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21 April 2004

The Secretary
Insurance Contracts Act Review Secretariat
c/- Department of the Treasury
Langton Crescent
Parkes ACT 2600

By e-mail: icareview@treasury.gov.au

Dear Secretary

**Review of the *Insurance Contracts Act (1984)* (Cth) (the “IC Act”):
exposure draft amendments to section 54 of the IC Act**

I refer to: the letter (undated, but received by e-mail on 8 March 2004) from Mr Alan Cameron AM and Ms Nancy Milne, enclosing for comment the 8 March 2004 exposure draft of the Insurance Contracts Amendment Bill 2004 (the “Exposure Draft Bill”) and accompanying commentary; and the Law Council’s meeting with Mr Cameron, Ms Milne, and staff on 29 March 2004.

In summary, the Law Council’s submission is:

1. To reaffirm its substantive positions made earlier¹ on section 54 of the IC Act, namely that the Law Council supports:
 - (a) dividing section 54 into two separate provisions – with section 54 in its current form applying to “occurrence” policies, and a modified section 54 applying to “claims made” and “claims made and notified” policies;
 - (b) that the modified section 54 should be in the terms of Option 2 of the Review of the IC Act’s *Issues Paper on Section 54* (the “*Issues Paper*”)² with the following additions:

¹ In its submission of 16 October 2003 to the Review of the IC Act.

² That is, to amend section 54 (and possibly section 40) of the IC Act to overcome the decision in *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (the “*Australian Hospital Care*” case) [2001] HCA 38. See the *Issues Paper* at pages 8-9.

2.

- (i) there should be a six month grace period after the expiration of the period of cover in which notifications of claims, and facts or circumstances which might give rise to a claim, can be made to an insurer (so as to cater for circumstances that occur near the end of the cover period); and
- (ii) there should be a provision which has the effect that if a purported notification within the six month grace period is rejected by an insurer as being invalid, the insured can notify its current insurer without penalty – so as to avoid an insured falling between coverage of two insurers; and
- (iii) there should be a discretion provided to the Court to extend, for reasonable cause, a notification period so as to allow the insured to comply.

2. Specifically on the Exposure Draft Bill, the Law Council states:

- (a) the Exposure Draft Bill does not include a provision to restrict the operation of proposed section 54A to those types of policies which presently are written on a claims made basis, as was recommended in the Review of the IC Act's *Report into the Operation of Section 54* (the "*Report*", at page 25) – the Law Council notes the discussion on this point at the meeting on 29 March 2004 (described below);
- (b) the drafting in the Exposure Draft Bill of the proposed section 54A of the IC Act is, with respect, too complicated – the Law Council prefers instead a new sub-section in section 54 of the IC Act, along the lines set out below;
- (c) noting the Law Council's points made earlier in relation to the extension period (see above), states that the 45 day period in the proposed sub-section 40(3) is arbitrary;
- (d) the Law Council recommends that the giving of a notice as required under the Exposure Draft Bill's proposed sub-section 40(2A) should be a condition for the insurer to rely on proposed section 54A; and
- (e) the Law Council does not believe that the term "claim" should be legislatively defined.

Background to this submission

The Review of the IC Act (the "Review") was announced on 10 September 2003, and is being conducted by Mr Cameron and Ms Milne, supported by a secretariat in the Treasury. Mr Cameron and Ms Milne were asked to report on section 54 of the Act no later than 31 October 2003 (the first stage of the

Review, which they did by their *Report*), and by 31 May 2004 in relation to the balance of the Act (the second stage).

This is the Law Council's final submission on the first stage of the Review. The submission follows on from earlier submissions, and appearances in person by the Law Council before the Review, on the first stage as follows:

- written submissions to the Review of 16 October 2003; and
- a meeting with the Review on 29 March 2004 (principally on the first stage of the Review). The Law Council delegation at that meeting was Mr Damian Scattini, Mr Stephen Knight and Mr James Greentree-White.

What is the Law Council?

The Law Council of Australia is the peak national representative body of the Australian legal profession. The Law Council was established in 1933. It is the federal organisation representing approximately 40,000 Australian lawyers, through their representative Bar Associations and Law Societies (the "constituent bodies" of the Law Council).

The constituent bodies of the Law Council are, in alphabetical order:

- ACT Bar Association;
- Bar Association of Queensland;
- Law Institute of Victoria;
- Law Society of the ACT;
- Law Society of NSW;
- Law Society of the Northern Territory;
- Law Society of South Australia;
- Law Society of Tasmania;
- Law Society of Western Australia;
- New South Wales Bar Association;
- Northern Territory Bar Association;
- Queensland Law Society;
- the Victorian Bar; and
- Western Australian Bar Association.

