

CHAPTER 10 - INSURANCE

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INTRODUCTION

The purpose of this chapter is to provide an overview of the law relating to general insurance, particularly for personal and small business claims.

WHAT IS INSURANCE?

Insurance is a contract between an insurer and the insured, by which, in exchange for money (the ‘premium’), the insurer agrees to ‘cover’ (indemnify) the insured to the extent of the agreement.

The contract is often referred to as a ‘policy’ and will include and is governed by the proposal, schedule, policy wording (in Australia, now contained in a Product Disclosure Statement “PDS”), the cover note (if applicable), statutes and the common law. Some insurers also adopt an industry code of conduct and use an industry dispute resolution scheme (a company named the Financial Ombudsman Service Ltd).

WHY INSURE?

Insurance should be considered as risk management for any peril that would threaten the financial wellbeing of the insured. For example, the cost of insuring for motor vehicle third party property damage is not great, compared to the potential risks of a large debt for repairs and damages on running into an expensive motor vehicle.

BROKERS AND AGENTS

The introduction of the *Financial Services Reform Act 2001* (Cth) and later Acts (the *FSR legislation*), has caused widespread changes to the industry, including the terms ‘broker’ and ‘agent’ – now superseded by ‘licensee’ and ‘authorised representative’. However, in principle a broker acts for the person who wants or has insurance. On the other hand, an agent is a person who acts on behalf of the insurance company in organising insurance and processing insurance claims. While either may charge a fee for services, it is important to know whether the licensee or authorised representative is acting for the insured or the insurer.

TYPES OF INSURANCE

This section discusses the common types of insurances available. Today, almost anything may be insured if a valid ‘insurable interest’ (see section on INSURABLE INTEREST below) is established.

PERSONAL INSURANCE

The following are common forms of personal insurance:

- motor vehicle property (including property liability);
- home building;

- home contents;
- personal property/tools of trade;
- pleasure craft (e.g. boats);
- travel; and
- income protection.

Liability for personal injuries caused by car accidents is insured and paid for at the same time as vehicle registration. It is commonly described as CTP (Compulsory Third Party) insurance. This is separate to motor vehicle property insurance.

Home insurance policies may relate solely to insurance of the contents of the home (such as furniture and personal effects) – this is known as home contents insurance. Home insurance may also cover loss of or damage to the building itself. Each of those will often include cover for liability as homeowner or occupant as the case may be (e.g. covering a visitor who fell down stairs). Many homeowners will take out a combination of home contents and building insurance with the same insurer.

Income protection (“personal accident or illness”) insurance is now better understood as important to those wishing to cover an income stream. The capacity to earn income may be a person’s greatest risk to insure. While general insurers still offer this cover, today it is more commonly part of a “life insurance package.” There are several types of life (or “risk”) insurances, including: trauma (lump sum insured against serious accident or illness), life insurance itself (lump sum insured against death or terminal illness) and income protection.

SMALL BUSINESS INSURANCE

The following products are available for small business risks:

- industrial special risk (ISR) comprehensive cover;
- business package components, including fire and related perils, business interruption, theft, money, plate glass, engineering, accidental damage for certain items, goods in transit and/or fidelity guarantee;
- construction and erection;
- commercial motor vehicle or fleet;
- liability, including: public, product, professional indemnity, directors and officers, pressure vessel and special risk; and
- income protection.

THE INSURANCE AGREEMENT

Each element of an insurance contract is important. As mentioned briefly above, the agreement (or policy) includes and is governed by the:

- proposal;
- schedule;
- policy wording (now included in the Product Disclosure Statement “PDS”); and
- cover note (where applicable).

In addition, the *Insurance Contracts Act 1984* (Cth) and the common law significantly impact on the operation of insurance policies.

THE PROPOSAL

The insured may receive guidance from a range of people in completing the proposal form. These may include the insurer’s staff, a licensee or authorised representative. Today it is often done over the telephone for personal insurance. While the situation may become complicated by others’ involvement, in simple terms, the person seeking insurance has a very important duty to disclose all that a person would consider relevant to an insurance company. These duties of disclosure and ‘utmost good faith’ are discussed below.

