

UBERRIMA FIDES - QUO VADIS?
Where to from here?

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Introduction

There is no general requirement that parties to a contract act towards each other with utmost good faith. Insurance contracts, however, are part of a special category of contracts, those classified as *uberrimae fidei*, where parties do have that obligation towards one another. It can be said at the outset that the word 'utmost' may add very little. It is the examination of 'good faith' that goes to the heart of the concept.¹

The definition of 'good faith' has many meanings in the legal sense but in essence it encompasses notions of 'fairness, and reasonableness ... and community standards of fairness, decency and reasonableness'.² It imposes a market standard of fairness, that is what is customary and acceptable conduct in the particular commercial activity. Good faith has been described further as 'loyalty' as a realistic concept because it allows for a balance without abandonment of self interest.³ Thus good faith may be seen as a concept linked to loyalty or fidelity in the relationship.

The New Zealand High Court case of *Vermeulen v SIMU*⁴ determined that the obligation to act in good faith is essentially one of honesty. The actual breach of a term under a contract does not necessarily imply a breach of the duty of good faith as in some cases where an insured may act under a misapprehension of his rights or obligations unaware that he was engaged in wrongdoing.

Although the term is not statutorily defined in Australia, the American Uniform Commercial Code defines 'good faith' as 'honesty in fact in the conduct or transaction concerned'.⁵

1 Scotford T, 'The Insurer's duty of Utmost Good Faith: implications for Australian Insurers' (1988) 1 ILJ 2 at 4.

2 Lucke H, 'Good Faith and contractual performance' in Finn P (ed) *Essays on contract* (1987) 155, 160.

3 Ibid 162.

4 (1987) 4 ANZIC 60-812 at 75,987.

5 Sutton K, *Insurance Law in Australia* LBC (1991) at 101.

Although the exact definition of the term may be somewhat elusive there are several cases which illustrate the sort of situations which are said to attract the obligation to act with the utmost good faith, and which have created certain broad parameters to the concept. These cases and the nature of the duty of good faith will be discussed in more detail in Part II of this article.

Currently in Australia, the law relating to the duty of utmost good faith appears poised on the brink of change. The *Insurance Contracts Act 1984 (Cth)* (ICA) contains many provisions which operate to protect insureds and to ensure fair conduct, by both insureds and insurers, in relation to aspects of the insurance contract. By virtue of section 9, however, the ICA does not apply to all types of insurance contracts in Australia. Specifically excluded from the operation of the ICA are contracts:

- (a) of reinsurance;
- (b) of insurance entered into by a health benefits organisation pursuant to the *National Health Act 1953*;
- (c) of insurance entered into by a friendly society or by the Export Finance and Insurance Corporation;
- (d) to or in relation to which the *Marine Insurance Act 1909* applies;
- (e) entered into or proposed to be entered into for the purposes of a law that relates to -
 - (i) Workers Compensation ; or
 - (ii) compensation for the death of a person, or for injury to a person, arising out of the use of a motor vehicle.

Also excluded from the operation of the Act are contracts of State insurance or Territory insurance. These contracts are all, therefore, based on the common law notions of good faith and fair dealing which differ significantly from the operation of the ICA in some areas. The major contribution of the ICA to the concept of good faith is that the concept is now enshrined as an implied term of the contract. This leads to the situation where a breach of that duty may lead to a remedy sounding in damages. This is as distinct from the common law situation where a breach of the duty to act in good faith could only lead to a rescission of the contract and, in some circumstances, a return of any premiums paid by the insured.

As a result of a few recent cases, in Australia and England, however, it appears that the common law position may no longer be quite so certain, or rigid. Academic writing on the subject discusses the balance to be wrought between common law positivists and those who seek to promote the concepts of good faith and fair dealings between parties.

Perhaps now, in certain distinct areas of law particularly insurance law, the balance is emerging, both in the decisions of the courts and in the area of statutory reform. It is not without moment that, somewhat

coincidentally, significant reforms relating to insurance contracts in Australia allow legal minds to adjust to a new balance, while case law in Australia and England, not to mention the United States, gives increasing emphasis to the 'liberal tradition' which flowered in mid eighteenth century England under the influence of Lord Mansfield CJ.⁶

The tide is turning for insureds under insurance contracts. It is increasingly possible for them to be able to obtain realistic remedies against insurers that fail to act towards them with good faith. On the other hand there are those that argue ably that, at least under the ICA, the pendulum has swung too far, and that although both insurers and insureds are required to act with good faith towards each other, breaches committed by insureds are able to be 'excused' at the discretion of the courts yet still render the insurers liable to indemnify the insured in many such circumstances.⁷ The ramifications of the 'flowering liberal tradition' of the duty of good faith for both parties are great. This paper will investigate the emerging situation pursuant to the ICA and the general law concerning good faith and indicate the potential future of the concept as a growing area of litigation.

Important features of the duty of good faith

The most obvious manifestation of the duty of good faith is the duty of disclosure.⁸ The reason for the duty of disclosure may be found in the oft quoted statement of Lord Mansfield CJ in the case of *Carter v Boehm*.⁹ In essence, his Lordship held that, as all of the information relevant to the risk to be insured against usually was known by the insured party only, the obligation on that party was to give as much of that information to the insurer as he was aware, and not to conceal that which he knows in order to draw the other into a bargain. The common law duty, therefore, compels disclosure of all material facts. In Australia, the test of 'materiality' is the so called 'prudent insurer' test as postulated in *Mayne Nickless Ltd v Pegler*.¹⁰ This test is an objective one and means that a particular fact is material at common law if it would affect the mind of a prudent or reasonable insurer

6 Above n 1 at page 2.

7 Tarr A, 'Insurance Law and the Consumer' (1989) 1 Bond LR 79 at 88; Hancey G, 'Recent trends in insurance law', a paper given at a Western Australian Law Society CLE 1994. Hancey stresses that care should be taken not to interpret the already adequate protection afforded by the ICA in such a way as to unrealistically protect insureds' rights.

8 Above n 5 at 105.

9 'Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the underwriter trusts to his representations and proceeds upon confidence that he does not keep back any circumstances in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risque as if it did not exist ... Good faith forbids either party, by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing to the contrary' (1766) 3 Burr 1905 at 1909.

10 (1974) 1 NSWLR 228 at 239, per Samuels J.

(not necessarily the insurer in question) either in deciding whether or not to accept the risk, or the terms upon which the risk would be accepted. This imposes a heavy and often unreasonable burden on the proponent who must possess near clairvoyant powers to discover what a reasonable or prudent insurer would regard as material.¹¹ This is still so at common law, but has been amended in relation to those contracts governed by the ICA.