The Law Council speaks for the Australian legal profession on the legal aspects of national and international issues, on federal law and on the operation of federal courts and tribunals. It works for the improvement of the law and of the administration of justice.

The Law Council represents, through the representative Law Societies and Bar Associations, lawyers who act both for claimants, and for insurers and defendants. The Law Council is the most inclusive, on both geographical and professional bases, of all Australian legal professional organisations.

This submission was made with the assistance of a Law Council working group on the Review of the IC Act.

The Exposure Draft Bill

The amendments in the Exposure Draft Bill are summarised in the commentary attached to the undated letter from Mr Alan Cameron AM and Ms Nancy Milne as follows:

“1.3 Possible amendments to subsection 40(2) of the IC Act are as follows.

- *Insurers would be required to notify insureds (both at the start of a policy and upon renewal) of the effect of subsection 40(3) of the IC Act.*
 - *Subsection 40(3) provides a statutory right for insureds in relation to liability contracts. If an insured notifies their insurer of facts that might give rise to a claim before the liability policy expires, subsection 40(3) ensures that the insurer must cover the insured for any claims that arise from those notified facts.*
- *To satisfy this proposed requirement, the notification must occur no earlier than 30 days before the contract expires and no later than 7 days before the contract expires.*

1.4 Possible amendments to subsection 40(3) of the IC Act are as follows.

- *When notifying facts that might give rise to a claim, an insured would be allowed an extended reporting period.*
 - *That is, so long as the insured notified their insurer of facts within 45 days after the contract expired (on the condition that the facts actually occurred within the policy period) then the insurer would be obliged to cover the insured for any claim that arose from those facts.*
 - *The requirement that the notification of facts occur as soon as reasonably practicable after the insured became aware of them, still applies in relation to the extended reporting period.*

1.5 It is proposed that a new section 54A, applying only to claims made and notified policies, could be created which would:

- *ensure that section 54 no longer applies where an insured notifies their insurer of facts which might give rise to a claim outside the period of cover provided for in the contract, or in the IC Act;*
- *essentially overcome the judicial interpretation in FAI General Insurance Company Ltd v Australian Hospital Care Pty Ltd (2001) 204 CLR 641; and*
- *still provide relief to an insured in respect of a claim made against them during the period of cover, but notified to the insurer outside that period.”*

Questions on the Exposure Draft Bill

The undated letter from Mr Alan Cameron AM and Ms Nancy Milne asks the following questions for discussion:

“In considering the draft Bill, you may wish to address the following questions.

- *Is the draft Bill consistent with the recommendations made in the report into section 54?*
- *Do you think there is a need to define what a ‘claim’ is? If so, how should it be defined?*
- *Is there a need for greater prescription in regard to the disclosure obligations under section 40?*
- *Should the amended section 54A extend to any other types of policies? If so, why?”*

What are “claims made” and “claims made and notified” policies?

Some categories of insurance, such as motor vehicle insurance and public liability insurance, are (at least generally) written on an “occurrence” basis, that is: the insurance policy covers claims that arise from incidents occurring during the policy period.

On the other hand, professional indemnity insurance and similar categories, such as directors and officers insurance, are more commonly written on a “claims made” or “claims made and notified” basis. These types of policies have been described as follows:

“Claims made type policies ... differ from ‘occurrence’ policies in that, instead of attaching the insurer’s liability to indemnify the insured to the happening of an occurrence during the period of cover, they attach the liability in various ways (according to the description in the policy) to the

*making of a claim against the insured, its notification by the insured to the insurer or the 'discovery' of a claim within the period of cover."*³

The Law Council's response to the questions on the Exposure Draft Bill

Is the draft Bill consistent with the recommendations made in the report into section 54?

