Submission on *Exposure draft Insurance Contracts Bill*

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Submission on the Insurance Contracts Bill Exposure Draft

Dr Simon Connell

Contact Privacy of natural persons

About me

I am a legal academic at the University of Otago, Faculty of Law. My research and teaching focus on contracts and accidents. I have taught the elective paper on insurance law for the last three years and taught contract law for around ten. I am writing from my perspective as a legal academic and also as a consumer of insurance. Please feel free to contact me if it would be helpful for me to elaborate on any aspects of this feedback.

Broad support for new Act and reforms

1. I am broadly supportive of both the introduction of a new Insurance Contracts Act, and the reforms contained in the Bill.
2. It is preferable to have as much of our statutory insurance law in one place as possible. A new Act is an improvement on law scattered through several Insurance Law Reform Acts. This should make teaching insurance law easier and also make it easier for policyholders, who could inadvertently miss important features of insurance law if they are not looking at the relevant statute/s. Several of my comments below are from the point of view that the statute should be accessible to policyholders, including consumers, and not exclude important aspects of insurance law.
3. I am supportive of the reforms to both the content of, and remedies for breach of, what the draft calls "disclosure duties".
4. I support the replacement of the current duty for consumers with a duty to take reasonable care to avoid making a misrepresentation for consumer insurance contracts.
5. I support the replacement of the current duty for non-consumer insurance with a duty of fair presentation of risk for non-consumer insurance contracts.
6. In my view these reforms strike a fair balance in that they respond to the asymmetry of information faced by insurers without imposing unrealistic expectations on policyholders.
7. In my view the new remedies provisions provide a more proportionate response than the current law.

Codification of the duty of utmost good faith

1. In my view, there is considerable uncertainty over the effect of cl 59 in the draft.
2. Since other Parts of the draft replace the current "utmost good faith" duties in relation to pre-contractual disclosures and representations, and provide new ones, cl 59 must do something else. But what exactly it does is unclear.
3. Subpart 7 is headed "Duty of utmost good faith" and cl 59 is headed "Duty of utmost good faith". However, the wording of cl 59 does not expressly impose any duties or provide for remedies for breach of duties.
4. The government agreed that "that the duty of utmost good faith be codified in legislation and will apply to both parties in an insurance contract".

5. In the context of insurance law, "the duty of utmost good faith" is sometimes used to refer specifically to obligations in relation to pre-contractual disclosures and representations (with the corresponding remedy of total avoidance). In theory, this duty applies to both parties, although it is relatively rare for a policyholder to establish a non-disclosure or misrepresentation by the insurer (and the remedy of total avoidance is often undesirable for policyholders).[1] The draft only expressly imposes "utmost good faith" duties in this sense on policyholders. One possible effect of cl 59 is to preserve the insurer's current disclosure obligations.
6. The "duty of utmost good faith" can also be used to refer to the idea that there is a general obligation to act in utmost good faith (sometimes expressed as an obligation to act in "good faith") that applies to both parties of an insurance contract. This approach was articulated by Gendall J in the High Court in *Young v Tower Insurance Ltd*:[2]

> [A] duty of good faith on the part of the insurer is implied in every insurance contract. It must, as I see it, be a necessary incident of these contracts (long said to be contracts of utmost good faith) and an obligation that flows both ways. To suggest otherwise would make no sense. And in my view, this duty extends beyond a mere obligation on the insurer and the insured of continued disclosure…

7. However, the Court of Appeal recently took a more conservative approach in *Taylor v Asteron Life Ltd* and then *Southern Response Earthquake Services Ltd v Dodds*,[3] expressed thus in the latter case:

> We would however observe that *it does not follow from the fact that a contract of insurance can be described as a contract of good faith that there is an implied term of good faith in every insurance contract, that applies across the board to all aspects of the parties' dealings in connection with the contract*. To the contrary, the authorities suggest that the obligations that one party owes the other are context-specific. For example, an insured must not act dishonestly in connection with the making of a claim. We consider that it is likely to be more productive to consider what obligations are implied by law, or can be implied as a matter of fact, in relation to particular aspects of the dealings between the parties.

