28/90

SUPREME COURT OF VICTORIA

ZURICH AUSTRALIAN INSURANCE LTD v CONTOUR MOBEL PTY LTD

Gobbo J

15, 16 February, 9 April 1990

[1991] VicRp 53; [1991] 2 VR 146; (1990) 6 ANZ Insurance Cases 76, 553

INSURANCE – NON DISCLOSURE – IF DISCLOSED RISK DECLINED – CLAIM FOR LOSS SUSTAINED – "REDUCED TO THE AMOUNT" – WHETHER INSURER'S LIABILITY REDUCED TO NIL: *INSURANCE CONTRACTS ACT* 1984 (CTH.) S28(3).

Section 28(3) of the *Insurance Contracts Act* 1984 (Cth.) ('Act') provides:

> "If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract ... has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place him in a position in which he would have been if the failure had not occurred or the misrepresentation had not been made."

1. Although s28(3) of the Act presumes the existence of a policy and the insurer's liability under it, an insurer may avoid the policy in the event of an innocent misrepresentation or non-disclosure by reducing its liability to nil.
***Twenty-First Maylux Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* (1989) 6 ANZ Insurance Cases 76, 302, followed.**

2. Where a magistrate found that an insurer would have declined to accept the risk had it known of the insured's non-disclosure, the magistrate was in error in holding that the insurer was not entitled to reject the insured's claim.

GOBBO J: [1] This is the return of an order nisi granted by Master Barker on 10 August 1989, at the instance of the applicant Zurich Australian Insurance Limited, calling on the respondent Contour Mobel Pty Ltd to show cause why an order made in the Magistrates' Court at Melbourne 12 July 1989 should not be reviewed and set aside.

The background to this matter may be summarised as follows. Mr Clarke, a manufacturing agent for the respondent, completed an insurance proposal form on behalf of himself and the respondent on 19 January 1988. The main purpose of this was to insure furniture with the applicant which Mr Clarke was to transport in a hired truck to Adelaide on that date. On 20 January 1988 the hired truck containing the furniture was left parked outside a motel on the outskirts of Adelaide. Mr Clarke later awoke that morning to discover that the truck had been removed. The truck was subsequently recovered but without the furniture. Mr Clarke submitted a claim for the loss to the applicant in the name of the respondent and himself.

The substantial matter argued by the applicant before the Magistrate was that the applicant was entitled to avoid the insurance policy because Mr Clarke gave incorrect answers to clauses 9.4 and 9.5 of the insurance proposal form. Questions 9.4 and 9.5 were as follows and were both answered "No" by Mr Clarke.

> "9.4 Is there any additional information or details of which you are aware and which may assist the company to assess the nature of the risks better?
>
> 9.5 Have you or to the best of your knowledge has any other person with an insurable interest in the property or risk proposed to be insured, even been convicted of an **[2]** offence relating to the theft of property or money or to fraud?"

In fact Mr Clarke had been convicted of seven offences of larceny, unlawful possession and deception arising out of five separate court appearances between 1965 and 1980. In addition there were a number of other convictions for driving or other offences not involving dishonesty. In

reply, the respondent submitted that, when completing clauses 9.4 and 9.5 of the cover note, Mr Clarke believed that he was answering on behalf of the respondent and not on behalf of himself.

The applicant argued that there was fraud and alternatively that the applicant should be able to avoid the insurance policy by the operation of s28(3) of the *Insurance Contracts Act* 1984 (Commonwealth), which states:-

> "If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under sub-s.(2) or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place him in a position in which he would have been if the failure had not occurred or the misrepresentation had not been made."

There was evidence from Mr Clarke – whose evidence the learned Magistrate accepted – that his belief was that he was answering on behalf of the company and that he did not turn his mind to his own position in relation to the two questions in issue in the proposal. He found that Clarke believed the truth of his answer because he did not believe the question referred to him. There was also evidence from a Mr Laxton, on behalf of the applicant. This witness was also described as truthful and his evidence as clear and convincing by the Magistrate. His evidence was that had Clarke's convictions been disclosed, **[3]** there would not have been any question of an additional premium but that the note would not have been underwritten by the applicant insurer.

