Submission on Issues Paper:

Review of Insurance Contract Law

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PROFILE

I am a Senior Lecturer at the Faculty of Law, University of Auckland. I have taught and researched in Insurance Law since 2012. I have also have experience in insurance litigation, including when in practice as a solicitor at Bell Gully and thereafter as a barrister. I have published on insurance law in legal journals, and am a contributing editor to *Colinvaux's Insurance Law in New Zealand*, the leading textbook on insurance law in New Zealand. I am also the author of the *New Zealand Law Review* triennial update on Insurance Law.

PRELIMINARY

This submission focuses on selected aspects of the Issues Paper only. I have not used the "Submission Template" as it does not fit the approach I have taken.

Before formulating any reform solutions or legislative changes, I believe it is both essential and prudent for the Ministry to obtain an accurate and complete picture of (a) the current rules and principles of insurance law and (b) current insurance industry practice.

On (a), having reviewed the Issues Paper carefully, I am concerned that a number of statements in it concerning current insurance law are either inaccurate or incomplete. These are noted below.

On (b), in approaching reform solutions or legislative changes, it is crucial not to mistake perception for reality. I therefore would urge the Ministry to conduct a systematic survey of the industry on key questions relevant to the Review. For example, before any reform of the duty of disclosure and/or the remedy of ab initio avoidance, it should be ascertained how often insurers exercise this remedy in practice.

I am happy to discuss any aspect of this further, whether by email, phone or in person.

SUBMISSIONS

3 Summary of objectives and key questions

Para 15(a): the reference in this objective to insureds having certainty that insurers will respond "as expected in the event of loss" is highly problematic. Insurance cover is **not** a matter of what is "expected" by the insured. It is a matter of what has been **contracted for** under the policy (i.e. the scope and terms of cover) and whether those terms respond to the actual event that has incurred and meet any or all of the actual losses suffered by the insured.

If this objective is implemented as it is, it will drastically transform the very purpose of insurance.

Para 16(a) and 17(e): there are two problematic references here. First, treatment of "customers fairly" begs the question of what "fairly" means. What is "fair" to one customer is not necessarily "fair" to another; entitlements to customers differ as much as policy terms differ. "Fairness" is an inherently nebulous notion, and should be avoided in favour of more specific criteria.

Second, in relation to possible "information asymmetries that customers may face", it should not be assumed that such asymmetries always exist. While insurers have considerably more information available than they did when the duty of disclosure originated, it is not the case that they are omniscient. There are some material facts which only the customer will be privy to, and the insurer is necessarily reliant on the customer to disclose these so that it can assess the risk adequately. One simple example is in motor vehicle insurance: only the customer know where the vehicle is usually parked at night, which is material to the insurer.

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4 Background

Para 22 (and also para 36 under "Issues that are likely to be of general interest"): missing from these lists is Part 2, Subpart 3 of the Contracts and Commercial Law Act 2017 (previously the Contractual Remedies Act 1979). These sections apply to all contracts (subject to section 34[1] which gives primacy to express provisions), and applies to insurance contracts in the event of at least misrepresentation (and arguably non-disclosure) in parallel with insurance-

[1] "If a contract expressly provides for a remedy for misrepresentation, repudiation, or breach of contract, or makes express provision for any of the other matters to which sections 35 to 49 relate, those sections have effect subject to that provision."

specific legislation.[2] The relationship between this legislation and insurance law principles and insurance-specific legislation is in dire need of clarification. This should be within the scope of the Review.

Some issues which arise are:

1. Whether and to what extent section 37 applies to pre-contractual non-disclosure in the insurance context (in other words, whether non-disclosure amounts to a "misrepresentation") with the remedy of cancellation being available.
2. Whether failure to comply with a condition precedent in an insurance policy entitles the insurer to cancel for repudiation or breach under sections 36 / 37.
3. In respect of conditions which are not conditions precedent (such as the obligation to pay the premium), to what extent are such conditions "essential" for the purposes of section 37(2).
4. In respect of warranties in insurance policies, the breach of which means automatic termination of the risk at common law,[3] whether the inclusion of such warranties amount to "express provision" for a remedy for the purposes of section 34.

