been primarily made by the judges. Small areas are governed by legislation of the United Kingdom, Commonwealth and State Parliaments. For the most part, it is still the judge-made rules of the common law which determine the rights and duties of parties to a contract of insurance in Australia. Many of these rules were developed in an earlier time and in the context of the specialised field of marine insurance. Many are no longer appropriate to our time. Today, a great number of our fellow citizens have insurance of one sort or another. Unlike the buyers of early

marine insurance, their individual bargaining power, as insurance consumers, will often be weak when compared to that of the insurer or its agents, including loss adjusters. The marketing of insurance has changed radically. Like other products, insurance is now sold to members of the public through television, radio and newspapers. In the not too distant future, it is likely that insurance will be available through computer-based communications systems. Clearly insurance is an essential attribute of a modern society. The continued good health of the insurance industry is important to Australia. So is the good health of the law in dealing with the disputes that inevitably arise in insurance contracts.

In 1978, as a focus for industry and community discussion, the Australian Law Reform Commission published a consultative document setting out various proposals for law reform in the area of insurance. I would outstay my welcome if I were to discuss all of the points made in this paper. In the preparation of the paper, the Commission had the assistance of loss adjusters and their representative bodies throughout Australia. Two of our consultants were Mr. E. Madill and Mr. Syd McDonald, members of your profession. At our public hearings, we received assistance from loss adjusters, most notably Mr. Peter Chapman, President of the Loss Adjusters Institute of Victoria, who came forward at a public hearing in Melbourne to press, orally, the Institute's submission concerning loss adjusters.

LICENSING OF LOSS ADJUSTERS

In the discussion paper, the Commission referred to the possibility of unfair and inadequate treatment of insurance claimants by loss adjusters. Reference was made to a possible system of licensing or registration of loss adjusters, though doubt was expressed as to whether 'the extent of the problem warrants such a costly and possibly ineffective solution'.[1] Mention was also made of a possible period of grace, after settlement with a loss adjuster, within which an insured could change his mind and reopen negotiations, though the value of this was also doubted..

At the public hearing in Melbourne, Mr. Chapman sought to overcome the doubts of the Commission concerning the need for a licensing system for loss adjusters. He expressed concern about the possibility of unskilled, inexperienced and even unscrupulous people taking part in insurance loss adjustment. He estimated that there were about 500 members associated with the Chartered Institute of Loss Adjusters. But because membership was voluntary, about 300 or 400 loss adjusters were believed to be outside the Institute. Furthermore, the sanctions presently available to the Institute for wrongful conduct were considered inadequate, because of the voluntary nature of the association. The oral and written submissions on behalf of loss adjusters urged the passage of legislation, preferably Federal legislation, to license loss adjusters.

It was suggested that costs could be saved by virtually delegating to the Institute the administration of the licensing scheme.

Few specific cases of unscrupulous conduct were called to attention. However, various possibilities were mentioned including:

> 'conflict of interests ... such as being a building contractor as well as being a loss assessor, or loss adjuster, or a panelbeater and loss adjuster';
>
> 'the situation 'could be' that a loss adjuster who was also a panelbeater could call for quotations from other panel beaters; could obviously see what the quotes were, put in a lower quote and secure the business, perhaps doing a secondclass job or job which is lower quality if necessary ... to secure the work'.[2]

The Law Reform Commission decided to proceed to report in its insurance reference in two stages. It first delivered a report titled Insurance Agents and Brokers'[3]. It is now working to complete the second stage, dealing with the general law of insurance contracts. Although the report on Insurance Agents and Brokers urged various legislative changes in the legal duties and obligations of brokers and agents, no occupational regulation was recommended in the case of loss adjusters:

> A claim to occupational regulation was also put forward on behalf of loss adjusters. ... It was not urged on the Commission as forcibly as were the claims of brokers and life agents. It did not meet with a favourable response from the insurance industry. While lapses on the part of the adjusters have been reported to the Commission, the improvement of standards should, at this stage, be left to insurers and to the self-regulatory bodies which represent loss adjusters.[4]