His Worship found that Clarke was both a co-insured and an agent of the company and that he also had an insurable interest in the furniture as a bailee. His Worship found that there was no fraud. As to whether the insurer could avoid liability by resort to s28(3) of the Act, the learned Magistrate denied that the sub-section did not entitle the insurer to reject the claim because the word "reduced" did not contemplate a rejection based on not accepting the risk in the first place.

There were two grounds relied upon by the applicant in challenging the decision of the learned Magistrate. The first ground was in substance that the learned Magistrate should have found fraud proved. This ground which understandably was not seriously pressed may be disposed of shortly. The test of overturning the Magistrate's decision is that it must be shown to be a decision that no reasonable magistrate could have reached. In my opinion this test is not able to be satisfied and this ground must fail.

The second ground of review is that the learned Magistrate misdirected himself as to the proper construction s28(3) of s28(3) of the Act. This turned on whether an insurer can escape liability under s28(3) if it satisfies the Court that if the misrepresentation had not been made it would have wholly declined the risk. It is convenient to look at the history of the provision which followed a draft Bill in **[4]** a Law Reform Commission Report. The Report is able to be looked at as extrinsic material by virtue of s15AB(2)(b) of the *Acts Interpretation Act* 1901 (Commonwealth) and has been referred to in a number of the decided cases.

The Law Reform Commission was of the belief that the clause of the draft Bill would entitle an insurer in the event of non-disclosure or innocent misrepresentation to pay nothing in respect to the claim except the premium paid by the insured. In para.192 of Report No. 20, the Law Reform Commission stated:-

> "Where the insurer would not have accepted the risk on any terms at all, the amount of its loss is clearly equivalent to the amount of the claim made against it. Where the insurer would have accepted the risk, but at a different premium, its loss is the difference between the actual and notional premiums. Where it would have accepted the risk on different terms (whether at the same premium or not), the loss is the difference between its liabilities under the actual and notional contracts. If it would have excluded the risk which gave rise to the claim, the amount of its loss is equivalent to the amount of the claim made against it. In that case, the insured would recover nothing."

Furthermore, the Commission stated in its notes to s29 of the *Insurance Contract Bill* (being the equivalent to s28 of the Act):-

> "An insurer is not entitled to avoid a contract for innocent misrepresentation or non-disclosure, but may reduce a claim by the amount of the loss it has suffered as a result of the misrepresentation or non-disclosure. The amount by which the claim is reduced is the amount which would place the

> insurer in the position it would have been in if the failure to comply with the duty of disclosure had not occurred or the misrepresentation had not been made. For example, if the insured would have charged a higher premium had the misrepresentation not been made, it would be entitled to reduce the claim by the amount of the additional premium. If the insurer would not have entered into the contract at all, it would be entitled to pay nothing in respect of the claim except the premium paid by the insured. If the insurer **[5]** would have inserted a different term in the contract, then the insurer would only be liable for the amount for which it would have been liable if that term had been a term of the contract. The principle is the one generally applied in assessing damages for misrepresentation.

The view that in these circumstances the Court is empowered to reduce the insured's entitlement to nil was rejected by Young J in *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1987) 4 ANZ Insurance Cases, 60-813 at 74,999-75,000. In reaching this view, His Honour essentially relied on the decision of the High Court in *Eastern Extension Australasia and China Telegraph Co Ltd v Commonwealth* [1908] HCA 59; (1908) 6 CLR 647; 14 ALR 542. In that case, the majority held that the power to reduce a scale of charges for telegrams did not entitle the Commonwealth to abolish the charges entirely. Adopting that approach, Young J in the *Advance Case* concluded that "it would only be in a very extraordinary case" that the Court would give to the phrase "reduced to the amount" the meaning of reduction to nil.

