Carter Newell LAWYERS

Insurance Newsletter

May 2014

Broad interpretation of section 54 of the *Insurance Contracts Act* continues

By Mark Brookes, Partner and David Fisher, Associate

Introduction

Section 54 of the *Insurance Contracts Act 1984* (Cth) (**ICA**) provides relief to insureds with claims that fall within the scope of a policy, but whose acts or omissions otherwise entitle the insurer to avoid paying the claim.

The section was recently considered at Appellate Court level by the Western Australian Court of Appeal in *Matthew Maxwell v Highway Hauliers Pty Ltd*[1] (***Highway Hauliers***), in which a broad interpretation was preferred.[2]

The decision of *Prepaid Services Pty Ltd & Ors v Atradius Credit Insurance NV*[3] is the next instalment in the growing line of judicial consideration of the scope and application of this section.

Although the claim for indemnity in this instance ultimately failed (because the loss suffered did not fall within the scope of the policy, such that s 54 of the ICA was not enlivened) the Court of Appeal unanimously supported a broad interpretation of s 54 of the ICA consistent with the approach in *Highway Hauliers*.

Facts

In 2007 telecommunications providers Optus and Virgin, and their selling agent Prepaid Services, entered into a policy of trade credit insurance with Atraduis. The policy provided indemnity against Bill Express - a retail distribution agent that sold access to the Optus and Virgin networks - defaulting in payment of amounts owed under various distribution agreements. The policy was

expressly stated to cover defaults by Bill Express of payments of amounts under contracts that required payment be made 30 days from the date of *invoice*.

The distribution agreement between Optus and Bill Express provided a payment period of 30 days from the date of account *statement*. This had the effect of giving Bill Express up to 60 days to pay the amounts due.

Between April and July 2008 Bill Express defaulted and eventually entered liquidation with debts to Optus in excess of $60 million.

Optus claimed losses of $27 million under the policy (being 90% of the maximum sum insured of $30 million). Atraduis declined the claim.

> ‘Recent decisions have shown that there now seems to be some uniformity among Appellate Courts on the broad application of s 54.’

The Judgment

Optus was unsuccessful at first instance. On Appeal, there were two questions to be determined, being:

- Were Bill Express’ defaults on payment to Optus an insured loss; and
- Did s 54 of the ICA relieve against Optus’ act of supplying under a contract which did not meet the description of the policy.

In determining the first question, the Court of Appeal considered the specific description in the policy of the loss insured against. The Court concluded the policy specifically related to a contract between Optus and Bill Express with payment terms of *30 days from date of invoice* and as such, the loss for which indemnity was sought (liabilities due 30 days from the statement account) did not arise under a contract of the kind insured by the policy.

Subject to the application of s 54 of the ICA, the Court of Appeal upheld the primary judge’s finding that Atradius was entitled to avoid the claim.

On that issue, Optus argued that s 54 was enlivened to prevent the respondent from denying indemnity. It was their case that the relevant act or omission for the purpose of the section was either their failure to contract with Bill Express on terms consistent with those described in the policy or the act of supplying network access to Bill Express on those terms.

Atradius countered by arguing that the subject matter of the policy was loss suffered by the failure of Bill Express to meet its payment obligations as identified in the insuring clause. It argued that the loss suffered by Optus did not fall within this description and was therefore not covered by the policy, and that its refusal to pay the claim was for this reason and not because of some act or omission of Optus or some other person.

In their consideration of the application of s 54(1), the Court of Appeal referred to the decision of *FAI General Insurance v Australian Hospital Care Pty Ltd*[4] where the High Court said that when considering the application of the section, close attention must be paid to the claim which the insured has made, the effect of the contract of insurance on that claim and the reason for the insurer’s refusal to pay the claim (factors which are echoed *seriatim* in *Highway Hauliers*).

The Court of Appeal highlighted that when considering the claim Optus had made, it is necessary to identify any inherent *restrictions or limitations* of that claim by reference to the characteristics of the event or circumstances

to which the policy responds. Essential here is the consideration of the type of loss that is contemplated by the insuring clause, absent consideration of whether the loss in question might also be the subject of an exclusion or condition in the policy.