THE SCHEDULE

The policy schedule will include particulars on any individual policy taken from both the insurer and the insured (usually from the proposal form). The insured should check that all particulars are correct, such as:

- those named as insured;
- those noted as having an interest in the policy;

- the thing(s) insured;
- the time period insured;
- the basis of insurance, such as indemnity only or 'reinstatement or replacement';
- the excess; and
- any special endorsements or conditions.

THE POLICY WORDING

The policy wording will be contained in the PDS. It is important to keep this document and carefully note:

- that the wording version in the PDS is the same described in the schedule;
- any notices highlighting the insured's duty of utmost good faith and disclosure;
- the definitions (e.g. 'contents' may not include all that a person wants to have covered such as cover for electrical appliances but not home office equipment);
- sub-limits, such as those applied to valuable items and collections;
- exclusions (e.g. fences may not be covered for storm damage);
- average or co-insurance clauses (e.g. if the insured item is under-insured (the value that the item is insured for is less than the actual value of the item), the insurance company may wish to reduce all claims in proportion to what the true sum insured should have been. This may be regardless of the value of the actual claim);
- conditions of cover, such as the responsibility to take all reasonable precautions to prevent loss; and
- the claims process, particularly in relation to the time limits and process for claims notification.

COVER NOTES

As insurance is sometimes required quickly, an interim insurance policy, known as a 'cover note' may be issued by an insurance company. The same principles of utmost good faith and disclosure apply, as they would to usual policies.

It has previously been the case that cover would be accepted subject to a satisfactory proposal being completed. If the insurer found things in the proposal that were outside its guidelines, it could deny cover and any claims which may have arisen. This is no longer possible and insurers must pay claims in accordance with insurance given under a cover note. A prudent insurance company will therefore be very careful about what it will insure by cover note and if such cover is given, it will require the proposal to be completed without delay.

INSURANCE LAW

INSURANCE STATUTES AND THE CODE

The *Insurance Contracts Act 1984* (Cth) (the *IC Act*) was made to reform and modernise the law of insurance contracts to strike a fair balance between insurers and the insured. The operation of this Act is overseen by the Australian Securities and Investments Commission (ASIC). At the time of writing, there has been a review of the *IC Act* and it is expected some legislative changes will be made soon.

As mentioned under BROKERS AND AGENTS above, the *Financial Services Reform Act 2001* (Cth) and later Acts (the *FSR legislation*), have reformed the entire financial services industry, including insurance, particularly in respect of policy information in the PDS, 'brokers' and 'agents'.

The *Insurance Act 1973* (Cth) and various other pieces of legislation apply to prudential and actuarial matters for insurers and are the responsibility of the Australian Prudential Regulation Authority (APRA).

Individual cases involving disputes about insurance are decided by judges and magistrates and these case precedents make up the common law (see CHAPTER 1: WHERE LAW COMES FROM).

An industry code of practice has also been adopted by some insurers. A copy is available from the Insurance Council of Australia (see CONTACT POINTS at the end of this chapter).

THE INSURANCE CONTRACTS ACT

The *IC Act* covers several important aspects of general insurance and has reformed the common law relating to insurance claims. This section will focus on the requirements under the *IC Act* in relation to:

- the insurer and insured's duty of utmost good faith;
- the insured's duty of disclosure;
- dishonesty and fraud; and
- other matters.

THE DUTY OF UTMOST GOOD FAITH

The *IC Act* includes a well-settled common law concept of '*uberrima fides*', or utmost good faith. Insurance policies are special contracts for several reasons, including because an insured is usually in a better position to know what risk is to be transferred to the insurer, and on the other hand, an insurer usually has far more negotiating power than a typical insured. See s13 of the *IC Act*.

Accordingly, both insurer and insured have a duty to act in the utmost good faith toward the other. The duty is not one of usual good faith, but utmost good faith and importantly, it is not to be diminished by any other obligation or right. There are important consequences for breach of this duty: the policy (along with claims falling under it) may be avoided for such breaches. Both insurer and insured should be mindful of this serious duty at all times.