For more detail, see chapter 5 in *Colinvaux's Law of Insurance in New Zealand*, which I authored.

Para 25(a): in the *Life Insurance* report (R 87, 2004), the Law Commission did **not** "consider applying" principles from the 1998 report to life insurance. The focus of the *Life Insurance* report was a **separate** review of life insurance (see sections 1-3) and regulatory requirements affecting insurance (see sections 4-7). The Commission also recommended an Insurance Contracts Act be enacted, and in doing so built in its 1998 recommendations on reform of non-life insurance (see section 8 and Appendix C).

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5 Issues that are likely to be of general interest

Para 33: the description given of the duty of disclosure is incomplete. It omits reference to the requirement that the non-disclosure must have **induced** the particular insurer to enter the contract at all, or to enter the contact on certain terms.[4] This is a significant restriction on the insurer's ability to avoid the

[2] This is as a result of the savings provision in section 59(1)(h): "Nothing in this subpart affects ... any other enactment to the extent that it prescribes or governs terms of contracts or remedies available in respect of contracts, or governs the enforcement of contracts."
[3] *Bank of Nova Scotia v Hellenic Mutual War Risks Assoc (Bermuda) Ltd* [1992] 1 AC 233. See also section 34(3) of the Marine Insurance Act 1908.
[4] *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, 521–551, 555–566 (HL).

contract ab initio. The insurer must prove, by evidence of the actual underwriter, that the non-disclosure induced it to enter the contract or to enter it on certain terms.[5] If it cannot prove this, it will not be able to avoid the contract for non-disclosure.

Para 34: As stated above, I suggest the Ministry survey insurers to ascertain how often the remedy of ab initio avoidance is exercised in practice. My own understanding is that it is rarely exercised. If this is the case, then I suggest a nuanced approach to the consequence of non-disclosure is taken, rather than the outright abolition of ab initio avoidance.

I would suggest that the "graduated" or "staged" approach taken in Schedule 1 to the Insurance Act 2015 (UK) is a useful model to follow.[6] Thus:

1. If a breach (of the "duty of fair presentation") is **deliberate or reckless**, the insurer may avoid the contract, refuse all claims, and need not return premiums.

2. Where a breach is **not** deliberate or reckless:
    a. If the insurer would not have entered the contract on any terms, the insurer may avoid the contract and refuse all claims, but return premiums.
    b. If the insurer would have entered the contract but on different terms (other than relating to the premium) the contract is to be treated as if it had been entered into on those terms.
    c. If the insurer would have entered the contract but would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on any claim (in accordance with a specified formula).

The terms "deliberate" and "reckless" do need to be defined (the UK legislation is silent on their meaning). It is unclear whether they equate to fraudulent conduct, or something less than this.

However, I do agree that there should be a statutory prohibition on insurers asking open-ended "catch all" questions of insureds going beyond the subject matter of the insurance being applied for,[7] and then be able to use negative responses to these questions as a means later to avoid for non-disclosure or misrepresentation. This would put the onus on insurers to ask clear and specific questions to obtain the information they need to assess the relevant risk.

If a "duty of fair presentation" (or, as I would prefer to call it, a *"duty of adequate presentation of material information"*) was enacted, such a duty is capable of balancing the interests of both insurers and insureds in consumer and

[5] *Benjamin v State Insurance Ltd* (1998) 10 ANZ Ins Cas 74,654 (NZCA); *Jaggar v QBE Insurance International Ltd* [2007] 2 NZLR 336 (CA).
[6] This is not to say that the Act is perfect: it appears that the UK insurance market is grappling with a host of issues regarding the meaning and application of provisions of the Act.
[7] For example, "Is there any further information likely to affect the acceptance of this insurance?"

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commercial contexts alike. It requires the insured to give the insurer adequate material information so it can assess the risk; but on the other hand, it does **not** burden the insured by having to give **more** than adequate material information, and also does not catch the insured out where the insurer has not asked a particular question. Further, because what is "adequate presentation" is fact-dependent, it is capable of applying to both consumer and commercial contexts alike. For this reason, I do not favour a legislative distinction between the two groups.