The Commission's report on insurance intermediaries, and the decision made in respect of the claim of loss adjusters, illustrate the care that must now be taken to weigh the costs and benefits of proposals for law reform. One of the guiding principles which the Commission accepted in making its recommendations was stated in the following terms:

> Forms of regulation which might have an anticompetitive effect on the insurance industry or on any section of it should be avoided. Diminution of competition might increase the cost of insurance and adversely affect the range and quality of services offered and on the development of the market in response to the needs of the insuring public. The Commission accepts the

guiding philosophy of the Trade Practices Act 1974 (Cwlth), namely, that interference with the freedom of competition is to be justified, if at all, by the public benefit which results from a particular form of regulation.[5]

In terms of the balance to be struck between the costs and inconvenience of legislation and the problem being addressed, the most serious issue involving insurance intermediaries appeared to us to be that raised by the number of broker insolvencies that have lately marred the insurance scene in Australia. Between 1970 and 1979, 27 Australian insurance brokers collapsed. Their total losses amounted to $7.25 million. This sum has doubled since the Commission's report was delivered to the government. In the ultimate, a large proportion of these losses must be borne by the insuring public.

Faced with the collapse of brokers, significant losses and a number of other problems, the Commission had to consider what, if anything, should be done. One possibility, also urged upon us by brokers and their organisations, was the introduction of strict licensing requirements. The Commission considered that the costs of licensing would outweigh the benefits that licensing would bring, even for the better regulation of proved areas of difficulty : insurance broking. Instead, the Commission recommended a modest form of regulation by way of registration of insurance brokers, compliance with trust account rules and a scheme for compulsory professional indemnity insurance. It was believed that this scheme would be cost effective, would address positively the problem of losses suffered by the insuring public, but at the same time would avoid anti-competitive limitations and a costly bureaucracy. The administrative costs would be borne by brokers themselves. It was estimated that two government employees only would be required for the new system. The Commission decided that these costs were warranted by the additional protections secured by the system of registration, not only for innocent members of the public who unexpectedly found themselves uninsured and unprotected by the law, but also for the good name of honest brokers and of the insurance industry itself.

Because of the high importance attached by the Law Reform Commission to cost effectiveness of legislative intervention, we were not convinced that licensing or other regulation of loss adjusters was needed at this time to solve the relatively few cases of unscrupulous practice brought to our notice. As you know, loss adjusters are licensed in South Australia, in certain classes of insurance. However, a submission on behalf of loss adjusters claimed that the system there 'does not serve the purpose, as any person may become a licencee merely by paying the requisite fee'.[6] All too often in the past, licensing provisions have become an inefficient means of gathering a paltry amount of government revenue, whilst providing little real protection for the consuming public.

It will interest you to know, in the light of the Law Reform Commission's conclusions on this subject, that the Federal Treasurer, in June 1981, announced that the government did not favour legislative regulation at all. Rather, it preferred 'the development of sound and appropriate self-regulatory practices'. This, it was said, would assure consumers 'freedom of choice to deal with intermediaries'. The 'ultimate judgment' would 'rest with the consumer'. Explaining the government's position, the Treasurer advanced a general proposition:

> As should now be well known, the government's general view of intervention in commercial relationships is that a clear need must be demonstrated before Commonwealth regulatory legislation is considered. The government does not believe that such a need has been established either by the Law Reform Commission or by others making submissions. Indeed, the recent decision of the Review of Commonwealth Functions requires ... critical examination of existing supervision of the insurance industry.

Arising out of this debate, the points I want to make are two. The first, specific to your branch of the insurance industry, is a simple one. If it cannot be established to the satisfaction of government that a system of registration and modest regulation is needed in the area of insurance brokers (where there have been proved, important and persistent problems) how much less likely is it that a system of licensing will be accepted in the case of loss adjusters, where the established problems of dishonesty, conflict of interests and unscrupulous dealing are few and the problems (at least as shown to the Law Reform Commission) are more theoretical than actual.