THE DUTY OF DISCLOSURE

It follows from the duty of utmost good faith that as the insured usually knows far more relevant information about the subject matter to be insured, they should disclose all that a reasonable insured person would know to be relevant to the insurer. This is a statutory requirement (see s21 *IC Act*). However, s21A of the *IC Act* has modified the disclosure required at the time a contract of insurance is first entered into. It requires the insurer to ask specific questions about what it considers relevant, rather than relying on a general question of the intending insured to reveal everything they think relevant. If there is no specific question asked and the matter is not 'exceptional' (as defined by the *IC Act*), the insurer will no longer be able to rely on a non-disclosure to deny a claim or avoid a policy.

By s22, the insurance company must, in writing and before the insurance agreement is entered into, advise a person seeking insurance that that person has a duty of disclosure.

DISHONESTY AND FRAUD

It is naturally inadvisable to be dishonest in any insurance matter. Insurers take fraud very seriously and may well prosecute even a low value fraudulent matter as a policy measure to discourage fraud throughout the insurance market.

Generally, where insurance has been obtained and there has been either fraud, misrepresentation or non-disclosure the insurance company has several options:

- it can avoid the contract if the non-disclosure or misrepresentation was fraudulent (s28(2) *IC Act*); or
- it can reduce its liability in respect of any claim under the policy to the extent of the non-disclosure or misrepresentation (s28(3) *IC Act*).

Under the *IC Act* an insurer is generally entitled to reduce the claim to the extent that its rights were prejudiced. For example, had the insurer known a vehicle was the turbo model, it may still have underwritten the policy, but with a higher excess and premium.

Outright fraud may be difficult to prove, but when done so, the insurer will be entitled to deny the portion of the claim which is affected. For example, in a theft claim, if the insured knew that a bottle of whisky was almost empty rather than almost full (as stated on the claim form), and fraud was proved, that part of the whole claim could be denied. However, if the fraud on the claim is indivisible (such as saying that a burnt-down house was in good condition when in fact it was condemned by the local council) the entire claim may be refused.

Special rules apply in relation to fraud, misrepresentation and non-disclosure in relation to life insurance contracts which allow a life insurance provider to avoid the contract or vary the policy terms (s29 *IC Act*).

An insured accused of dishonesty should seek legal advice immediately.

THE COMMON LAW (AND EQUITY)

Although the *IC Act* is a comprehensive review of the law of insurance, it is not a statutory code, so it still falls to the common law to interpret statutory provisions and continue making law in areas not otherwise covered. Fundamentally, an insurance policy is a contract, so general contractual principles will apply.

THE GENERAL INSURANCE CODE OF CONDUCT

The General Insurance Code of Practice (the *Code*) is an industry agreement adopted by many, but not all insurers. It is administered by the Financial Ombudsman Service Ltd (FOS) (formerly Insurance Enquiries and Complaints Ltd), and a failure by an insurer to comply with the *Code* may be disclosed by the FOS in its annual report.

ELEMENTS OF A CLAIM

A claim can basically be broken down into a number of elements:

AN EVENT

The event which gives rise to the claim is usually thought of as a single sudden one. While this is often the case, it need not always be so. For example, an event may be a steady drip from a shower pipe behind a bathroom wall, the damage of which occurred and remained hidden for some years.

PROXIMATE CAUSE

The loss or damage must be proximately caused by an insured event. For example, a piece of jewellery may have gone missing, but it is usually still for the insured to prove that it was in fact stolen. Similarly, where a house has been damaged, it is still the responsibility of the owner to prove that the damage was caused by an event which is covered by the insurance policy (such as a fire or storm).

THE SUBJECT MATTER IS INSURED

The subject of the claim, which has been lost or damaged, may not be covered, either because it falls outside of what is so defined (e.g. the home building when only contents are insured), or it is excluded (such as a motor vehicle in a claim under a home contents policy, even though it was stored in the home building).