8. In other words there is no general duty of good faith in all insurance contracts, although the courts have recognised various specific duties that insurers and policyholders owe.[4]
9. The difference between these two approaches is not academic. Under the former approach, to establish a breach, policyholders need only show that an insurer's conduct is contrary to good faith. That can then lead to remedies for breach of contract.
10. Under the latter, policyholders seeking a remedy will normally need to establish that the insurer's conduct falls within a previously recognised category of breach of insurer's obligations, such as that the insurer has failed to pay an established claim promptly,[5] or has made a misrepresentation or engaged in misleading conduct.[6]

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[1] See *Colinvaux's Law of Insurance in New Zealand* at 34.4.8.1.
[2] *Young v Tower Insurance Ltd* [2016] NZHC 2956 at [163].
[3] *Southern Response Earthquake Services Ltd v Dodds* [2020] NZCA 395 at [194]. Emphasis added.
[4] See Neil Campbell "The Scope of an Insurer's Post-Contractual Duty of Good Faith" (2016) 27 ILJ 185.
[5] *State Insurance v Cedenco Foods Ltd* Court of Appeal, 6/8/1998, CA216/97.
[6] The plaintiffs in *Southern Response v Dodds*, to whom the insurer had failed to disclose information in the claim settlement process, established liability for misrepresentation (under the CCLA) and misleading conduct (under the Fair Trading Act).

11. If the intention is that the new Insurance Contracts Act provides that there is a general duty to act in good faith for the duration of an insurance contract, for which insurers or policyholders may seek a remedy, I do not consider that the wording of cl 59 clearly achieves that. The current wording ("A contract of insurance is a contract based on the utmost good faith") could be read as consistent with either approach.
12. If the intention is to provide for a general good faith duty, this could be achieved by clearer wording, such as:

59 Duty of utmost good faith

(1) Insurers and policyholders must, during a contract of insurance between them, deal with each other in good faith.[7]

(2) A breach of this duty is a breach of contract.

13. This would make it clear that a general good faith duty is being imposed, and that the remedies available are those for breach of contract.

Codification of the fraudulent claims rule

14. The fraudulent claims rule is a well-established feature of insurance law. Under the fraudulent claims rule, if a policyholder makes a claim that is dishonest the insurer is entitled to decline to the claim.
15. Under the rule, where a claim is dishonest in part, the insurer can decline the whole of the claim. For example, a policyholder makes a claim under their contents insurance after a fire, and fraudulently claims that they owned a new television. The insurer can decline the whole claim, including for items genuinely lost in the fire.
16. Like the remedy of total avoidance for a breach of pre-contractual utmost good faith duties, this is a unique feature of insurance law which goes further than the usual remedies for breach of contract or misrepresentation, in a way that is favourable to the insurer.
17. The content of the fraudulent claims rule is relatively well-settled.
18. One contentious point has been whether the rule applies only when the policyholder is dishonest about a matter that is material to their claim. That is, whether a collateral lie still allows the insurance to decline the claim. A 4:1 majority of the United Kingdom Supreme Court found that the rule only applies to material dishonesty and not collateral lies.[8] The New Zealand Court of Appeal in *Taylor v Asteron* adopted the same position.[9]
19. However, the legal basis for the rule is not settled in New Zealand. As the Court of Appeal put it in *Taylor v Asteron*:[10]

> [T]here is considerable uncertainty about the nature and source of the insured's obligation, in the absence of any express term in the policy. Is there an implied term to this effect? If so, is that implied term an essential term for the purposes of s 37 of the CCLA [Contract

[7] "must deal with each other in good faith" is used in the Employment Relations Act 2000, s 4(1)(a). That section provides an extended definition of "good faith", which would be an alternative approach that could be taken in the Insurance Contracts Act.
[8] *Versloot Dredging BV and another v HDI Gerling Industrie Versicherung AG and others* [2006] UKSC 45.
[9] *Taylor v Asteron* at [109], although materiality of the dishonesty was not a significant issue in the case the way it was in *Versloot*.
[10] *Taylor v Asteron* at [100].

> and Commercial Law Act]? Alternatively, is the fraudulent claims rule a freestanding common law or equitable rule? If so, what are the consequences of a breach of that rule — in particular, is the policy voidable prospectively or retrospectively? Or is this rule one aspect of a broader common law or equitable principle that the parties to insurance contracts owe each other a duty of utmost good faith? And, if so, what are the consequences of a breach of that broader duty?