As to what "adequate presentation of material information" requires, the legislation could usefully define what sort of information is material (for example, the subject matter, its value, the insured's claims history, loss history, previous insurance being declined or cancelled or refused, etc) but there should be a residuary category of "any other information which a prudent insurer would regard as material" given the nature of the insurance applied for.

What the law is overseas

Para 42 and 43: while the consumer-focused reform is described, the business-focused reform is missed. Please see the previous page.

Para 49: statement that "The test of materiality is subjective". This is incorrect. The test is **objective**: the standard is what a hypothetical "prudent insurer" would treat as material, not the particular insurer.[8] See also the definition of "material" in the following legislation:

> Marine Insurance Act 1908, s 18(2):
>
> > "Every circumstance is material which would influence the judgment of a **prudent insurer** in fixing the premium or determining whether he will take the risk."
>
> Insurance Law Reform Act 1977, s 6(2):
>
> > "A statement is material only if that statement would have influenced the judgment of a **prudent insurer** in fixing the premium or in determining whether he would have taken or continued the risk upon substantially the same terms."

Para 57: statement that "Insurers have the ability to avoid a claim even if the disclosure of the relevant facts would not have made them decline cover." This is strictly correct, but does not tell the full story. As explained above, the non-disclosure must have **induced** the insurer to either enter the contract at all, or to enter the contact on certain terms.

Conduct and supervision

Duty of utmost good faith

[8] *State Insurance v McHale* [1992] 2 NZLR 399, 409 (CA).

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Para 73: reference is made to the High Court finding in 2016 that a mutual duty of utmost good faith was implied in every insurance contract. This was not a new development: the duty of utmost good faith has been regarded as mutual since at least 1766.[9]

The problem is that, although the duty definitely exists, its scope remains unclear, as are the consequences of breach.

In my view, legislation should settle these matters, because it will likely take the courts an indefinitely long time to do so (and this depends on the fortuity of a suitable case reaching an appellate court). In addition to what I have said about duties in claims handling below, I would suggest that legislation should make it clear that both insurers and insureds are under a duty to not withhold material information from each other during the period of insurance and not make any misrepresentations. Breach should give rise to damages, usually assessed on a reliance measure.

Consumer complaints we have heard relating to insurers' and insurance intermediaries' conduct

Claims handling

In my view, some reform is justified in this area but it needs to be approached with care and caution.

There have undoubtedly been issues with claims handling, but this needs to be put in context:

1. In general, insurers need adequate time to assess the claim, undertake investigations, and make an informed decision. The higher the value of the claim and the greater its complexity, the more time is required.

2. Insureds may themselves cause delay in claims handling by delaying in providing evidence in support of the claim, by providing inaccurate or misleading information, or by generally failing to co-operate.

3. In relation to claims handling in the context of the Christchurch earthquakes, it must be noted that these were both extraordinary and catastrophic. They generated an unprecedented number of claims and placed massive pressure on insurers. Some delay was, and has been, inevitable in claims handling and also in repairs/replacement being effected. Wholesale reform in reaction to this would be rash and ill-advised.

I suggest that reform should only go so far as imposing on insurers a duty to act reasonably in assessing, accepting and settling a claim, and should only be in breach where (objectively) they have delayed or acted unreasonably during the claims process (e.g. not assessing all available information properly, or pressuring the insured into a low-ball settlement), or unjustifiably rejected a valid claim, or delayed in payment once the claim is settled or liability is

[9] *Carter v Boehm* (1766) 3 Burr 1905, 1909.

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proven.[10] In assessing this, the Court should be required to take account of specified factors, such as the size and complexity of the claim, the conduct of the insured, and whether the insurer is facing multiple claims arising out of the same event or succession of events.

Any reform which goes further than this will burden insurers, who are likely to pass on compliance costs to consumers, resulting in increased premiums.

As for a remedy:

1. Where the insurer has acted unreasonably – the insured should be entitled to compensatory damages in respect of any loss caused by the insurer's actions or inactions.

2. Where the insurer has unjustifiably rejected a claim or delayed in payment once the claim is settled or liability is proven: the insured should be entitled to compensatory damages as of right (e.g. for loss of use of the money), as well as general damages to compensate for inconvenience, distress and anxiety. Possibly, interest should be imposed at a statutory rate. The existence of this power would serve as a deterrent to insurers.