Other important and relevant aspects of the duty of disclosure are:

- ? it arises out of common law outside the contract of insurance and is not an implied term of the contract;¹²
- ? it terminates when the contract is concluded although it may continue if a term of the contract requires it;¹³
- ? the duty to disclose is absolute: it is not relevant that any non disclosure came about as a result of negligence or accident.¹⁴

Notwithstanding that the duty of disclosure is seen as an important part of the duty of good faith, the Australian Law Reform Commission in its *Report No 20 on Insurance Contracts* stated that in principle it should apply equally to all other aspects of the insurance relationship.¹⁵ Although this comment is of primary relevance to the ICA, which was based on the recommendations of the ALRC report, the common law has also recognised this aspect of the duty:

It is the essential condition of a policy of insurance that the underwriters shall be treated in good faith, not merely in relation to the inception of the risk, but in steps taken to carry out the contract.¹⁶

The duty of good faith commences before the policy is made via the duty of disclosure, and continues so long as the parties are in a contractual or continuing relationship with one another. This was made clear in *Boulton v Holder Bros*.¹⁷ In that case the insured initially made an honest and legitimate claim against his policy of insurance guarding against fire damage. This claim was persisted in even after a second fire which was intentionally lit by the insured. The court held that the insured had failed to act in good faith and that the insurer was entitled to deny his claim.

Other elements of the doctrine of good faith that have been identified by the courts include the following:

11 Tarr A (et al), *Australian Insurance Law*, LBC (1991).

12 (1974) 1 NSWLR 228 at 239, per Samuels J.

13 Ibid.

14 Ibid.

15 At para 328.

16 *Boulton v Holder Bros* (1904) 1KB 784 at 791.

17 Ibid; see also *The Litsion Pride* case above n 13.

- ? The insurer's duty to exercise its rights under the contract with due regard to the insured's interests.

The Australian High Court case of *Distillers Co Biochemicals (Australia) PL v Ajax Insurance Co Ltd*¹⁸ involved a public liability policy and the obligation of the insurer to indemnify the insured against a third party. Comments were made by Stephen J which identified the duty of good faith as having a mutual impact on the contract of insurance. The insurer was bound to act with good faith towards the insured in relation to the granting or withholding of consent to admissions or settlement of a claim, where the insured was conducting its own third party litigation and not the insurer.

The implied obligation imposed on the insurer to have regard to more than its own interests when exercising its rights and powers under the contract of insurance, is perhaps most clearly seen in the well established doctrines of the United States' courts ... This duty of good faith and fair dealing must, I think, not only control the actions of an insurer who has taken over its insured's defence, but will equally apply to the insurer's exercise of its power of granting or withholding of consent to the making of admissions etc even if it elects not to take over the defence. It would I think be improper for the insurer to refuse its consent to an otherwise proper and reasonable settlement ...¹⁹

- ? The duty is a mutual one binding both parties to the insurance contract and touches any matter arising: a) under a contract that is during its existence or performance; or b) in relation to it a term which is no doubt wide enough to include negotiations leading up to its formation;²⁰
- ? The duty means that the insurance policy must be drawn in clear and unambiguous terms 'so as not to deceive and entrap the unwary',²¹

In the case of *Re Bradley & Essex & Suffolk Accident Indemnity Society* the insurance company declined to pay a workers' compensation claim on the basis that a condition precedent relating to the keeping of wage books had not been met. Farwell J said at page 430:

Contracts of insurance are contracts in which uberrima fides is required, not only from the assured but also from the company assuring. It is the universal practice for the companies to prepare both the form of proposal and of policy: both are issued by them on printed forms kept ready for

18 (1973) 130 CLR 1.

19 Ibid at 31.

20 *Distillers Co Bio Chemicals PL v Ajax Insurance Co Ltd* above n 18 at 31; Sutton K, above n 5 at 103.

21 *Re Bradley & Essex & Suffolk Accident Indemnity Society* (1912) 1 KB 415, at 433; Mullins S. 'Bad Faith', a paper presented at Western Australian Law Society Conference, Current Issues in Insurance Law (1991) at 5; Scotford T, above n 1 at 6.

use; it is their duty to make the policy accord with and not exceed the proposal, and to express both in clear and unambiguous terms... it is especially incumbent on insurance companies to make clear, both in their proposal forms and in their policies, the conditions which are precedent to their liability to pay.

A similar approach is evident in the 1932 House of Lords' decision of *Provincial Insurance Co v Morgan*.²²

I have read the policy with this in view, but I have been unable to discover how or where any obligation is imposed on the insured by this endorsement. It may be that we have here some form of commercial shorthand, which an expert could transcribe into a contractual obligation. I am unequal to the task.
(per Lord Russell of Killowen)

The insurers' appeal was dismissed.

In summary:

- ? the duty of good faith encompasses the duty of disclosure but is not limited to it;
- ? the duty of good faith commences before the policy is made via the duty of disclosure, and continues so long as the parties are in a contractual or continuing relationship with one another; and
- ? the duty is a mutual one incumbent on both parties to the insurance contract.

Whilst the common law requires the parties to treat each other with good faith this has not been reflected in Australian case law. Indeed, when the ALRC made its Report on Insurance Contracts²³ there were no reported Australian cases which applied the duty of good faith to the payment of claims. The overwhelming majority of cases have concentrated on the duty of good faith via the insured's duty of disclosure, rather than the issue of ongoing mutual good faith throughout the contract relationship.

Remedies available for breach of the duty of good faith at common law

In the past few years, courts in both England and Australia have attempted to identify the origin and nature of the duty of good faith in order to pass judgment in cases before them. 'Whilst the existence of the duty is well established, it is surprising to see that there is still much disagreement over

22 (1933) AC 240.

23 See above n 15 at para 328.

its genealogy'.²⁴ The significance of the debate is the nature of the appropriate remedies which may be granted. If the duty of good faith is viewed as an equitable doctrine, it will attract equitable remedies, yet if it is categorised as an implied term of the contract, a breach of that duty may very well sound in damages.

