

# Insurance Brief

## The Australian Insurer's Duty of Utmost Good Faith

- AMP Financial Planning Pty Limited v CGU Insurance Limited [2005]

Federal Court of Australia, Full Court, 2/09/2005 -

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The Australian Federal Court recently provided some interesting comment regarding insurers' duties of utmost good faith. The decision helpfully summarises where an insurer will be in breach of its good faith obligations when handling claims.

AMP carried on business as a finance, investment and insurance adviser. It operated through a number of agents. It was discovered that some of its agents had signed clients to unapproved investments that failed, and as a result the Australian Securities and Investment Commission ("ASIC") became involved. AMP made a claim on its professional liability policy. ASIC put pressure on AMP to settle the investor's claims or risk losing its licence.

AMP informed CGU of this. CGU reserved its rights and told AMP to act as a prudent uninsured until a decision on indemnity was reached. CGU also advised AMP that it agreed in principle to a suggested protocol for handling the investors' claims. AMP made payments in excess of \$3,000,000 to settle and then sought reimbursement from CGU. CGU denied the claim on the basis that AMP had not established it owed any liability. In response, AMP claimed that by approving the protocol, CGU had induced AMP to believe that, if it acted in accordance with the protocol and settled the claims, CGU would grant cover. It was argued that because of its reliance on the protocol, it would be a breach by CGU of its duty of utmost good faith (under Section 13 of the Insurance Contracts Act) not to pay. In the first hearing, it was found that there had been no breach of the

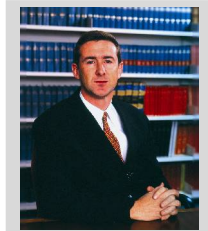
utmost good faith obligation. The primary judge held that in order to prove a breach, what was required was proof of a lack or want of honesty.

On appeal, the majority of the Court said that while a lack or a want of honesty will be sufficient to prove that there has been a breach, a breach can also be established without dishonesty. Importantly, the Court held that the notion of acting in good faith meant acting with honesty **and** propriety. A lack of propriety could be sufficient to breach the duty.

Other points of note were:

- A non-disclosure at inception can constitute a breach of the duty of utmost good faith. That does not necessarily mean that there has been a lack of honesty by the insured. It could be an inadvertent non-disclosure but if that non-disclosure is material it can amount to a breach of the duty.
- The precise content of the concept of utmost good faith depends on the context in which it is used. In the context of an insurance policy, the phrase encompasses notions of fairness, reasonableness and community standards of decency and fair dealing.
- Dishonesty will constitute a breach of the duty. However, so will capricious or unreasonable conduct (even if not "*dishonest*").
- Dishonesty is not a prerequisite for a breach of the duty.

For an insurer, a failure to make a prompt admission of liability, when there is a good claim, could amount to a breach of the duty.



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- An insurer could also be liable for a breach of the duty if it failed to make a prompt payment in respect of a sound claim. However, if an insurer is still awaiting details that are necessary for it to make a fully informed decision then that will not amount to a breach.
- A failure by an insurer to make and communicate a decision of acceptance or rejection within a reasonable time may constitute a breach of the duty.
- Acting with the **utmost** good faith involved something more than **mere** good faith. Otherwise, the word *utmost* would have no effect.

The appeal was upheld and the case sent back to the primary judge to answer a further series of questions. Even though the decision is not binding on New Zealand Courts, the summary of principles is in line with decisions in Canada and the United Kingdom and should be kept in mind when handling claims. Whilst an insurer is entitled to wait until all relevant information is to hand, it is not allowed to stall a decision or refuse to pay a sound claim without some very good grounds for doing so.

## ROPING IN “REASONABLE DISCOVERABILITY”

*Murray and Ors v Morel & Co. Ltd & Ors, Court of Appeal 22/12/2005*

A perennial problem for underwriters of Professional Indemnity policies is to manage the long tail nature of those policies.

Over the past decades, the law of negligence has developed around it the notion of “reasonable discoverability” to provide for plaintiffs a delayed starting point for the limitation period in which a cause of action might be brought. The longer the period until a claim is time barred, the more difficult the task is to manage.

The Limitation Act provides for a 6 year period within which to bring claims in tort such as negligence (There are different periods for different claims under that Act and the Fair Trading Act).

Cases in the building arena had seen the concept of latent defect develop with the resultant principle that time does not run until the latent defect was “reasonably discoverable”. “Reasonable discoverability” is a doctrine whereby a cause of action does not accrue until the plaintiff knows or ought to know of the facts necessary to establish his or her cause of action. This principle appeared to be followed and enshrined in NZ law by the Privy Council in *Invercargill City Council v Hamlin*, or was it?

On the Court of Appeal’s analysis in *Morel*, the approach in *Hamlin* was no more than application of the normal rule that a cause of action accrues when all the facts giving rise to the cause of action are in existence (regardless of whether they are then known to the plaintiff). In the Court of Appeal’s view of *Hamlin*, the owner of the house found to contain defects sued not

for the physical damage to the house but rather for loss to his pocket. That loss occurred when the market value of the house was depreciated by reason of the defective foundations. Had the house been resold at full value before the defect was discovered, no loss would have been suffered.



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The Court held that the normal rules regarding accrual of a cause of action remained. “Reasonable discoverability” did not extend as in *Morel’s* case to a claim for the breach of the Securities Act. Nor, (therefore) would it extend to claims in negligence against professionals (which may be more the interest of the readers of this publication).

The Court held that there were exceptions recognised in tort claims involving latent defects which were limited to personal injury cases and sexual abuse cases but no further. The Court appeared not to accept latent defect as being the proper analysis for building cases which it said were more properly claims for economic loss and not for property damage.

Interestingly, the Court considered its earlier decision in *Gilbert v Shanahan & Partners* but did not look at the approach taken in that case of present and contingent liabilities as a device for deferring commencement of limitation periods. That approach may yet provide plaintiff lawyers with a way around the apparently now corralled concept of “reasonable discoverability.”

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