The insuring clause indemnified Optus against loss resulting from the failure of Bill Express to meet particular payment obligations during the term of the policy. Because Optus had contracted on terms other than those specified in the insuring clause, its loss did not arise under a contract meeting the description of the policy, and therefore was not a loss indemnified by the policy.

The Court of Appeal concluded that Atradius' reason for denying indemnity was not because of Optus' act of contracting with Bill Express on terms inconsistent with the policy, but because the loss suffered was not one covered by the policy. As such, Atradius was entitled to refuse the claim and s 54 was not enlivened to prevent it from doing so.

Conclusion

The Court of Appeal's approach to the application of s 54 in this decision sits squarely with the approach taken in both the earlier High Court decision in *Australian Hospital Care* and the Western Australia Court of Appeal decision in *Highway Hauliers*. These decisions highlight the fact that, when considering the potential application of s 54(1), it is first necessary to consider whether the claim made by the insured is covered by the insuring clause (that is, it is within any inherent restrictions or limitations) and whether an insurer's ability to deny indemnity was the result of an act or omission of the insured or someone else triggering an exclusion or condition.

Remembering that *Highway Hauliers'* significance lies in its departure from the reasoning of the Queensland Court of Appeal in *Johnson v Triple C Furniture & Electrical Pty Ltd*[5] (***Triple C***), there now appears to be at least some uniformity among Appellate Courts on the broad application of s 54.

Justice Meagher in the present case was particularly critical of Justice Chesterman's reasons in *Triple C*, saying that his Honour proceeded other than in accordance with the principles and approach stated in *Australian Hospital Care* and applied in *Highway Hauliers*, by taking into account an exclusion in the policy when identifying the risk insured.

The decision in *Atradius* continues the trend towards a broad interpretation of s 54 of the ICA. While *Triple C* remains the most recent reported decision on s 54 in Queensland at least, it seems the approach in *Highway Hauliers* and *Atradius* is gaining acceptance.

[1] [2013] WASCA 115.
[2] See *Court of Appeal endorses broad application of section 54 of the Insurance Contracts Act*; by Mark Brookes and David Fisher, Insurance Newsletter September 2013.
[3] [2013] NSWCA 252.
[4] (2001) 204 CLR 641.
[5] [2010] QCA 282.

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Upcoming presentation

Cyber Risk

Please join us as Katherine Hayes, Senior Associate and Greg Stirling, Solicitor discuss the emerging cyber related liabilities that pose a threat to any business with an online presence.

Katherine and Greg will examine recent 'real-world' examples of losses resulting from cyber risks and steps that businesses can take to protect themselves from those risks. They will also consider the recent amendments to the Commonwealth Privacy Act and how they make protecting your business from cyber risks more important than ever.

This seminar will also cover:

1.Potential for mandatory notification of data breaches in the future.

2.How businesses can protect themselves against cyber risks.

3.Limits of traditional insurance policies.

4.Benefits of cyber risk policies.

For more information or to RSVP, please visit www.carternewell.com

Where

Queensland Law Society

Level 2

179 Ann Street

Brisbane

Date

21 May 2014

Time

7.30am - 9.00am

Australian Civil Liability Guide

The Australian Civil Liability Guide 8th Edition is a product of the continual evolution of previous publications by Carter Newell Lawyers.

The guide addresses legislative and case law developments relevant to civil liability federally and in all Australian States and Territories since the reform process began in 2002.

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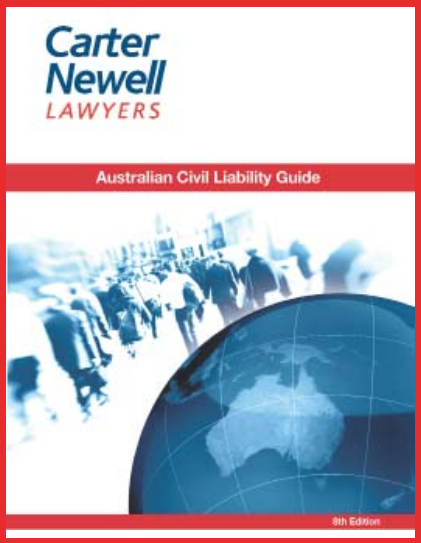

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