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DUTY OF DISCLOSURE

Introduction

The full bench of the Federal Court has recently considered the circumstances in which an insurer is entitled to reduce its liability to indemnify an insured to nil as a consequence of the insured's non disclosure and misrepresentation. The decision[1] underlines the importance of disclosure of matters relevant to an insurer's assessment of the risk the subject of the proposed cover but also the importance of an insurer having clear guidelines so it can establish that it would not have entered into the contract if the non-disclosure have not been made.

Facts

The appellant, Sagacious Legal Pty Limited (**Sagacious**) took out a policy of motor vehicle insurance with Wesfarmers General Insurance Limited (**Wesfarmers**). The policy was issued under a binder by an underwriting agency, Prestige Car Insurance Pty Limited (**Prestige**) The wife of a director of Sagacious was the nominated driver (**Mrs O'Shanassy**) of the motor vehicle.

Mrs O'Shanassy drove the motor vehicle after consuming a significant quantity of alcohol. The motor vehicle left the road, hit some trees and overturned. It was a write off. Fortunately, Mrs O'Shanassy sustained only light to moderate injuries.

Sagacious made a claim on the Wesfarmers' policy for the full value of the motor vehicle.

The insurer declined the claim.

At first instance

At trial[2], the insurer argued that it was entitled to decline indemnity on the ground that, amongst other things, Sagacious had failed to disclose the cancellation or suspension of Mrs O'Shanassy's driver's license in 1999. This failure to disclose and/or misrepresentation was a breach of the duty of disclosure pursuant to section 21 of the *Insurance Contracts Act* 1984 (Cth) (**Act**).

Section 21 of the Act requires an insured to disclose every matter that it knows, or reasonably could be expected to know in the circumstances, would be relevant to the insurer's decision whether to accept the risk and enter the contract.

The proposal form completed by Sagacious in 2004 required the disclosure of previous license disqualifications of the nominated driver. There was no temporal limit in respect to this question in the proposal form. Sagacious argued that on a proper construction of the proposal form its duty was limited to a disclosure of any offences or of disqualifications within the last three years of the date of proposal form.

Importantly, under the terms of its binder Prestige was required to decline cover for any nominated driver in circumstances where the driver had more than one conviction for driving under the influence or had their license cancelled or suspended more than once.

In fact, Mrs O'Shanassy had been disqualified from driving twice for being under the influence of alcohol (in 1999 and 2002), but only disclosed one of those convictions in the proposal.

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[1] Besanko, Perram and Katzmann JJ (*Sagacious Legal Pty Limited v Wesfarmers General Insurance Limited* [2011] FCAFC53)

[2] Rares J (*Sagacious Legal Pty Limited v Wesfarmers General Insurance Limited (4) [2010] FCA482)*

At trial there was a credit contest between Mrs O'Shanassy and Prestige as to whether Prestige had informed Mrs O'Shanassy that she need only disclose convictions falling within a prior three year period. The trial judge found in favour of Prestige and so the insurer in respect of this issue.

In summary, the trial judge held that Sagacious knew, or a reasonable person in its position would have been expected to have known, that the omission of the 1999 conviction would have been relevant to the decision of the insurer to accept the risk of Mrs O'Shanassy as a nominated driver. In those circumstances, Justice Rares was of the view that the insurer was entitled to reduce its liability to nil as a consequence of the non disclosure and/or misrepresentation because the insurer would have rejected Mrs O'Shanassy as a nominated driver if full disclosure had taken place.

His Honour also found that an exclusion in the policy for damage caused by a driver under the influence of intoxicating liquor was activated. However, for the purposes of this article we intend to focus only on the issue of duty of disclosure.

Sagacious appealed to the full bench of the Federal Court.

Full bench of the Federal Court

The full bench of the Federal Court upheld the trial judge's determination. The full bench held that:

- there was no temporal limit in respect to the question in the proposal form '*have you or any nominated driver been charged or convicted in connection with intoxicating liquor or drug*.' The full court could not identify any reason to import a time limit into the question and in fact such a time limit was inconsistent with it;
- Sagacious' misrepresentation was not excused pursuant to section 26 of the Act. That section operates where a statement was made by a person which was in fact untrue, but which was made on the basis of a belief that a reasonable person in the circumstances would have held. The evidence adduced at trial did not establish that Sagacious held any such belief. In short, it was found that Sagacious knew that the earlier conviction was relevant to the insurers' consideration of accepting the risk or not. Sagacious instead gave the impression that a full driving history had been disclosed by disclosing the 2002 conviction only; and
- Sagacious' argument that its answers were '*obviously incomplete'* and therefore, either the insurer had waived compliance with the duty of disclosure under section 21 of the Act, or the answers were not misrepresentations of by reason of section 27 of the Act was without merit. Section 27 provides that an obviously unanswered, incomplete or irrelevant question is not a misrepresentation. The Court did not think that the answers were obviously incomplete and they considered that, as Sagacious had disclosed one conviction, it was open to the insurer to assume that Mrs O'Shanassy's full driving record had been disclosed.

It is interesting to compare the outcome in this case to the outcome in *Dawes Underwriting Australia Pty Ltd v Roth*.[3] In *Roth*, the New South Wales Court of Appeal considered similar circumstances arising from an insured's failure to fully disclose a bad driving record. Despite the insured's failure, the Court of Appeal considered that the insurer was not entitled to decline indemnity.

The brief facts in *Roth* are that the insured had provided details of his driving record over the telephone and subsequently completed a proposal form which was inconsistent with his verbal account of his driving record. The insurer did not query or follow up the inconsistencies. The Court of Appeal considered whether the insurer would have entered into the insurance contract upon the same terms and conditions if the non disclosure had not taken place. It was found that the insurer would have done so and this activated section 28 of the Act (which prevents an insurer from relying upon non disclosure to decline indemnity if the insurer would have provided cover if full disclosure had taken place). The important distinction between the *Roth* and *Sagacious* decisions is that the underwriting agent in Sagacious was required to decline cover to a nominated driver who had more than one conviction. The court accepted

[3] *Dawes Underwriting Australia Pty Ltd v Roth* [2009] NSWCA 152

that, had full disclosure been made by Sagacious, cover would not have been provided to Mrs O'Shanassy.

Observations

The duty of disclosure is crucial from an insurer's perspective as it allows the insurer to properly assess and value the risk that it is being asked to cover. This is a favourable decision for insurers because it is authority for the proposition that the courts should not read time limitations into questions in proposal forms where on the proper construction of the question no such limitation exists. Further, insurers should be alert to discrepancies in the proposal information provided by insureds and query any inconsistencies if they wish to avoid the application of section 28 of the Act.

From the perspective of insureds, this case is a timely reminder that insureds should err on the side of caution and disclose all factors which they consider relevant to the insurer's assessment of the risk sought to be covered. It should be noted that in this particular case, the insured was ultimately ordered to pay indemnity costs to the insurer on the basis that the insured had acted unreasonably in the conduct of the litigation (by pressing an untenable claim) and by not accepting a walk away offer.

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