Secondly, and more generally, law reformers of the future and indeed the courts and lawmakers, will become much more familiar with the economics of what they are about and much more aware of the economic impact of law changes. Clearly, it will be an ineffective use of public resources for law reform commissions, Royal Commissions or others proposing new laws to do so in complete ignorance of and indifference to the costs of their proposals. If they adopt this course, they are almost certainly bound to conflict with those forces in society determined to rope in public expenditure and to diminish controls over economic freedom.

ALTERNATIVES FOR RESOLVING INSURANCE DISPUTES

Against this background, let me turn now to some of the proposals for reform of the law relating to settlement of insurance claims, which the Commission is considering before delivering, early next year, its second report on insurance.

One of the great problems which arises in relation to the settlement of insurance claims, as well as other areas of the law, is finding the best way of settling disputes. The bodies primarily entrusted with the power to resolve disputes are, of course, courts of law. But courts usually involve expensive legal procedures which can rarely be afforded by ordinary citizens. Their formality often causes fear and anxiety which dissuade many members of the public from pursuing their real or apprehended legal rights. Legal proceedings may also involve lengthy delays. They are particularly inappropriate where the dispute arises through a misunderstanding. One suggestion received by the Commission to overcome these problems in the case of disputes arising out of the adjustment of insurance claims was to give the Insurance Commissioner and Life Insurance Commissioner authority to hear and resolve disputes informally. At present, only the Life Insurance Commissioner deals with complaints by insurance consumers and then only on a limited and informal basis. Clearly the Commission will need to consider this proposal very carefully in the light of the economic considerations about which I have just been talking.

Another possibility is suggested by developments in the United Kingdom. There, some insurers themselves have developed a unique approach to the problem of ensuring that claims are settled fairly. They have banded together to set up an independent Insurance Ombudsman Bureau. The Bureau is designed to give members of the public, who have insured with the companies concerned, an informal, independent and free procedure for dealing with their grievances. The Ombudsman is restricted to dealing with complaints relating to personal insurance. He may not intervene until the normal complaints procedure of the company involved has been exhausted. An insured is not entitled to commence court proceedings while a complaint is being heard by the Insurance Ombudsman, although he is not precluded from taking the dispute to court if he is dissatisfied with the decision of the Insurance Ombudsman. Once a complaint is received by the Insurance Ombudsman, the insurer must give him free access to all the relevant files. The Insurance Ombudsman is expected to make a commonsense and fair decision based on law and general insurance practice and to do so speedily and with a minimum of formality.

This United Kingdom initiative appears to be a welcome development in times when governments are increasingly looking to industry, and industry bodies such as your own, for help in solving the problems which up until now have been dealt with by legislation and the imposition of regulatory controls. I hope that the insurance industry in this country will pay close attention to the progress of the Insurance Ombudsman in the United Kingdom to see whether a similar body might not also be appropriate to Australian needs, to supplement legal rights.

A third alternative to facilitate the settlement of claims is to set up specialised tribunals with simple procedures to deal with disputes quickly and cheaply. Several states have already set up Small or Consumer Claims Tribunals. Hearings before these tribunals are informal. Parties are not entitled to legal representation and the tribunals have no power to award costs. In each state the primary obligation of a 'referee' is to resolve disputes by conciliation. Referees are not bound by the rules of evidence when they hear disputes. In some states the referees are required to decide the dispute in a way that is fair and equitable to all the parties to the proceedings. In other states they are required to apply the law. However, only in New South Wales have tribunals such as these been given jurisdiction to hear disputes arising out of a contract of insurance. The Commission is examining the question of whether similar tribunals in other states might not also be given Federal jurisdiction in relation to insurance contracts, if that can be done compatibly with the Constitution..