INSURABLE INTEREST

Even if the subject matter of the claim meets other requirements, the insured must have an 'insurable interest' in it. The concept of an insurable interest bears similarities to legal interest, but is not necessarily the same. For example, by virtue of marriage, a spouse may have an insurable interest in a motor vehicle, even though registered ownership is with the partner. This distinguishes insurance from a wager, where one may not have any interest in an event (apart from the bet).

PROOF OF OWNERSHIP AND VALUE

It can be distressing when the subject of an insurance claim is either gone or destroyed and proof of the insured ever owning it and/or its value is questioned by the insurer. Keeping purchase invoices, ownership manuals and other documentation is clearly better than throwing such things away. However, alternatives such as making Statutory Declarations under the *Oaths Act 1867* (Qld), or providing photographic evidence may be sufficient.

CLAIMS PROCEDURE

It is important that the proper procedure in making a claim is adhered to, as breakdowns in procedure may well translate to delays and/or less than maximum entitlement being received by the insured.

READ THE POLICY!

After immediate matters (such as putting out fires) are dealt with, the next thing an intending claimant should do is read the policy, including all of the following, as the case may be:

- proposal;
- schedule;
- Product Disclosure Statement ("PDS") including policy wording;
- cover note (where applicable); and
- relevant communications and file notes.

It is always better to deal with the insurer from a position of some knowledge.

SUBMITTING A CLAIM

Service including claims handling procedures will vary from insurer to insurer. A good first step for a person making a claim is to telephone the company and find out if there will be one or a series of claims staff appointed to deal with the claim. If one person, take their direct contact information.

Once the insurer has been contacted, there is a good chance the claims officer will have a standard procedure to follow in handling the matter. This may include:

- taking the insured's name and policy details;
- asking for a brief description of the loss and its cause;
- either taking the basic claim details over the telephone or sending out a claim form;
- asking the insured person to obtain quotations to repair the damage; and
- advising that a loss adjuster/assessor will be in contact to go through the claim on site.

LOSS ADJUSTERS

Also known as insurance assessors, loss adjusters are either employees of the insurer or contractors to it. Their role is to assess liability and recommend what amount (sometimes called 'quantum') should be paid by the insurance company. Loss adjusters may either come from the ranks of the related trade (which is particularly common in motor vehicle claims) or from an insurance company, legal or other background.

INVESTIGATORS

Investigators are usually appointed where a loss adjuster is not able to gather all the information desired by the insurance company. This could be for a number of reasons, including:

- witness statements need to be taken;
- the claim is of a large amount and company procedure is to have every large claim investigated;
- every claim of a certain type (such as loss of all luggage) is investigated; or
- the insurer considers there are unusual or suspicious circumstances and wants to investigate further before accepting liability.

Unless the insured is concerned that something is wrong, assisting the investigator is advisable. However, if there are concerns, the insured should say nothing and obtain legal advice immediately.

REPAIRERS

Various tradespeople and professionals (such as engineers) may be involved in the claim process. As with adjusters and investigators, the insured should know what repairers are involved and what work they are doing. A copy of all relevant documents (including their reports) should be sent to the insured person.

The work of repairers should be checked regularly and without delay. Quality issues with work should be directed first to the adjuster, or directly to the insurer direct if no adjuster is appointed.

REPRESENTATIVES HIRED BY THE INSURED

Public insurance adjusters, investigators, repairers and other professionals may be hired by the insured themselves to deal with insurance claim matters. While this is not uncommon in countries such as the USA, it is for the insurer to decide if it will pay for such representatives and indeed what weight, if any, is placed by it on their opinions. This will be a matter of negotiation and may be better placed in the hands of the insured's solicitor.

CLAIMING ON ANOTHER PERSON'S INSURANCE

Those claiming on the insurance of the at-fault party (e.g. a negligent truck driver) are often described by the insurer's staff as 'third parties'. They are a third party to the policy of insurance between the insurer and the insured. So-called third parties may wish to claim on another's insurance, as they either have no insurance, or do not wish to lose their own 'no claim bonus'.