In *Ferrcom Pty Ltd v Commercial Union Assurance Co Australia Ltd* (1989) 5 ANZ Insurance Cases 60-917, Giles J, departed from the view adopted by Young J in the *Advance Case*, stating at pp75,813-4:-

> "If there be a power to reduce liability without a direction as to that to which it is to be reduced, then it may be that the liability cannot be reduced to nil. But in s28(3) there is a specific direction as to that which the liability is to be reduced. It would not be a misuse of language to talk of "a reduction to nil"; so if the direction requires that, if the circumstances be appropriate, the reduction be to nil is to be given effect."

In *Lindsay v CIC Insurance Ltd* (1989) 16 NSWLR 673; (1989) 5 ANZ Insurance Cases 60-913, Rogers CJ adopted the same view as Giles J in the *Ferrcom Case*. In this case, Rogers CJ **[6]** concluded that, on the evidence, the insurer would not have accepted the risk and entered into the policy had there been disclosure of the use to which the premises were to be put by the plaintiff. In His Honour's view, s28(3) thus offered an indirect means for the insurer to avoid the policy *ab initio*. At ANZ Insurance Cases p75,864, he stated:-

> "The intention [of sec28(3)] is to put the insurer in the position it would have been in if the relevant disclosure had, in truth, been made. If, in those circumstances, the insurer would not have accepted the policy, then the only way in which the insurer can be restored to the position it would have been in is by reducing the payment required to be made under the policy to nil. That is because the damage suffered by the insurer is the total amount of the claim made against it. It may be that in a case where the premium had been paid the reduction should be to an amount allowing a refund of premium to be effected ... This question was not argued. Otherwise, in truth, the insurer would be in a better position than it would have been had the disclosure been made and cover refused "

An alternative construction of s28(3) was offered by Deane J *obiter* in *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* ([1989] HCA 22; (1989) 166 CLR 606; (1989) 85 ALR 161; (1989) 5 ANZ Insurance Cases 60-910; (1989) 63 ALJR 365) in an appeal to the High Court. At p171 of the judgment, His Honour stated that, while the provision could entitle an insurer in certain circumstances to reduce its liability to nil, this did not offer an indirect means of avoiding a policy:-

> "Section 28(3) does not offer an indirect means of avoiding a policy. Its starting point is the existence of a policy and the insurer's entrenched liability under it. Its operation in a case to which it applies, is to reduce the amount of that liability. That being so, any reduction in the amount of the insurer's liability would, in the postulated circumstances, have fallen to be calculated on the basis of the position which would have existed if the insurer had issued a policy after full disclosure of the claims history. That is to say, the insurer's liability under the policy would be reduced by any additional amount or amounts of premium it would have charged if **[7]** there had been full disclosure. If the evidence established that, in such circumstances, the additional amount of premium which would have been charged would have exceeded the amount of the claim, the amount of the insurer's liability would be reduced to nil. In that regard. I respectfully dissent from the view of the learned trial Judge that sec 28(3) can never operate so as to reduce the amount of the insurer's liability to a nil amount in the circumstances of a particular case."

The approach taken by Deane J in the *Advance Case* was subsequently followed and applied by Keall J of the District Court of Western Australian in *Delphin Lumley General Insurance Ltd* (1989) 5 ANZ Insurance Cases 60-941; (1989) 6 SR (WA) 161. However, in a subsequent decision by Rogers CJ in *Ayoub & Anor v Lombard Insurance Co (Australia) Pty Ltd* (1989) 97 FLR 284; (1989) 5 ANZ Insurance Cases 60-933, His Honour reviewed and re-affirmed his interpretation of s28(3) in the *Lindsay Case* in light of the observations by Deane J in the *Advance Case*. Commenting on the approach taken by Deane J in the *Advance Case* he stated at p76,036:-

> "With great respect, I find the path prescribed by His Honour's words very difficult. If the underwriter, upon proper disclosure, would have rejected the application for cover, then, in the words of the Report of the Law Reform Commission, "if it would have excluded the risk which gave rise to the claim, the amount of its loss is equivalent to the amount of the claim made against it. In that case the insured would recover nothing". In such circumstances, what is required to be offset against the claim of the insured is not an additional premium but the amount of the loss suffered by the underwriter. The additional premium concept imports the artificiality of holding that the underwriter would have extended cover at a premium equal to the amount of the loss when, in fact, the evidence demonstrates he would have declined cover altogether."