Recently, the English Court of Appeal, held that the power to grant relief from a breach of the duty of good faith was equitable in nature, thus a remedy of rescission of the contract only and not of damages.²⁵ That case, *Banque Financière de la Cité SA v Westgate Insurance Co Ltd*,²⁶ is an important one and warrants discussion. A person named Ballestero persuaded a syndicate of banks (the plaintiff) to lend very large sums of money to companies that he controlled. By way of security he pledged various gemstones and credit insurance policies i.e. policies providing the bank with indemnity in the event that the loans were not repaid. Those policies were issued by the defendant and included an exclusion clause avoiding liability in the event of fraud. The plaintiffs did not forward the money to Ballestero until they were satisfied that such insurances were in place. Ultimately the loans were defaulted upon. It was discovered that the security given of the gemstones was useless, and that there were no other assets in any of the Ballestero controlled companies because he had embezzled them. The bank claimed under the insurance policies and the insurance company denied liability relying on the fraud exclusion clauses. However, the plaintiff bank relied on a further act of fraud - that of a Mr Lee of the broking agency who had issued the three certificates of insurance as required by the bank. At the time of issuing the three cover notes, the second and third were fraudulent as no insurance cover existed in respect of them. The plaintiff bank forwarded the money as a result of these certificates. Subsequently, within a matter of a couple of months, Mr Lee obtained cover for the second and third layers to be placed. Mr Dungate, an employee of the insurance company, discovered the fraud, and later the defendant insurance company issued other policies, but they did not inform his employers or the bank of Lee's fraud. The bank claimed under the insurance policies but the insurance company denied liability as a result of Ballestero's fraud. Finally, the banks only realistic remedies lay against Dungate's employers for his failure to disclose the broker's fraud. The bank alleged that the duty of good faith owed towards them by the insurance companies had been breached by Dungate's material non disclosure concerning Lee. It also claimed that the insurance company had breached its common law duty of care towards it.

The second limb of the bank's claim concerned the possible liability of the insurance company toward it in tort.

24 Davis R, *The origin of Disclosure under Insurance law* 1991 ILJ Vol 4 No 1 73.

25 *Banque Financière de la Cité SA v Westgate Insurance Co Ltd* (1989) 3 WLR 25.

26 *Ibid.*

At first instance²⁷ the trial judge held that the defendants *had* breached their duty of good faith towards the plaintiff bank, but that that duty was not one implied by the insurance contract:

the body of rules which are described as the *uberrima fides* principle, are rules of law developed by judges. The relevant duties apply before the contract comes into existence, and they apply to every contract of insurance. In my judgment it is incorrect to categorise them as implied terms.²⁸

The next and most controversial part of the decision followed and concerned whether the banks could recover damages as a result of the insurer's breach of good faith. Prior to this case the only cases involving breaches of the duty of good faith involved a breach on the part of the insured party. Accordingly, in those cases the equitable remedy of rescission of the contract was an adequate remedy for the insurers. In the case before him, however, the trial judge was faced with a different circumstance. Clearly, rescission of the contract was not a remedy that the banks were seeking or would find appropriate. The judge felt that certain circumstances may give rise to an insured's rights being protected through an action for damages. The judge justified the right to award damages on the grounds that the non disclosure had induced the insured to enter into the contract of insurance.

The banks also relied upon the second limb of their claim, that the insurer was liable in damages in tort for economic loss suffered by the bank. The judge held that this was a claim open to the banks notwithstanding their contractual relationship under the policy. Again the judge found refuge in the good faith doctrine.²⁹

The existence of a duty of care is consistent with the requirement of good faith and fair dealing which ought to govern the relations between insured and insurer.³⁰

The judge rejected the proposition that a tortious liability could not arise in a contractual setting. He held that the duty could arise in a pre contractual setting, and encountered no problem in deciding that there was a sufficient proximity between the parties. The banks had to show 'that there was a manifest and obvious risk that a failure to disclose would lead to financial loss by the banks'.³¹ On the facts, the judge found that this had been established.

²⁷ *Banque Kaiser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1987] 2 WLR 1300.

²⁸ *Ibid* at 1326.

²⁹ Scotford T, above n 1 at 17.

³⁰ Above n 27 at 1341.

³¹ *Ibid*.

On appeal in the Court of Appeal,³² the decision at first instance was overturned. The court held that although there was indeed a reciprocal duty of good faith on the parties, and that that duty had been breached, the remedy did not sound in damages, but in rescission of the contract and possibly, return of the premium. Further, the court rejected the claim that the duty of disclosure was an implied term of the contract.³³ The court held that the duty of disclosure did not arise as a result of the contract but existed outside of it. It is a condition precedent to the contract in that it ceases to exist once the contract is made.

In relation to the findings of a duty of care owed in tort, the court held that no such duty was owed by the insurers to the banks.

On appeal to the House of Lords,³⁴ the decision of the Court of Appeal was upheld. However, the court held that although a duty of good faith was owed to the banks by the insurers, this duty had *not* been breached. The court held that the loss was caused not by the non disclosure of Mr Dungeate, but upon the fraud of Ballestero.

Thus, at the end of this long and complex litigation the outcome is dictated by a short point on the construction of the fraud exclusion clause as applied to a combination of circumstances of a very unusual nature which is unlikely ever to be repeated. This ground alone means the appellants fail on the issues of both duty and causation.³⁵

In relation to the issue of the duty of good faith being an implied term of the insurance contract, the House of Lords upheld the Court of Appeal decision in that regard. Lord Templeman commented that he agreed with the Court of Appeal that a breach of the duty of good faith is not an implied term of the contract and breach of that duty does not sound in damages.

The only remedy open to the insured is to rescind the contract and recover the premium.³⁶

Lord Bridge found that the duty of good faith through disclosure had not been breached by the insurers. He adopted the reasoning of Slade LJ of the Court of Appeal decision.

In our judgment, the duty falling on the insurer must at least extend to disclosing all facts that are known to him which are material either to the nature of the risk sought to be covered, or the recoverability of a claim

32 (1989) 3 WLR 25.

33 Robert Davis above n 24 at 73, argues that the Court of Appeal was incorrect in finding that the duty was an equitable one. Based on the history and development of the law relating to the duty, he claims that it is a common law doctrine rather than an equitable one.

34 (1990) 2 All ER 947.

35 Ibid at 973 per Lord Bridge.

36 Ibid at 959, 960.

under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer.³⁷

On the facts, Lord Bridge held that no question of any disclosure arose.

The result is that the questions of law so fully and carefully canvassed in both judgments below become academic. I reserve my opinion on the issues of law that the judge and the Court of Appeal differed, thinking it better that they should be resolved if and when they arise again on facts requiring their determination.

Lord Jauncey also held that the duty of disclosure was not an implied term of the insurance contract, and that breach of the same did not sound in damages.³⁸

Arguably, these findings are restricted to the duty of good faith as it relates to disclosure only, which leaves open the fairly slim possibility of an action being mounted for breach of good faith, after the precontractual stage, with the remedy sounding in damages.³⁹

In relation to the issue of the duty of care arising in tort the Law Lords more or less left the question open ended.

Lord Templeman rejected the claim that Mr Dungeat owed a duty of care to the banks to disclose the fraud of Lee.

Mr Dungeat did not by his silence assume any responsibility for the trustworthiness in the future of Mr Lee and the banks did not rely on his silence that a representation that Mr Dungeat believed Mr Lee to be honest.⁴⁰

Accordingly no duty in negligence lay to warn the other party of Dungeat's suspicions, because the fraud of Mr Lee was not the reason that the insurers were entitled to deny liability.