Unless there is an unusual circumstance, such as a contractual arrangement between the third party and the insured, the insured has died or gone missing and cannot reasonably be found, there is often no legal entitlement for the third party to claim on the policy direct.

It is usually the case that cover is dependent on the insured:

- making a claim themselves;

- passing on the third party's claim and requesting cover for that also; and
- meeting other contractual requirements, such as payment of an excess.

The third party should send a letter of demand with a time limit for compliance to the insured themselves. Personal delivery of the letter is preferable. However, litigation is sometimes necessary before an insured will complete all required steps.

CLAIM ENTITLEMENTS

As mentioned previously, this chapter is intended to provide an overview of common types of domestic insurance claims. This part should also be read in that context.

Each home and motor vehicle policy will be worded differently. While it is impossible to say exactly what entitlement may be owed to a particular insured, the following general principles will apply and should be considered.

Once a claim, on the face of things, is established (as described in ELEMENTS OF A CLAIM above), one must then look at limiting factors.

IF COVER IS LESS THAN PRESCRIBED BY GOVERNMENT

For policies of domestic motor vehicle insurance, home building and home contents insurance, the Commonwealth Government has prescribed a statutory minimum policy cover (and exclusions) in the *Insurance Contracts Regulations 1985* (Cth).

If the insured has less cover than that prescribed by statute because, for example, the insurance contract puts sub-limits on payments for certain types of claims, then, pursuant to s35 of the *IC Act*, the insurer must still pay an amount equal to the minimum prescribed cover unless the insured either:

- knew or could reasonably be expected to know that the cover was less than the minimum statutory prescribed cover; or
- was clearly informed in writing, prior to taking out the insurance, that the contracted cover was less than the minimum statutory prescribed cover.

This information (such as a clear policy wording notice) can be supplied with the uncompleted proposal form when a person is taking out cover.

SUB-LIMITS

Insurers often apply policy sub-limits to certain items. Examples include:

- jewellery and watches;
- any item containing a precious metal or gem stone;
- antiques, manuscripts and curios;
- collections of stamps, coins, medals etc;
- art works, tapestries and hand-made rugs;
- cash, bullion, bonds etc;
- computers and computer equipment;
- mobile phones;
- items used in business or trade; and
- contents in the open air.

Such sub-limits are usually less than government prescribed minimum cover and therefore must be explained to the insured prior to taking out the policy. If this has not been done, the insured is entitled to the minimum cover determined by government.

CO-INSURANCE / AVERAGE CLAUSES

Under-insurance is seen by the industry as a big problem in this country. Where an insured has insured an item for less than its actual value, some insurers will reduce any claim in proportion to what the correct sum insured should have been. For example, if the insured owned a car valued at \$50,000, but only had it insured for \$25,000, the insurance company might then say it is only responsible for half of any claim. If the car owner then claimed \$10,000 in repairs for a car accident, the insurance company could 'average' out its liability and say that as it was only responsible for half of the insurance value, it need only pay half of the claim, in this case \$5,000.

Under s44 of the *IC Act*, an insurance company can only rely upon averaging where there is an averaging clause in the contract and it has clearly notified the insured person of the effect of that clause.

Moreover, the section operates:

- to provide an under-insured buffer of 20%. This means that an insurer cannot rely upon an averaging clause where the value insured is 80% or more of the actual value. In the above example, if the car owner had insured the car for \$42,500 (or 85% of its real value), the insurance company could not limit its liability to 85% of the total claim but would have to pay the whole claim; and
- where an item is more than 20% under-insured, the insurance company cannot average out to more than 80% of the insured value. So, in the above example where the car owner insured the \$50,000 car for \$25,000 and then claims \$10,000 in repairs, the insurance company would have to pay an amount using a formula which related the sum insured to 80% of the value of the property.