20. As the paragraph quoted above indicates, the legal basis for the rule is not a purely academic question. If it imposes a contractual duty then it interfaces with remedies for breach of contract, including cancellation under the CCLA. If the basis of the rule is a common law or equitable obligation, different rules may apply.
21. The introduction of an Insurance Contracts Act is an opportunity to provide greater clarity over both the legal basis and the content of the fraudulent claims rule.
22. The alternative to codification is to allow the courts to continue to develop the fraudulent claims rule. The proposed codification of utmost good faith could be used to argue that the legal basis of the rule is statutory,[11] but unless the statute sets out the content of the rule it would still be open to the courts to develop it.
23. Codification is preferable, because:
    a. It would remove any doubt over the legal basis for the rule;
    b. The content of the rule is already reasonably settled; and
    c. The fraudulent claims rule is a significant feature of insurance law, which policyholders would have to find out about from a source other than the Insurance Contracts Act were it not codified.
24. I recommend codification along the lines of the formulation provided by the Court of Appeal in *Taylor v Asteron*, that is:[12]
    a. Impose a duty on policyholders to be honest when making claims;
    b. The performance of that duty is deemed to be essential for the purposes of s 37(2)(a) of the CCLA (which allows the insurer to cancel the contract); and
    c. Provide a remedy for the insurer where a policyholder has breached this duty by making a claim that is false in some material respect, specifically that the insurer can decline the whole of the claim.
25. The final part of this formulation is necessary because cancellation under the CCLA is prospective and does not automatically allow the insurer to decline the whole of the claim; an insurer would need to ask the court to grant relief to that effect under CCLA s 43.
26. Codification of the duty would also mean consideration could be given to:
    a. Imposing upon insurers a duty to warn consumers of their obligation to be honest when making claims, and the potential consequences of not doing so, as is done in relation to disclosure duties in cl 55 (and limiting the insurer's access to the remedy of total declinature if they have failed to do so); and
    b. Prohibiting insurers from contractually providing for a more onerous version of the rule. Currently, an insurer could provide contractually for a version of the fraudulent claims rule that was triggered by collateral dishonesty.[13]

"Increased risk exclusions"

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[11] See *Taylor v Asteron* at [101] in relation to discussion in English cases of a similar argument based on the Marine Insurance Act 1906 (UK), which expressly provides that "[a] contract of marine insurance is a contract based upon the utmost good faith".
[12] *Taylor v Asteron* at [109] and [116].
[13] See *Taylor v Asteron* at [110].

27. I support the continuation of the policy that, in general, increased risk exclusions are not enforceable when the insured can show that the event/circumstance did not contribute to the causation of the loss ('the general approach'). This because, in general, it is not fair that coincidental, rather than causal, events/circumstances, should result in loss of cover.
28. Placing the onus on the policyholder to establish causation substantially mitigates the concern that the general approach is unfair to insurers.
29. However, I agree that there are difficulties with the current law. The current law, as the Law Commission put it, "takes no account of the extent to which an exclusion may be framed with … statistical likelihood in mind".[14]
30. There are some increased risk exclusions that relate to events/circumstances that statistically increase risk, but it is difficult in practice for an insurer to demonstrate the causal link in relation to a particular incident. An example of this is an exclusion in relation to a driver's qualifications or experience. In general you would expect more qualified/experienced drivers to be involved in fewer accidents. However, it can be difficult to show in practice how a driver's qualifications or experience affected the causation of a particular incident. This is not the case with all such exclusions. For example, where there is an exclusion for driving a vehicle off-road and the driver collides with a tree, it is clear that there is a causal link.
31. I think it is reasonable to provide for an exception to the general approach in relation to these sorts of increased risk exclusions (ie where the causal link is difficult to establish). In particular I support an exception for exclusions based on qualifications or experience.
32. The exception to the general approach for exclusions based on age has human rights implications.[15] Age is a prohibited grounds for discrimination under s 21 of the Human Rights Act (HRA) 1993,[16] which engages s 19 of the Bill of Rights Act (BORA) 1993. By providing for an exception to the general approach for increased risk exclusions concerning age, cl 71(3)(a) arguably discriminates on the basis of age. Section 48 of the HRA addresses different treatment by insurers on the grounds of sex, disability or age based on data, but only modifies s 44 which relates to the provision of services. Consideration should be given to whether the discrimination in cl 71 is justified in terms of s 5 BORA. At the moment, cl 71 arguably provides for a blanket acceptance of an insurer's age discrimination based on the insurer's view of risk, compared to s 48 HRA which requires contemplation of whether the insurer's different treatment is both reasonable and evidence-based. Perhaps a more rights-consistent version of cl 71(3) would provide that an insurer's age-based exclusion is effective only if reasonable and based on evidence.
33. Consider the hypothetical example of an insurer that provides motor vehicle insurance with an exclusion for when the vehicle is driven by someone in the 30-35 age bracket, based on an unreasonable view, unsupported by data, that drivers in that age range are more likely to have accidents. That insurer would be in breach of the HRA by discriminating on the basis of age in the provision of services. However, under the draft, the exclusion would be an increased risk exclusion to which the general approach does not apply, and the exclusion would be effective as a matter of insurance law.