Lord Jauncey investigated the issue of a tortious duty owed by the parties to an insurance contract a little more thoroughly:

Any facts known to the insurer but not to the insured, which would reduce the risk, should be disclosed by the insurer. There is in general no obligation to disclose supervening facts which come to the knowledge of either party after conclusion of the contract ... In the present case the risk

37 Above n 25 at 80-81.

38 Above n 34 at 960, per Lord Jauncey.

39 Mullins S, above n 21.

40 Above n 25 at 955.

to the insured was the inability, other than by reasons of fraud, that Ballestero ... would be unable to repay the loan to the banks. Lee's dishonesty neither increased or decreased that risk ... If the obligation of disclosure incumbent upon parties to a contract of insurance could ever per se create the necessary proximity to give rise to a duty of care, a matter upon which I reserve my opinion, it is clear that the scope of any such duty would not extend to the disclosure of facts which are not material to the insured.⁴¹

Accordingly any question of proximity must relate to the relevance of the risk of the claim. It may not be sufficient to establish the necessary proximity simply by the relationship of the insurer and insured, this is a matter upon which Lord Jauncey did not commit himself.

From the House of Lords decision, it seems clear that the duty of good faith at common law is not a term of the contract but arises outside of the contract. The remedy for breach of that duty is rescission and not damages. However, concerning the matter of damages for breach of a common law duty of care owed in tort, the decision is intentionally inconclusive. The court held that on the special facts of this case, no common law duty of care arose. As to whether such a duty may ever arise, and as to whether the relationship of insurer and insured was enough, of itself, to create the necessary proximity required to create such a duty, the court did not make any commitment. The comments of both Lords Templeman and Jauncey indicate that it is possible for a tortious duty of care to arise in a contract of insurance but as to how and when that duty may arise Their Lordships remained silent. It is arguable that the House of Lords did not preclude a tort duty subject to the facts being appropriate.⁴² The trial judge's comments that a tortious duty may arise in a pre contractual setting was not expressly overruled, and therefore remains a live issue. Obviously if this eventuates through future case law the potential benefits will lie squarely with the insured parties as for them, the current remedies are woefully inadequate, as distinct from the position of the insurers.

The issue of a duty arising in tort was canvassed further in Australia: *Gibson v Parkes District Hospital*⁴³ and the duty of good faith giving rise to a cause of action in tort, breach of which may sound in damages.

The Supreme Court of NSW has confirmed that a duty of good faith may arise in Australia where there is a 'special relationship' between parties such that breach of that duty may give rise to an action in tort sounding in damages. In *Gibson v Parkes District Hospital and Government Insurance*

41 Ibid at 960.

42 Fleming J, 'Insurer's Breach of Good Faith - A New Tort' (1992) 108 LQR 357 at 359; Mullins S, above n 39 at 6.

43 (1991-1992) 26 NSWLR 9.

*Office of NSW*⁴⁴ the plaintiff instituted proceedings against her employer in relation to a Workers Compensation matter. Later she sought leave to join the workers compensation insurer alleging a breach of good faith in that party's handling of her claim. Leave was granted and the matter came on for appeal before Badgery-Parker J. The Master had granted the plaintiff leave to file an amended statement of claim to join GIO in a cause of action based on an alleged breach of the duty of good faith. The Judge approached the matter on the basis of the general principles laid down in *General Steel Industries Inc v Commissioner for Railways (NSW)*.⁴⁵ The test for determining whether the amendments to the statement of claim contained a viable cause of action is whether the defendants can show that the plaintiff's case is clearly untenable and that if the amendment were allowed it would be liable to be struck out. His Honour said:

It is acknowledged that there is no case in any Australian jurisdiction in which the cause of action now pleaded has been acknowledged ... That the proposed cause of action is novel does not compel a decision adverse to the plaintiff.⁴⁶

and earlier:

The common law has always shown itself capable of developing causes of action where justice so demands, whether by creation of new torts or the extension of well established principles to new types of fact or situation has been noted earlier, novelty is not of itself a barrier to a proposed claim.⁴⁷

Badgery-Parker J considered the body of American law which very clearly supports tortious liability, sounding in damages, for a breach of the duty of good faith.

It seems that in some jurisdictions the implied covenant of good faith and fair dealings has a statutory basis; elsewhere it is held to be implied by a doctrine of common law.⁴⁸

Upon a further review of the American, and especially the Californian, cases his Honour concluded that:

What is clear is that the duty of good faith and fair dealing is imposed by contract, but it is only the breach of that duty in a case...where a special relationship exists that gives rise to Tort liability.⁴⁹

44 Ibid.

45 (1964) 112 CLR 125.

46 Ibid at 34, 35.

47 Ibid at 23.

48 Above n 44 at 17.

49 Ibid at 18.

The judge considered the English common law position as outlined by the House of Lords in the *Banque Financière* case, and concluded that it was not open to the court to hold that a contract of insurance, (except by virtue of the ICA, which did not have relevance in this case) contains implied contractual terms that the parties will act in good faith towards each other. However, in categorising the duty as one emerging from tort law and not the law of contract, his Honour continued:

that ... the tort only arises from the breach of that duty in the presence of a 'special relationship' supports, in my view, the proposition that the tort may arise where the nature of the relationship brought about by the contract, as distinct from the terms of the contract, is such as to impose a duty to act in good faith. On that basis the duty is a true tort duty, not a contractual duty, and the existence of a contractual term is not a necessary foundation for it.⁵⁰

His Honour concluded by saying that the defendants had not convinced him that the plaintiff's amended claim would be untenable if it were allowed to stand.

This matter does not appear to have been taken to trial, and it thus remains to be seen whether such actions ultimately will be successful. It would seem, however, that they are able to be maintained as causes of action.⁵¹ Although the case falls well short of establishing a tortious duty of good faith in the Australian general insurance law, perhaps, in combination with the open endedness of the House of Lords in the *Banque Financière* case, it signals the readiness of the Australian courts, at least in some quarters, to entertain such an application. The implications of this for all parties to the insurance contract are enormous. Note that the comments of Badgery-Parker J, state very clearly that in his opinion, the relationship of insurer and insured is sufficient to create a 'special relationship'. This extends the remarks of Lord Jauncey in the *Banque Financière* case where he declined to commit himself on that very point. If a court can imply the duty in tort as a result of the special relationship of insurer and insured, the potential liability for insurers becomes great. The duty, which already exists in relation to all aspects of the relationship, may now, in breach, sound in damages in tort.

The only comments that can be made in relation to the matter of a tortious duty of utmost good faith are speculative as a result of the dearth of case law in the area. This potentially exciting area of insurance law may develop and grow in the future, at which time more meaningful comments may be made in relation to it.