Finally, in *Twenty-First Maylux Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd* [1990] VicRp 81; [1990] VR 919; (1989) 92 ALR 661; (1989) 6 ANZ Insurance Cases 60-954, Brooking J reviewed the **[8]** above authorities to conclude that the construction adopted by Rogers CJ in the *Lindsay Case* and *Ayoub Case* was preferable to that taken by Deane J in the *Advance Case*. In His Honour's view, while recognizing the logic of the approach adopted by Deane J this required accepting the artificial assumption that the insurer would have issued a policy at an inflated premium had disclosure or knowledge of the misrepresentation been made at the outset. In a more realistic, commercial context, His Honour was of the opinion that the insurer, if possessed of this knowledge, would simply have refused to write the business. Accordingly, it was preferable for the Court to accept the construction that s28(3) entitles the insurer to avoid liability entirely upon the basis that it would have declined the business entirely.

With great respect to those who favour the opposite construction, I prefer the reasoning in the judgments referred to above that recognize that s28(3) can assist an insurer who can prove that it would not have entered into the contact at all. In my view, the correct construction of s28(3) is that, although it presumes the existence of the policy and the insurer's liability under it, it offers an indirect means in an appropriate case of avoiding the policy in the event of innocent misrepresentation or non-disclosure by reducing the liability to nil, being the position the insurer would have been in if there had not been a misrepresentation. In the present case, the test that should have been applied by the learned Magistrate was whether the applicant, had it known of Mr Clarke's **[9]** non-disclosures at the time it entered into the policy would have declined to have accepted the risk.

It is necessary to refer to a further argument put in support of the learned Magistrate's order. It was argued that the policy in the present case should be construed as being a composite and not a joint policy. It should be read as one where there were two insured persons who insured their respective interests; their duties and obligations apart from the obligation to pay the premium were separate and independent. On this basis it was submitted that Part V of the Act should be applied in such a way that in a composite policy the non-disclosures of one co-insured could not affect the other co-insured.

In the *Advance Case*, the Court of Appeal distinguished between joint and composite insurance policies and the legal consequences in each case where a party failed to disclose material facts under s28 of the *Insurance Contracts Act*. In the case of a joint policy, the majority held that an insurer could not seek to avoid the policy under s28(2) for failure of one insured to disclose a material fact, unless all parties jointly insured had knowledge of the relevant matter. Conversely, in the case of a composite policy which insured the several interests of the different persons, it was held that the insurer may avoid the contract insofar as it affects the separate interest of the insured person who has fraudulently failed to disclose a relevant matter. The High Court in the *Advance Case* however did not draw a distinction between joint and composite contracts, but ruled that, as a general principle, s28 **[10]** applied where one co-insured failed to disclose a material fact, notwithstanding the fact that the other did not know of the non-disclosure.

While this interpretation might seem harsh on the innocent co-insured who was unaware of the non-disclosure, it would, in my view, be inherently unjust in the circumstances to prevent the insurer from avoiding the contract of insurance which it would not have entered into but for the non-disclosure. I do not therefore consider it necessary for me to decide whether the policy in this case was joint or composite, since I am of the view that irrespectively, the insurer should be entitled to avoid the policy where one co-insured has failed to disclose a material fact. Having disposed of this argument, I return to my finding that, in my opinion, the correct construction of s28(3) is that the insurer can avoid liability if it satisfies the court that if the misrepresentation or non-disclosure had not been made it would have wholly declined the risk. It is clear from the evidence that this would have been the case. The result that should follow is that the order nisi be made absolute.

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