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[14] Law Commission *Some Insurance Problems* at [43].
[15] It may also be that some of the other grounds, such as qualifications and experience, effectively amount to discrimination on the basis of age.
[16] Human Rights Act 1993, s 21(1)(i). Age generally means "any age commencing with the age of 16 years".

34. Further, there is also the specific issue of an event/circumstance that increases the frequency of use of insured property, and thereby the risk of a covered event occurring, even though the event/circumstance may not increase the risk of anything going wrong for each individual use. An example of this given in the Consultation Paper is where a vehicle is used commercially in addition to private use (where the policy covers only private use).[17]
35. I agree that there should be an exception to the general approach in relation to this second category of increased risk exclusions (ie those that relate to increased frequency of use).
36. In my view use "for commercial purposes" (other than those permitted by the contract of insurance) should be defined more clearly. There may be uses that could be considered to be "commercial" that increase neither risk nor frequency of use. Where a policyholder has used their private vehicle to take paying passengers for a service like Uber, this is clearly use for commercial purposes, and has increased the risk of a covered event occurring because the policyholder would not have otherwise been making that drive. However, if a policyholder takes a paying passenger on a commute or road trip that they were already taking (as oppose), is this use for "commercial purposes" even though it is a trip that the policyholder would be taking anyway?
37. If the intention of an exception for "commercial purposes" use in cl 71 is to capture increased usage, this could be made express. Or possibly the exception could be only for use "primarily for commercial purposes", which would not apply where there is some incidental commercial gain from predominantly private use (such as with the passenger example above).
38. I agree that provision for exceptions from the general approach to increased risk exclusions should occur at Act-level rather than through regulations, because that could make it difficult for policyholders to access information on which sorts of exclusions were exempt.

Standard of proof

39. There are several references in the draft to a party proving something. These are generally in relation to clauses that deal with rights and duties as between insurer and policyholder (eg s 29(2), s 51, 71) but also in cl 94 which establishes an offence.[18]
40. To make the statute more accessible to policyholders it may be worth expressly setting out the standard of proof, especially if a different standard is intended for the offence.

"Disclosure" duties

41. In this section I have some more specific/technical comments on the wording in the draft.
42. The titles in Part 2 refer to "disclosure" duties in several instances. However, the language of "disclosure" is awkward when discussing the new duties for both consumer and non-consumer insurance.
43. The new duty for consumer insurance is a deliberate move away from the paradigm of a duty based on disclosure.
44. The new duty for non-consumer insurance is concerned with both representations and disclosures.

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[17] MBIE *Consultation Paper – Exposure draft Insurance Contracts Bill* at 22.
[18] Cl 94(3)(b). See also *Some Insurance Problems* at [43].

45. Describing these duties as “disclosure” duties may cause confusion over their true nature, especially in relation to the consumer duty.
46. The duties differ significantly, and classifying them both as forms of “disclosure duties” may suggest that they have more in common than they do.
47. I suggest that consideration be given to finding different language. Perhaps the duties could collectively be described as “information provision” duties.
48. I do not find the intent behind cl 16 very clear. I think it is intended to respond to situations where there is something about the policyholder – perhaps they have a cognitive impairment – that might make it more difficult for them to avoid making a misrepresentation, compared with someone else in their shoes without that characteristic or circumstance. If that is the case, I support this being taken into account if the insurer knew or ought to have known about it. Perhaps it also works the other way: if a policyholder is an architect or builder, more might be expected from them when they are making representations about the construction of their home when seeking insurance. The use of examples may shed light on the kinds of “particular characteristics or circumstances” that cl 16 is intended to respond to.

Conflict of laws

49. I agree that parties to consumer insurance contracts should not be able to contract out of being governed by New Zealand’s insurance law.
50. I have had the benefit of reading a draft of Maria Hook and Jack Wass’s submission, and agree with their recommendations regarding cl 7.