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Court of Appeal endorses broad application of section 54 of the Insurance Contracts Act

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Section 54 of the *Insurance Contracts Act 1984* (Cth) (ICA) has been one of the most contentious and litigated provisions of the ICA, for the broad relief it offers insureds whose acts or omissions otherwise entitle an insurer to refuse to pay a valid claim.

A recent example is the decision of the Western Australian Court of Appeal in *Mathew Maxwell v Highway Hauliers Pty Ltd* [2013] WASCA 115, which supports a broad interpretation of s 54 and is significant for its departure from the reasoning of the Queensland Court of Appeal in *Johnson v Triple C Furniture & Electrical Pty Ltd* [2010] QCA 282 (***Triple C***).

Background

Highway Hauliers Pty Ltd (**Highway Hauliers**) carried on a long-haul transport business. It held cover with Mr Maxwell, on behalf of a Lloyds' syndicate (**Underwriters**), which provided cover for, relevantly, accidental damage to its vehicles.

Two of Highway Hauliers' vehicles sustained damage in separate road accidents, both during the relevant period of insurance. Highway Hauliers made two claims under the relevant policy for the cost of repairs to the damaged vehicles.

Whether the damage suffered by Highway Hauliers was damage contemplated by the policy was not in issue. What was in issue was the operation of an endorsement (exclusion) which provided that "*no indemnity is provided under the policy … unless the driver has a PAQS[1] driver profile score of at least 36.*"

On the basis the drivers involved in the incidents had not completed the applicable PAQS testing (and had therefore not achieved the required profile score), Underwriters refused to indemnify Highway Hauliers in respect of the two claims.

Section 54

Highway Haulers conceded that the requirements of the endorsement had not been met, but argued it was nonetheless entitled to be indemnified by virtue of s 54(1) of the ICA, which provides that:

> *'Subject to this section, where the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of which subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.'*

Essentially, the section will operate where a claim that is otherwise within the scope of cover provided by a policy, but for which the insurer is entitled to refuse to pay by reason of some act or omission of the insured (or some other person).

It is well accepted that the section is not directed to instances where an insurer is entitled to refuse to pay a claim because it falls entirely outside the cover provided by a policy.

With that in mind, Underwriters contended that:

- The scope of the relevant cover was the operation of trucks by drivers who had satisfactorily completed a PAQS test. In other words, completion of a PAQS test was a condition precedent to cover being available. Underwriters submitted that non-satisfaction of this requirement meant the claims were outside the scope of cover under the policy, and were not something capable of being rectified by s 54 (the effect of s 54 in these circumstances would be to alter the scope of cover available under the policy); and
- Alternatively, the drivers' failure to satisfactorily complete a PAQS test to a certain level was not an 'act' or 'omission' as contemplated by s 54, but was rather a '*state of affairs*'.

Underwriters' argument on this second point was undoubtedly based on the reasoning adopted in *Triple C*, involving a relatively indistinguishable situation to the present case. In *Triple C* the insured's act of failing to successfully complete a flight review (as required by a policy covering damage to an aeroplane) was held not to form an "act or omission" in the relevant sense, thereby falling outside the scope of s 54. It was reasoned that one cannot omit to do something that requires reliance on a third party to exercise their discretion, in that case the flight review instructor to pass the pilot in a competency test.

Primary Judgement

At first instance Justice Corboy held that the PAQS requirement was not a condition of the policy that had to be met for cover to be available, but rather operated to exclude from cover a claim that was otherwise within the scope of cover, saying:

> *'The PAQS endorsement conditioned the Insurers' obligation to meet a particular claim that otherwise fell within the scope of cover; it did not form part of the way in which the scope of the policy was defined.'*

His Honour also held that the relevant "act" for the purpose of s 54 was the insured's operation of its trucks with a driver who did not satisfy the requirements of the policy, as opposed to the driver's failure to take the test (as was the case in *Triple C*).

In rejecting each of Underwriters' arguments, Justice Corboy held that s 54 of the ICA operated to excuse the insured in the circumstances. Cover was therefore found to be available.

Court of Appeal

Underwriters appealed the primary judge's findings, running the same case – outlined above – on appeal. In separate judgments, the three Justices of the Court of Appeal unanimously dismissed the appeal.

President McLure first agreed with Justice Corboy's determination that the PAQS exclusion did not form a condition of or define the scope of the policy. The objective importance of the PAQS endorsement was not such to justify its elevation to a condition of cover nor provide justification for the non-application of s 54.

The Court of Appeal therefore held the claim was one to which s 54 may have prima facie application.