One of the major problems which arise in relation to the settlement of claims is delay. Some delay is, of course, inevitable if insurers and loss adjusters employed or engaged by them are properly to investigate the circumstances surrounding a claim. In many cases, however, insurers are responsible for delays for which no reasonable explanation can be found. In some cases, the length of the delay is extreme. In 1977 the New South Wales Consumer Affairs Bureau reported that it had complaints against one insurer for having delays of up to five years, with delays of up to six to 12 months being not uncommon.[7] One possible solution to this problem is to require insurers to pay interest on claims. Interest might not only encourage insurers to settle claims quickly, but it could also compensate insureds for the decrease in the value of their claims through inflation.

In the United States courts themselves have developed another solution in the form of a new civil wrong of insurance 'bad faith'. The wrong has been described in this way:

> Insurance bad faith law has jumped into [a] regulatory vacuum to provide a useful and potent weapon for consumer protection. This judicially fashioned remedy is one that imposes no taxes and creates no new bureaucracy. This new weapon — commonly referred to as the insurance bad faith law suit — allows an aggrieved policyholder to bring the offending insurance company into court and seek damages for the wrongfully withheld insurance policy benefits plus all further damages for mental anguish or economic loss, proximately caused by the insurance company's bad faith handling of the claim.[5]

A principle somewhat similar to this one probably already exists in Australian law. At common law, both insurer and insured are required to act in the utmost good faith in their dealings with one another in relation to a contract of insurance. It is often thought that this duty is only important at the commencement of a contract of insurance. At that time it imposes an obligation on the insured to disclose every material fact which is known to him. Although no Australian court has applied the duty of good faith to the conduct of the insurer in settling a claim, Mr. Justice Stephen, in the High Court of Australia, has indicated that he believes the duty of good faith requires an insurer to have regard to the interests of an insured in settling a claim.[9] Legislation may be required to make it clear that Mr. Justice Stephen's statement of the law is given general application.

CONCLUSIONS

I want to close by returning to the issue with which I began.

In reminding us of the need to look at the costs as well as the benefits of proposed government regulation, the important economist Milton Friedman and his School are plainly right and they do lawyers a service. Lawyers tend to talk as if 'justice' is beyond any price. It is not so. People in the business of lawmaking will increasingly have to pay regard to the cost as well as the benefits of what they are doing. We must all recognise that there are some legal complaints which will probably not be solved because to solve them will cost too much. At the same time, in doing these sums we must not lose sight of the broad principles which form the very basis of our society. No-one I know says we should not have laws against murder, fraudulent misrepresentation and the other expensive paraphernalia of the state simply because statistics show that only 0.01% of the population will be murdered or suffer in this or that way. Plainly such an approach (dictated by dollars and cents alone) would be unacceptable. Costs will always be necessary if the foundations of our society are to be preserved. Where the line is to be drawn requires judgment and choice.

I hope what I have said to you today will convince you that the Law Reform Commission is alive to these issues in facing the difficult task of developing laws which will meet the needs of all Australians. I hope that in developing the policy thinking of your own Institute concerning future laws, you will also turn your attention (as you do in your daily lives) to the rude necessity of doing the sums.

FOOTNOTES

1. Australian Law Reform Commission, Discussion Paper No. 7, Insurance Contracts, 1978, 55, para. 106.

2. ibid, transcript of public hearings, insurance contracts, Melbourne, 22 November 1978, 150A.

3. ibid, Insurance Agents and Brokers (ALRC 16), 1980.

4. ibid, 33, para. 53.

5. ibid, xiv.

6. Loss Adjusters Institute of Victoria, Submission, 29 March 1979, 2.

7. Annual Report, 1977, 28.

8. W.M. Shernoff, 'Insurance Company Bad Faith Law', 17 Trial 23 (1981).

9. See Distillers Co. Biochemicals (Australia) Pty Ltd v. Ajax Insurance Co. Ltd (1973-4) 130 CLR 1, 31.