   It should be noted that section 13A of the Insurance Act 2015 (UK)[11] creates an implied term that sums "due" must be paid within a "reasonable time", but does not make clear what sort of remedy is available (apart from a reference to "damages").

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Unfair contract terms exceptions in the Fair Trading Act 1986

Paras 93-102:

While I consider that the existing exemptions are necessary to protect the "legitimate interests of the insurer" (and indeed to make insurance workable), in my view, this legislation is ineffective, for two reasons. First, the exemptions for insurance contracts (section 46L) encompass the bulk of the terms that might be perceived as "unfair" by consumers, making this **type** of legislation largely useless. Second, the unfair contracts terms can only be enforced by the Commerce Commission (section 46H), not the consumer, which means it lacks real teeth, since the Commerce Commission will take action only in the most serious and meritorious cases, given its limited resources.

In fact, a search of relevant legal databases (BriefCase and Linxplus) does not reveal **any** cases to date, insurance-related or otherwise, where the Commission

[10] It should be noted that in liability insurance, there is no duty to indemnify until *after* the claim is settled or liability is proven. Before this, there are no sums due to the insured.

[11] "It is an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time."

has successfully applied for a declaration that a contract term is unfair.[12] This highlights the ineffectiveness of the legislation.

As a result, I believe that other and more effective legislation is required in this area.

If the exemptions are retained (in any form), then their relationship with existing legislation needs to be considered carefully. For example, in relation to the exemption for a term that excludes or limits liability (section 46L(4)(c)), such terms may be subject to section 11 of the Insurance Law Reform Act 1977, meaning the insurer cannot rely on them anyway. Further, in relation to terms which specify claims conditions such as time limits for making claims, which are not covered by the exemptions, section 9 of the Insurance Law Reform Act 1977 may mean such terms are not binding in the absence of prejudice to the insurer.

Exclusions that have no causal link to loss

Paras 128-131: In my view, section 11 does need reform. It is drafted too broadly, and is capable of applying to a range of terms which the original Contract and Commercial Law Reform Committee probably did not envisage it would capture. That Committee was concerned with the harsh effects of temporal exclusion clauses, and did not consider the effects of other clauses which truncate cover. Despite this, the courts have applied (uncritically) section 11 to warranties[13] and claims conditions including 'no admissions' clauses.[14]

I suggest that the reform proposed by the Law Commission in 1998 is appropriate.[15] In addition, I would recommend that the term "exclusion" be defined to clarify what it captures (e.g. only true exclusion clauses, or also warranties and claims conditions?).

In addition, I consider that the terms "caused" and "contributed" at the end of section 11 need clarifying ("...if the insured proves on the balance of probability that the loss in respect of which the insured seeks to be indemnified was not **caused** or **contributed** to by the happening of such events or the existence of such circumstances"). They are not defined in the legislation and this is a source of enduring uncertainty.

The question is what is required for causation or contribution. "Causation" seems to require that the relevant events/circumstances were an effective cause of the loss (even if not the sole cause), whereas "contribution" is more problematic. "Contribution" is a lesser standard than "causation" and seems to assume a context where several different factors contribute to the loss, of which

[12] The Commerce Commission has reviewed certain telecommunication contracts, but is yet to take any enforcement action: http://www.comcom.govt.nz/the-commission/media-centre/features/telecommunications-first-up-on-unfair-contract-terms-review/

[13] *NZI Ltd v Harris* [1990] 1 NZLR 10 (CA).

[14] See *AMP General Insurance (NZ) Ltd v Hugo* (2003) 12 ANZ Insurance Cases 61-563.

[15] *Some Insurance Law Problems* (R 46), section 3.

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the relevant event or circumstance is one. It is not clear how much of an impact the contribution must have.

Accordingly, I would suggest that "contributed" needs to be qualified by a materiality requirement, thus "...was not caused or **materially** contributed to...". Otherwise, the insured has to prove that the relevant events/circumstances had nothing whatsoever to do with the loss, which is a heavy burden.

Question 52

Please see above regarding Part 2, Subpart 3 of the Contracts and Commercial Law Act 2017.

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