50 Ibid at 46.

51 Francey N, 'A new tort based on a duty of good faith?' (1992) Australian Product Liability Reporter at 19.

Remedies for breach of the duty of good faith pursuant to the Insurance Contracts Act (1984) (Cth)

The equivocal approach of the courts to the duty of good faith at common law was examined by the Australian Law Reform Commission prior to its recommendations contained in its report in relation to insurance contracts.⁵²

This requirement (of good faith) has usually been recognised in connection with the duty of disclosure. In principle it should apply equally to all other aspects of the insurance relationship ... However, there is no reported decision in Australia applying the duty to the payment of claims. The position must, therefore, remain in some doubt. That doubt should be resolved. Legislation should make it clear that the duty of good faith applies to all aspects of the relationship between the insurer and the insured, including the settlement of claims. An insured should be entitled to recover damages for losses suffered by him as a result of the insurer's breach of the duty of good faith in relation to the settlement of a claim.⁵³

Part 11 of the ICA is headed 'The Duty of Utmost Good Faith', and contains sections 12 to 15 inclusive. There is no definition of the duty of good faith contained within the Act, and very little guidance as to its definition. Section 12 establishes that the duty is a paramount one which is not to be limited or restricted by any other law, including the subsequent provisions of the ICA. Section 14 of the Act prohibits a party from relying on a term of a contract if to do so would be to fail to act with utmost good faith. The duty of disclosure is dealt with in section 21, and section 12 makes it clear that the duty of good faith does not extend the duty of disclosure. In line with the stated concerns of the ALRC, section 13 was inserted into the Act, which makes the duty a contractual one so that it could give rise to a claim for damages for breach of the contract, particularly where an insurer failed to agree to a reasonable settlement of the claim.⁵⁴ Section 15 is worthy of mention as it makes clear that the ICA is a code dealing with insurance contracts, and any other statutory provisions that deal with 'harsh, oppressive, unconscionable, unjust, unfair, or inequitable contracts' will not apply to contracts of insurance. Section 7 preserves the rules of the common law except in so far as the act provides.

Beyond these areas the scope and operation of the duty is unclear. Sutton⁵⁵ describes it as meaning to act with 'scrupulous fairness and honesty'. It was not intended, however, to alter the general law content of

52 Above n 15.

53 Ibid at para 328.

54 ALRC Report above n 15 at paras 51, 327, and 328; Hancy G above n 7 at pages 5, 6.

55 Above n 5 at page 103.

the duty;⁵⁶ thus the preceding discussion concerning the scope of the duty at common law has relevance in relation to the duty pursuant to the ICA. The major difference between the common law and the ICA is that the Act transforms the duty into a contractual one, the breach of which sounds in damages, thereby avoiding many of the problems encountered in the *Banque Financière* cases.

Section 13 of the ICA implies the duty of good faith into the contract of insurance.⁵⁷ Accordingly, breach of the duty under the ICA, in that it is a breach of condition implied into the contract, may, unlike the common law position, sound in damages. Not only does the provision emphasise the contractual nature of the duty, but there is also a positive statement that it applies 'in respect of any matter arising under, or in relation to' the contract of insurance. This is very broad language. Thus all of the provisions under the ICA which govern the terms and operation of the contract are bound by the overriding obligation of utmost good faith. Clearly, from the comments made in the ALRC report, the duty is intended to cover the manner in which insurers deal with claims. Further, as seen from the case of *Re Bradley & Essex & Suffolk Accident Indemnity Society*⁵⁸ the duty requires good faith in the drafting of insurance proposals and policies. If there is a term in the contract which calls for compliance, but to insist upon such compliance would be to fail to act in good faith, the ICA precludes a party from relying on such a provision.

S14(1) If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision.

The insured's duty of disclosure is contained in section 21 of the ICA. So that that duty is not undermined by an allegation of breach of good faith on a more general basis it is specifically provided in section 12 that section 13 does not impose on an insured a duty other than that prescribed by section 21. Accordingly, an insurer could not argue that failure to give disclosure after the formation of the contract amounted to a breach of utmost good faith. The duty of disclosure is limited to precontractual conduct, and cannot be extended by reliance on the general terms of section 13. Thus, even though the duty of good faith continues throughout the entire duration of the insurance relationship, it does not require ongoing disclosure after the contract has been entered into. This accords with the common law position on the subject.

The essential features of the contractual nature of section 13 are as

56 ALRC Report above n 5 at para 51.

57 Section 13 reads as follows: 'a contract of insurance is a contract based on the utmost good faith, and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under it or in relation to it, with the utmost good faith'.

58 Above n 21.

follows:

- ? the remedies are available to both the insurer and the insured parties, and both parties are bound to observe the duty of good faith;
- ? in contractual terms intention is normally irrelevant when dealing with breach of a contractual term. However, in relation to good faith, intent is a necessary component. A person cannot intentionally lack good faith. Thus the duty of good faith has both a subjective and objective element. The objective element is whether the party has acted fairly.⁵⁹
- ? it is the insurer who is most exposed to breaching the duty of good faith and not the insured.⁶⁰ Once an insured party has complied with the requirements of disclosure and paid the contract premium, his major exposure to a breach of the duty of good faith involves a fraudulent claim. On the other hand, the insurer is exposed to a claim relating to an alleged breach of good faith in a number of areas. The use of the words, 'in respect of any matter arising under, or in relation to it' in section 13, referring to the insurance contract, provides ample scope for the duty to have potential application to a wide range of relations including settlement of claims, admissions and denials of liability:
 - unreasonable delay in admitting liability and paying a claim has been held to be a breach of good faith⁶¹;
 - failure to give proper explanation of the policy and its terms may amount to a breach of the duty;
 - failure to pay the claim promptly could breach the duty;
 - an allegation against the other party of a breach of good faith may in itself be a breach of the duty if the allegations cannot be substantiated,⁶² and so on.

The duty of good faith incumbent upon an insured party

The insured has a duty to act with good faith towards the insurer. Breach of this duty may sound in damages although realistically, an insurer's interests will usually be adequately served by avoidance of the contract.

Circumstances in which an insured party has been held to have breached his duty of good faith include effecting a material non disclosure or misrepresentation; releasing, diminishing, compromising or diverting the insured's rights of subrogation under the policy;⁶³ contracting out of the

59 Mullins S, above n 21 at 9.

60 Ibid.

61 *Moss v Sun Alliance Australia Ltd* (1990) 6 ANZIC 60 - 976.

62 Sutton K, above n 5 at 106.

63 *SGIO (Queensland) v Brisbane Stevedoring Pty Ltd* (1969) 123 CLR 228; *Morganite Ceramic Fibres Pty Ltd v Sola Basic Australia* (1987) 4 ANZIC 60 - 803.

insurer's subrogation rights;⁶⁴ and failing to take reasonable steps to minimise or to reduce the liability of an insurer within certain limits implied by the contract.⁶⁵ Essentially however, the ICA does not extend the insured's scope or range of duties of good faith.