President McLure then offered some practical guidance on the steps involved in considering the

application of s 54 of the ICA, by reference to previous decisions of the High Court[2] :

1. *'Identify the relevant s 54 act or omission;*
2. *Determine whether the act or omission is one to which s 54(2) applies. If yes, determine whether s 54(3) or s 54(4) applies. If s 54(2) does not apply, determine whether s 54(1) applies;*
3. *In assessing whether s 54(1) applies:*
    i. *determine whether there are any restrictions or limitations inherent in the actual claim by reference to the type or kind of insurance in issue. If facts of the claim are outside any inherent restrictions or limitations, it will not be a claim under the insurance contract, any relevant act or omission will not satisfy the causal requirements below and s 54(1) will not apply;*
    ii. *determine whether the effect of the insurance contract is that the insurer may refuse to pay the claim (in whole or in part) in question by reason of the act or omission; and*
    iii. *determine whether the insurer is refusing to pay the claim by reason only of that act or omission. If yes, the insurer may not refuse to pay the claim (but the insurer's liability may be reduced to the extent its interests were prejudiced as a result of the act or omission).'*

In identifying the relevant 'act', the Court of Appeal gave preference not to the more recent judgment in Triple C but to the High Court's earlier decision in *Antico v Health Feilding Australia Pty Ltd* [1997] HCA 35 (***Antico***).

The conduct of the insured in *Antico*, being the incurring of legal costs without the consent of the insurer, was characterised as an omission, being the failure of the insured to obtain consent before incurring those costs. The policy in that case provided that there would be no indemnity unless the insured first obtained the consent of the insurer.

The Court of Appeal determined that the structure of the PAQS endorsement in the present instance was much the same as the relevant provision in *Antico,* and in applying the reasoning in *Antico* to the present case held there was an omission, '*being the failure of the insured's nominated drivers to satisfactorily complete the test before driving the insured's nominated vehicles*.'

In a manner somewhat critical of *Triple C*, Her Honour (with whom Justice Pullin agreed) went on to say that it matters not whether it is the failure of the drivers to satisfactorily complete the PAQS test before driving the nominated vehicles, or the failure of the insured to use drivers who have satisfactorily completed the test, as s 54 applies to an 'act' of the insured or of another person.

This somewhat artificial distinction between the competing act or omission of the insured and its drivers became largely redundant; the crucial point being each act or omission was one that occurred after the policy was entered into and was the only basis on which Underwriters could (and did) rely for refusing to pay the claim.

Her Honour cast further doubt on the judgment in *Triple C* by refusing to classify the act or omission as necessitating a consideration of the involvement of a third party who is required to exercise its discretion, which she found to be of little significance.

Accordingly, it was considered that when the omission was fully formulated consistently with Antico, it was an omission for the purpose of s 54. In doing so, the Court of Appeal rejected Underwriters' argument and the narrow interpretation of s 54 preferred in *Triple C*.

Consequently, it held that s 54(1) operated to prevent Underwriters from refusing to pay the claim.

Conclusion

The contrasting decisions of Highway Hauliers and *Triple C* highlight the conceptual difficulties faced by Courts when interpreting s 54 of the ICA, even at the appellate level. The issue is further compounded by the fact leave to appeal to the High Court was refused in *Triple C*.

Uncertainty remains as to how the jurisdictions of Australia's Eastern States – Queensland and New South Wales in particular - will approach similar issues in the future.

> However, despite what might seem like a particularly broad application of s 54, insurers should remain mindful that not every refusal to pay a claim will result in the successful application of s 54. Much will depend on the particular policy and the underlying facts of each case.

Before s 54 will apply, an insurers' refusal to pay a claim must be

> '*by reason of (and only of) some act or omission of the insured or some other person occurring after the contract was entered into*.'

If a Court finds the only reason which exists for refusing to pay the claim was by reason of that act or omission, then the insurer may not refuse to pay the claim. This is to be contrasted to situations where the proper characterisation of the facts of the claim take it outside the scope of cover in the first place, for which s 54 has no application.

[1] PAQS is a safety consultant, which provides psychometric assessment training.

[2] Notably, in FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd (2001) 204 CLR 641; Antico v Heath Fielding Australia Pty Ltd (1997) 188 CLR 652; and Ferrcom Pty Ltd v Commercial Union Assurance Co of Australia Ltd (1993) 176 CLR 332.

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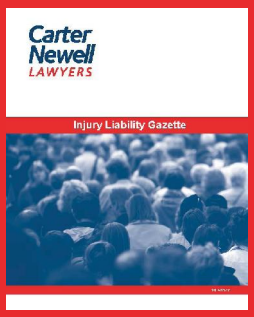

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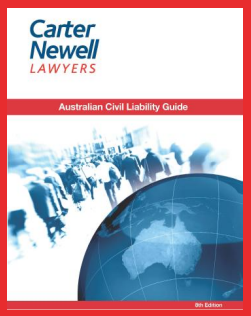

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