The Exposure Draft Bill is consistent with the recommendations made in the *Report*, with the exception that the Exposure Draft Bill does not include a provision to restrict the operation of proposed section 54A to those types of policies which presently are written on a claims made basis. What the *Report* said on this was:

"The amendment should ensure that it is restricted to those types of policies which presently fall within the classes of insurance written on a 'claims made' basis, and that it cannot be used by insurers to draft around section 54 by converting 'occurrence' policies to 'claims made'. To avoid such an outcome, the amendment could exclude from its operation any class of contract prescribed by regulation or declared by the Australian Securities and Investments Commission (ASIC). Alternatively the amendment could be limited to a specific class of insurance contracts. Initially the class would include those types of policies that have been identified in submissions and consultations with the Review Panel, that is:

- *contracts of professional indemnity insurance;*
- *contracts of insurance that provide cover for liability of a person in their capacity as a director or officer of a corporation, including any related contract of insurance which provides cover for a corporation in respect of its liability to indemnify a person in their capacity as a director or officer of that corporation;*
- *contracts of insurance that indemnify a trustee or trust fund in relation to a loss or liability incurred by the trustee in the course of carrying out the trustee's functions in relation to the trust;*
- *contracts known as errors or omissions contracts of insurance;*
- *contracts of insurance commonly known as a product recall or product guarantee insurance contracts; and*
- *contracts of medical malpractice."*⁴

³ *Australian Hospital Care* [2001] HCA 38 at paragraph 64 per Kirby J (concurring) – footnote omitted.

⁴ *Report* at page 25.

This was discussed at the Law Council's meeting on 29 March 2004. The Law Council understands from the meeting that Ms Milne believed it was unlikely that the insurance market would shift to writing on a claims made basis those areas which are now commonly written on an occurrence basis, and that if that occurred then it may be justified to amend the IC Act to address the issue. The Law Council does not believe that legislative amendment is warranted at this time, but would like the issue to be covered in any report by the Review on the Exposure Draft Bill.

Although the Exposure Draft Bill's proposed section 54A of the IC Act carries into effect the relevant recommendation of the *Report*, the provision is, with respect, too complicated. The Law Council prefers instead a new sub-section in section 54 of the IC Act being the "modified section 54" provision, along the lines set out below:

*Where a contract of liability insurance provides indemnity in the event that a claim provides indemnity where circumstances that may give rise to a claim are notified to the insurer during the period of insurance, the insured's failure to notify the insurer during the period of insurance about the circumstances is not an omission for the purposes of this section.*⁵

The Law Council believes that drafting along these lines would be clearer than the proposed section 54A in the Exposure Draft Bill, while achieving the same result.

Noting the Law Council's points reiterated above in favour of a six month grace period for late notification, and also for a judicial discretion to extend the notification period for reasonable cause, the Law Council considers that the 45 day period in the proposed sub-section 40(3) is arbitrary.

Do you think there is a need to define what a 'claim' is? If so, how should it be defined?

The Law Council does not believe that the term "claim" should be legislatively defined.

The Law Council working group on the Review of the IC Act gave some consideration to what a legislative definition would look like. The working group found the exercise to be complex (particularly in differentiating claims against an insured from claims on the insured's insurance policy) and also unnecessary. The lack of a legislative definition does not appear to have been a problem to date. The question of what is a "claim" should be left to consideration by the courts. If in the future, any difficulties are posed by judicial interpretation, then a legislative definition could be undertaken.

Is there a need for greater prescription in regard to the disclosure obligations under section 40?

⁵ Drafting based on a suggestion to the Law Council by Perth barrister Mr Geoffrey Hancy.

The Law Council does not believe that there should be greater prescription in regard to the disclosure obligations under section 40 than is set out in the Exposure Draft Bill. It is sufficient to indicate, as the Exposure Draft Bill does, what has to be disclosed, and the time period for doing so.

However, in a related point, the Law Council recommends that the giving of a notice as required under the Exposure Draft Bill's proposed sub-section 40(2A) should be a condition for the insurer to rely on proposed section 54A.

The Law Council recognises that this was considered and rejected in the *Report*,⁶ but believes that it should be reconsidered as an issue of individual fairness. There is no consolation to an insured who has lost the opportunity to make a notification of circumstances, because of the insurer's failure to give notice of the requirements, in the insurer being subject to a fine. It would be appropriate to not allow the insurer to rely on the proposed section 54A (or the sub-section Law Council proposes above, if that were adopted).

Should the amended section 54A extend to any other types of policies? If so, why?

No. On the contrary, the Law Council is concerned at the potential for "creep" of the proposed section 54A to areas that are not currently written on a claims made basis. See discussion at page 7 above, as noted there the Law Council does not believe that legislative amendment to restrict the types of policies to which section 54A would apply (as had been recommended in the *Report*). However, the Law Council does not believe that the proposed section 54A should be cast wider than presently drafted.

Further contact

If you have any questions in relation to this submission please contact Mr Greentree-White on (02) 6246 3715.

Yours faithfully



Peter Webb

⁶ *Report* at page 26.