In relation to non disclosure, the ICA has altered the common law. Section 22 compels the insurer to inform the insured, in writing, of the general nature and effect of disclosure. Failure to inform an insured results in the insurer not being permitted, by the ICA, to exercise any rights in respect of a non disclosure, unless that non disclosure was fraudulent.

If the non disclosure is innocent the insurer may be able to avoid the contract but must return the premiums to the insured party. The contract can only be avoided if the particular insurer (subjective test as opposed to the objective, 'reasonable insurer' test) would have refused to accept the risk had the material fact been disclosed (section 28). If that insurer would not have refused to insure the risk then the policy is dealt with as if it were drawn on the terms that *would* have been included had the material fact been disclosed.

The importance of sections 12-14 is enormous. First, it is made clear that the paramount obligation of both parties to the contract is to act towards the other with utmost good faith. Secondly, the legislation states that the duty arises in respect of any matter under, or arising out of the insurance contract (section 13) which gives the potential application of the duty an extremely large scope. Thirdly, there is implied into all contracts of insurance under the ICA a provision requiring the contracting parties to act with utmost good faith.

The paramountcy of this duty in the relationship dictates that in the factual situation which necessitates a choice, between a strict application of a contractual term and the duty to act with utmost good faith, the latter must prevail.

In light of this paramount obligation to observe good faith, the latitude extended to fraudulent insureds is surprising.⁶⁶ For instance, even in those situations where an insurer is entitled to avoid a contract for fraudulent misrepresentation or non disclosure (section 28(2)), the fraudulent insured may still be protected. Section 31(1), (2) of the ICA gives the court discretion to disregard avoidance if it would be harsh and unfair not to do so and the insurer has not been significantly prejudiced by the failure or misrepresentation. In the exercise of his discretion the judge must

64 *Morganite Cement* case *ibid*.

65 *Newnam v Baker* [1989] 1 Qd R 393, Sutton K, above n 5 at 106.

66 Tarr A, *Insurance law and the consumer* (1989) 1 BondLR 79 at 88.

'juggle and weigh these hairy coconuts'⁶⁷ and, in addition, have regard to the need to deter fraudulent conduct and must weigh the extent of the culpability of the insured in the fraudulent conduct against the magnitude of the loss that would be suffered by the insured if the avoidance were not disregarded (section 31(3)). As well, pursuant to section 31(1), the amount recoverable lies within the court's discretion as instead of allowing recovery for the whole amount, the court may give judgment for part of the amount as it considers just and equitable.

Section 31.

(1) In any proceedings by the insured in respect of a contract of insurance that has been avoided on the grounds of fraudulent failure to comply with the duty of disclosure or fraudulent misrepresentation, the court may, if it would be harsh and unfair to do so,...disregard the avoidance and, if it does so, shall allow the insured to recover the whole, or such part as the court thinks just and equitable in the circumstances, of the amount that would have been payable had the contract not been avoided.

...

(3) In exercising the power conferred by sub section (1), the court -
(a) shall have regard to the need to deter fraudulent conduct in relation to insurance, and
(b) shall weigh the extent of the culpability of the insured in the fraudulent conduct against the magnitude of the loss that would be suffered by the insured if the avoidance were not disregarded.

With respect to misstatement of age in relation to life insurance, section 30 of the ICA provides that there is to be no avoidance of the contract, even if the misrepresentation was fraudulent. Instead, a retrospective adjustment is to be made according to a formula provided in the Act, and the amount decreased accordingly. The outcome is to substitute for the benefits provided under the contract, an amount that is reasonable given the true age of the insured party. Naturally this sum takes account of the increased premiums that should have been paid over the period.

A further example may be found in the effect of section 56(2) of the ICA. This subsection provides:

In any proceedings in relation to a (fraudulent) claim, the court may, if only a minimal or insignificant part of the claim is made fraudulently and non payment of the remainder of the claim would be harsh and unfair,

⁶⁷ Ibid. Taken from a paper delivered by Callaghan, 'The new insurance legislation', Law Society of South Australia, April 1985.

order the insurer to pay, in relation to the claim, such amount (if any) as is just and equitable in the circumstances.

This provision was included as a result of the ALRC recommendations.⁶⁸ In its report the Commission acknowledged that fraud had to be discouraged but considered that 'a rule that fraud in respect of one claim taints another claim under the same policy can operate most unevenly between an insured with a number of separate policies and one with a composite policy covering numerous risks'.⁶⁹ Where an insured's fraud was seriously disproportionate to the harm which the insured's conduct has or may have caused, a court should be entitled to order an insurer to pay that amount that is just and equitable in the circumstances.

Tarr states that there are some 'totally irreconcilable positions adopted by the *Insurance Contracts Act* (1984) (Cth). A paramount obligation on the parties to observe utmost good faith ... does not sit (even uneasily) with a judicial discretion to excuse fraudulent claims, non disclosure, or misrepresentation, or a provision that precludes an insurer from avoiding a life insurance contract for fraudulent misstatement as to age'.⁷⁰ Conversely, the Act does introduce a certain amount of flexibility and judicial discretion in circumstances where it would be inequitable to allow the insurer to cancel a policy for 'minor and trivial frauds'.⁷¹ Hope is expressed that the case law in this area will not reflect too liberal an interpretation of 'just and equitable' in favour of the insured, as fraud on the part of either party should be actively discouraged.⁷² It is argued that the Act already affords much protection to insureds, and that there is no need for 'strained constructions'⁷³ in order to adequately protect the interests of insureds.

The duty of Good Faith incumbent upon the insurer

It is upon the insurer that the brunt of the weight of the duty of good faith falls. The breadth of the wording of section 13 potentially incorporates the duty of good faith into most aspects of dealing with the insured party, including policy wording, notification, claims handling, and settlement conduct. Apart from section 13, the ICA has specifically set out some of the duties incumbent upon an insurer which could otherwise be dealt with under section 13 and the duty of good faith.

At common law it was established that an insurer must have regard to

68 Above n 5 at 243.

69 Ibid.

70 Tarr A, above n 11 at 89.

71 Ibid.

72 Ibid.

73 Hancy G, above n 7 at 28.

the rights when exercising any rights or obligations under the contract of insurance. Likewise, the insured was to act with utmost good faith in achieving a settlement.⁷⁴ The ICA has supplemented these common law rules with section 14.

S14.

- (1) If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on that provision;
- (2) Subsection (1) does not limit the operation of section 13;
- (3) In deciding whether reliance by an insurer on a provision of the contract of insurance would be to fail to act with the utmost good faith, the court shall have regard to any notification of the provision that was given to the insured, whether a notification of a kind mentioned in section 37 or otherwise.