EXCLUSIONS

In contrast to the subject matter simply not being insured or under-insured, a number of exclusions are typically applied to any one insurance policy. These may come in many forms, but some examples include:

- flood;
- wear and tear, rust or corrosion;
- depreciation;
- storm or tempest loss or damage to fences, gates or retaining walls;
- theft by a person ordinarily residing with the insured person(s);
- intentional damage;
- damage in connection with an unlawful purpose;
- government expropriation (seizure);
- insects or vermin damage;
- racing, pacemaking, a reliability trial, a speed or hill-climbing test; and
- some types of loss or damage where the building remains unoccupied for more than 60 continuous days, even when on holiday.

Some exclusions, such as flood, may seem as contentious and are the subject of litigation from time to time. Depending on the circumstances, the issue may be a matter of fact or a matter of law. If for example it is a matter of policy interpretation on whether the loss was caused by “flood” as defined in Product Disclosure Statement compared with rainwater runoff, then the insured may wish to seek legal advice.

DEALING WITH DISPUTES

An insured may believe their insurer’s claims procedure is not appropriate, or that a claims decision is wrong or unreasonable.

Generally, procedural matters should first be raised with the claims officer. If no acceptable result is forthcoming, the insured should discuss the matter with the relevant claims manager. This may resolve the problem, but if not, a formal letter of complaint should be written to the Internal Dispute Resolution (“IDR”) Officer, with a time limit of 15 business days for compliance.

On the other hand, serious procedural and claims decision disputes should be discussed with a solicitor immediately. A solicitor will be able to advise on reasonable turnaround times, policy interpretation and other matters. Hopefully, a solicitor’s letter and some phone calls will be all that is required.

THE FOS COMPLAINTS SCHEME AND CLAIMS PANEL

Insurance Enquiries and Complaints Ltd (“IEC”) was set up in 1991 by the Insurance Council of Australia (the primary insurer interest group) as an insurance industry dispute resolution service. It is now the Financial Ombudsman Service (“FOS”). The FOS fields general enquiries and runs a complaints scheme, including a panel which makes decisions. The FOS is currently able to make binding decisions on personal and small business insurance claims of up to \$280,000 in value. There is a limited power to decide on third party motor vehicle property claims of up to \$3,000 in value.

Applications to the FOS should be made as soon as practicable and within three months of any IDR decision. Once the claim is forwarded to the FOS, there is exchange of application and response documents from both

sides and then an FOS claims manager prepares the case and presents it to the decision making body (usually its “panel”). On the FOS making a decision, both the insured and insurer are notified. If the insured accepts the decision, the insurer must pay the decided amount within one month. If the insured does not accept the decision, they can then proceed to pursue their other legal options through the courts.

There are some limits to the Terms of Reference of the FOS, for example in matters of alleged fraud. It is best to consult a solicitor before submitting a complaint. Upon notice of an FOS referral, it is common for insurers to instruct defence lawyers immediately.

LITIGATION

Where a significant claims dispute arrives at an impasse, legal action may be unavoidable. Legal representation is naturally recommended for any litigation action, as the insurer will instruct specialist lawyers to defend the claim. There are a number of steps before a matter reaches court and these ordinarily require the attention of a solicitor experienced in insurance disputes. Contact details of solicitors experienced in insurance law are available from the Queensland Law Society referral service (see CONTACT POINTS below).

FURTHER READING

InsuranceHub, www.insurancehub.com.au

Mann & Lewis, *Annotated Insurance Contracts Act 1984*, 4th Ed, Law Book Company, 2003

Kelly & Ball, *Principals of Insurance Law*, Looseleaf Service, LexisNexis

Sutton, K. *Insurance Law in Australia* 3rd ed, Law Book Company Australia, 1999

Derrington & Ashton, *The Law of Liability Insurance*, 2004, LexisNexis

CONTACT POINTS

Australian Securities & Investment Commission (ASIC)

Level 20, Commonwealth Bank Building

240 Queen Street

Brisbane Qld 4000

Tel: (1300) 300 630

www.asic.gov.au

Insurance Council of Australia

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www.insurancecouncil.com.au

Financial Ombudsman Service Ltd

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