Subsection 1 of the section precludes a party from relying on the terms of a contract if to do so would be in breach of the duty of good faith. A relevant factor in this regard is whether the insurer has brought to the attention of the insured the particular provision sought to be relied upon - presumably before or at the time the contract was entered into.⁷⁵ Presumably the rationale behind section 14(3) is that the insurer should be given credit, which may negate any allegation of bad faith, if the actual term has been brought to the insured's attention prior to seeking to rely upon it.

A fairly recent illustration of the operation of this subsection may be found in the case of *Australian Associated Motor Insurers Ltd v Ellis*.⁷⁶ In that case there was a contract of insurance taken out in respect of a motor vehicle. It was a term of that contract that any modifications to the vehicle should be communicated to the insurer prior to being installed and consent for those modifications should be obtained from the insurer on pain of refusal of indemnity for any loss. The insured party put mag wheels on to his car without obtaining the consent of the insurer, and without even notifying the insurer of this modification. Damage was caused to the car when it was driven by a person under the age of 25 years. The loss was not causally related to the modifications. Section 54 of the Act came into play entitling the insurer to reduce its loss under the policy to the extent that it was prejudiced by the breach. On the facts, it was held that the insurer's liability could be reduced to nil as with the modifications it would have refused to indemnify against any loss if the driver was under 25 years of age. Nevertheless, the insurer was held liable to indemnify the insured as it had

⁷⁴ Sutton K, above n 5 at 106.

⁷⁵ Sutton K, above n 5, notes that the term 'notification' in section 14(3) is not defined. This should be compared with section 37, which deals with the duty of notification in relation to unusual terms in a contract of insurance. Those terms are described to mean 'not usually included in contracts of insurance that contain similar cover'. Section 11(11) defines notification in relation to section 37 as being before or at the time that the contract was entered into.

⁷⁶ (1990) 6 ANZIC 60-957.

failed to act with utmost good faith towards the insured. Cox J held that section 13 required the insurer to bring to the attention of the insured the details of any conditions that operated after the contract was entered into and which had the effect of allowing it to refuse to indemnify the insured. It was conceded that the particular term was not so unusual in similar insurance contracts, but that the combination of sections 13 and 14(3) led to the obligation of good faith on the part of the insurer to notify the insured party of the term. His Honour equated the duty contained in section 22 of the Act with the duty contained in subsection 14(3). Section 22 relates to the duty of the insurer to clearly inform the insured in writing of the nature and duty of disclosure. Section 13 thus imports into section 14(3) the duty to give adequate warning of the nature and consequences of any obligation to give disclosure after the formation of the contract. That obligation was not discharged by including the details of the clause on the proposal and policy documents.⁷⁷ As a result, reliance could not be placed by the insurer on the breach of the condition.

Sutton⁷⁸ believes that the decision gives subsection 14(3) an extended operation and is of great consequence. It would seem to require that the effect of a breach of *any* condition is to be explained to the insured, presumably at the time of entering into the contract. Section 14 is primarily aimed at insurers. Pursuant to the recommendations of paragraph 51 of the ALRC report⁷⁹ the section seems to envisage that insurers will take care with the wording of their policy documents so as to avoid any unfair practices.

A more recent case dealing with the insurer's duty of good faith *Kelly v New Zealand Insurance*⁸⁰ has recently been heard in the Supreme Court of Western Australia before Walsh J. The plaintiff insured was an antiques dealer who insured the contents of his home with New Zealand Insurance. The sum insured was \$500,000. The policy provided, inter alia, that any items of fine art, paintings, works of art, antiques or curios, were limited to \$1000 per item up to a maximum of \$5000 per event. This proviso could be avoided if the insured listed relevant items for the insurer. Subsequently, the property of the insured was burgled and several items stolen. The insured lodged a claim which was denied by the insurer relying on the grounds including: (a) that the insured had failed to supply the insurer with a list of specified items of value which thus brought into play the proviso limiting the insurer's liability to \$1000 for any item up to a maximum of \$5000; and (b) that the insurer was prejudiced by the insured's failure to supply the list because it had been deprived of the opportunity, before accepting the risk, of carrying out valuations and ensuring adequate security was in place at the insured's property.

77 Ibid at 76,329 - 331.

78 Above n 5 at 482.

79 Above n 15.

80 (1993) 7 ANZIC 61-197.

The insured argued that the insurer, by purporting to rely on the proviso, had breached section 13 of the ICA, and that it was not entitled to do so by virtue of section 14. Additionally, the insured argued that section 54 of the Act had relevance and that the failure to specify items constituted an 'act' to which section 54 applied. The insured argued that the insurer was precluded from relying on that 'act' (omission) except to the extent that the liability in respect of the claim was reduced by an amount that fairly represented the extent of the insurer's interests that were prejudiced as a result of the act. Further, the insured claimed that the insurer had suffered no 'prejudice' such as was contemplated by section 54. The insurer had knowledge that the contents of the insured's house contained artwork and antique items worth more than \$1000 per item and that it had accepted further premiums from the insured and increased his cover.

It was held that the defendant insurer had not failed to act with good faith although the insurer had increased the cover and accepted further premiums with full knowledge that the list had not been received, and with an appreciation of the contents of the insured's house. The insured did not act contrary to the duty when it relied upon the exclusion clause, and refused to pay the claim in full. On the facts, his Honour accepted that the insured was aware of the proviso and that the existence of the clause was specifically brought to his attention on several occasions, in both verbal and written communications.⁸¹

In relation to the operation of section 54, it was held that the insured had not brought himself within the ambit of the section.

It is my opinion ... that the defendant, in the present circumstances did not seek to deny liability under the policy because of the failure of the plaintiff to do something, but because the plaintiff did not elect to extend the scope of the cover pursuant to the relevant clause in the policy.⁸²

The result was that the insurer was not liable under the policy and the insured's claim accordingly failed.

This case is helpful - not least in determining the ambit of section 54 of the Act. This gives some indication as to the way that courts may construe an insurer's obligations of good faith according to the ICA, or, conversely, 'excuse' an act or omission of the insured notwithstanding demonstrated good faith on the part of the insurer. His Honour may have construed section 54 narrowly in order not to penalise the defendant insurer who had done more than could be reasonably expected to draw to the plaintiff's attention the relevant proviso. Arguably, the interpretation of the section is technical and could have been as convincingly construed to include the plaintiff within its ambit. It may be that in the future, if a similar

81 Ibid at 78,257.

82 Ibid at 78,249.

factual situation differed in that an insurer did *not* take such comprehensive steps to alert an insured party to such a proviso, a case may be made out that the insurer had failed to act towards an insured with utmost good faith, and consequently, the scope of the operation of section 54 would have a much reduced impact. The concerns that courts may interpret the provisions of the ICA unrealistically in favour of insureds⁸³ appear not to have materialised in this instance.

The case was ultimately decided on its own facts and, in part, illustrates the relationship between the 'flowering liberal tradition' of the Mansfield era as exemplified by provisions of the ICA, and common law positivism, as discussed earlier in this paper. The facts showed that the insured was informed on more than one occasion, and in very clear terms, that it was in his best interests to provide the defendant with an itemised list of valuables. The insured omitted to do so. Consequent upon this, the insurer was entitled to rely on the exclusion clause and to refuse to indemnify the insured in whole even though the effect of doing so may be seen to be somewhat harsh on the insured.

Appeal papers have been lodged in this matter and the Full Court will hopefully expand upon and further clarify this potentially growing and yet still relatively embryonic, field of litigation.

Section 37 of the Act, as previously mentioned in relation to section 14, requires the insurer to give notice of any unusual terms contained in the contract. It does seem, from the small amount of case law in this area, that the insurer can rely on any terms, unusual or not, if it has clearly informed the insured, in writing, of the potential effect of them.

Although beyond the scope of this paper, the provisions contained in section 71(1) of the Act should be noted. In brief, that section provides that if the contract of insurance is arranged by an insurance broker not acting as agent for the insurer, provisions under the Act, relating to the giving of notice to an insured, have no effect on the insurer. This raises many interesting issues as to the relationship between sections 14(3), 13, and 71(1). Ultimately, the court needs to be satisfied that the insured has become aware of certain provisions of the insurance contract. To that end, it may be that:

the insurer is not content, in order to preserve his good faith status, to rely on the efficiency of the broker, in notifying a provision, whether it be unusual or not, to the insured. Providing an Australian insurer makes every effort to get the terms of the insurance policy into the mind of the Australian insured, then it is suggested that it would be difficult for an insured to argue that a particular provision that he did not actually know

83 Hancy G, above n 7.

about could not be relied upon by the insurer on the basis that such reliance would constitute bad faith.⁸⁴

Tort and the duty of good faith under the ICA

The final dimension of exposure to insurers which has a connection to the duty of good faith is the extent to which a general duty of care exists in relation to contracts of insurance.

The concept of liability in tort for breach of the duty to act in good faith is far more developed in America than it is in Australia. In California, the law has actually codified the number of practices which may give rise to a tortious liability.⁸⁵ These include:

- ? misrepresenting to insureds relevant insurance policy provisions pertaining to the coverage at hand;
- ? failing to acknowledge and act promptly upon any communications relating to claims under insurance policies;
- ? failing to confirm or deny within a reasonable time after appropriate proof of loss requirements have been submitted by the insured, whether the insurance company will accept or deny liability;
- ? not attempting to effect a fair and equitable settlement in good faith after the issue of liability has become clear;
- ? attempting to settle a claim for less than what a reasonable person would have believed he was entitled to by reference to materials provided with or forming a part of the contract of insurance; and
- ? failing to provide a prompt response concerning the basis in law upon denial of a claim or offer of settlement.

In Australia, it is appropriate to consider the ALRC recommendations concerning the scope of section 13. The ALRC specifically considered the American position and the potential for damages in tort to be awarded on the basis of bad faith,⁸⁶ and concluded that 'it is doubtful that such an extension (to include a potential tortious liability) would be desirable'. The Commission felt that the main reason that the American courts introduced a tort of bad faith was to 'enable an insured to recover punitive damages and damages for mental distress. Punitive or exemplary damages are awarded only rarely in Australian courts ... The mere introduction of a tort of bad faith in Australia would not add substantially to the remedies available to an insured.'⁸⁷

84 Scotford T, above n 1 at 24.

85 Mullins S, above n 21.

86 ALRC Report, above n 15 at para 327 and 328.

87 Ibid para 328.

In light of the apparent intent of the Commission it is doubtful whether a tort of bad faith does or will co-exist with the contractual duty implied by section 13. Furthermore, 'the 'necessary intendment' of section 13 seems to favour contractual boundaries for the duty, so that section 7 may not allow the common law duty to co-exist in relation to the precontractual setting. This is debatable'.⁸⁸

Even given the comments of the ALRC, there appears to still be scope for a duty founded in tort to arise in those situations where the court considers that there is an area of damages that should be awarded to an insured party but which cannot be awarded within contractual parameters. Perhaps the reference to punitive and exemplary damages made by the ALRC gives some guidance on this. In any instance where a court feels that such damages are appropriate and yet not recoverable in contract, the tortious duty may arise. Mullins⁸⁹ maintains that an important factor which will ultimately determine whether the tort of bad faith is recognised in Australia or not, is the extent to which a plaintiff would thereby be entitled to recover damages that are not recoverable under contract law.

Conclusion

Both at common law, and pursuant to the ICA, changes are being wrought to the law relating to the duty of good faith.

At common law, it now seems settled - at least in relation to precontractual matters - that the duty of utmost good faith is not a contractual term. Although some commentators feel that there may be a slim possibility that any post contractual dealings may properly be classified as contractual in nature,⁹⁰ case law subsequent to the *Banque Financière* cases all seem to accept the non contractual nature of the doctrine. Accordingly, the remedy for breach of utmost good faith at common law is rescission of the contract and, in some cases, the return of premiums.

As the duty relates to tort, however, the field appears more wide open. The House of Lords in the *Banque Financière* case left open the suggestion that the duty of utmost good faith may be based in tort, and that breach of the same would sound in tort, depending on the proximity of the relationship between the parties, and also the materiality of the matter in dispute (in that instance the materiality of the non disclosure by Lee). Whether the mere relationship of insurer and insured was sufficient to create that proximity was not ruled upon. The matter was taken further by Badgery-Parker J in the *Gibson v Parkes District Hospital* case. His Honour

88 Scotford T, above n 1 at 22.

89 Above n 21 at 15.

90 See above n 39.

decided that in fact it would be sufficient proximity that the parties were in the insurer, insured relationship. The limitations of that case have been noted earlier in this paper. However, the case is of predictive value and actual outcomes will become apparent only as more cases are brought before the courts pleading damages for breach of the duty of good faith sounding in tort.

Section 13 of the ICA undoubtedly entitles parties to a contract of insurance to obtain damages as a result of the breach of the duty. The onus to ensure that the duty is properly observed appears to fall squarely on the insurers as it is on their shoulders that the greatest potential for breach of the duty falls. Care must be taken by both parties in relation to all aspects of the contract relationship that utmost good faith is adhered to.

In relation to tortious liability for breach of the duty, the possibility still exists that this might be recognised by Australian courts if the remedies available in contract are inadequate in all the circumstances. Again, as in the common law situation, more case law is required before meaningful comments can be made about the future of the doctrine.

The potential for claims based on the duty of good faith is great. The very small number of cases that have been brought before the courts in relation to the duty indicate that either there are very few problems being experienced by parties to insurance contracts, or that parties, and their legal advisers, are largely unaware of their expanded rights and obligations either at common law or pursuant to the ICA.