HERBERT SMITH FREEHILLS

INSURER CONFIRMED TO HAVE WAIVED ITS RIGHTS GOODBYE

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Legal Briefings – By **Mark Darwin, Travis Gooding and Jess Downing-Ide**

By a 2-1 majority, the Full Court of the Federal Court has upheld last year's decision to treat an insurer's confirmation of coverage as being binding

By way of an email the insurer had advised it would not rely on potential non-disclosure and would provide indemnity. However, a year later the insurer made a 'take it or leave it' offer and advised that if the offer was not taken it would deny the claim on the basis of non-disclosure. Both at first instance an on appeal the Courts have refused to allow the insurer to resile on its representation.

WHAT WAS THE CASE ABOUT?

Our summary of the primary decision can be found in our Insurance Policyholder Highlights 2020 (link here).

To recap, in 2014, Delor Vue Apartments, a body corporate for 62 Queensland apartments, became aware of a range of defects in the roof of the apartment complex. In 2017, while the defects had still not been repaired, a new property damage and public liability policy was taken out. The roofing defects and repair works being conducted were not disclosed.

Five days after the policy was entered into, Cyclone Debbie caused significant damage to the apartment complex including its roof.

The pre–existing defects quickly became apparent to the insurer in adjusting the claim, but nevertheless insurer informed the policyholder by email that 'despite the non–disclosure issue' the policy would still be honoured. Specifically, the email stated (in part):

Despite the non–disclosure issue which is present, [the insurer] is pleased to confirm that we will honour the claim and provide indemnity to the Body Corporate, in line with all other relevant policy terms, conditions and exclusions.

Over the next year, the parties debated the measure of indemnity under the policy, with the insurer seeking to deduct the cost of repairing the pre–existing defects from the cost of repairing the cyclone damage. During this time the insurer was given unfettered access to the property, engaged engineers, arranged for a scope of works, obtained quotations for repairs and its lawyers advanced the possibility of a subrogation claim.

Ultimately, the parties could not reach agreement on the measure of indemnity, culminating in the insurer making a 'take–it–or–leave–it' settlement offer. The insurer threatened to decline the claim entirely if the offer was not accepted, on the basis that the insurer claimed it had been prejudiced in that it would not have insured the building at all had the pre–existing defects been disclosed (exercising its remedy for non–disclosure under section 28(3) of the *Insurance Contracts Act*). The policyholder rejected the offer and commenced proceedings seeking payment of its claim.

THE DECISION AT FIRST INSTANCE

At first instance, the Court held that the policyholder had breached its duty of disclosure and that the insurer would have otherwise been entitled to reduce its liability to nil (as it was accepted that the insurer would not have insured the building).

However, the policyholder's claim succeeded because of the express confirmation in the email that the insurance policy was to be honoured despite the insurer being aware of non–disclosure issues. This was based on either the doctrine of waiver or estoppel (the Court rejected a further argument based on the doctrine of election).

The Court also held that the insurer had breached its statutory duty to act with utmost good faith by making a 'take–it–or–leave–it' deal.

On Appeal: Could the insurer reverse its position on indemnity?

The appeal involved a detailed analysis on the doctrines of election, estoppel and waiver. We do not propose to discuss the differences in detail. However, the Court did make a number of comments which are of broader assistance to policyholders in rejected that the insurer was entitled to deny cover after confirming it with knowledge of the non-disclosure.

Election: In a joint judgment, McKerracher and Colvin JJ concluded that the doctrine of election did apply.

Specifically, the doctrine applies where a party is required by law to make a binding choice. This means that the doctrine would not apply where the insurer is investigating the claim and is yet to uncover relevant facts. However, it was held to apply here, where the insurer knew it had the right to refuse indemnity for non-disclosure and chose not to exercise that right. Their Honours helpfully explain that:

In the case of an insurance contract it applies at least where the insurer has a right to disclaim liability but proceeds to exercise rights conferred by the contract of insurance. In such a case, the insurer cannot reserve its position. It can disclaim liability and request the insured to take steps of the kind that would be taken if there was liability under the policy as part of a process of considering whether the insure[r] may reverse its decision to disclaim. But the insurer, knowing the relevant facts, cannot seek to exercise rights under the contract of insurance whilst at the same time denying liability under the policy. In such a case, having regard to the nature of an insurance contract, as a matter of fairness, the law requires the insurer to elect between disclaiming any liability and seeking to rely upon the rights conferred by the policy.

…

… there is an evident inconsistency between the insurer adopting the position that there is no liability under the policy by reason of a failure to comply with the duty of disclosure (on the one hand) and seeking to enforce rights of subrogation and access to the insured property (on the other hand). Both positions cannot be consistently maintained.

Waiver and estoppel: Their Honours upheld the first instance decision on both waiver and estoppel. In relation to estoppel, their Honours rejected the insurer's argument that it was necessary to play out a counterfactual of what would have occurred had the insurer denied the claim from the beginning in order to establish reliance by, and detriment to, the policyholder.

Instead, they held that reliance may be established by reference to the representation and conduct of the insurer and evidence of what actually occurred. The longer the state of affairs induced by the insurer's representation (that it would cover the claim) went on, the more likely it was that there would be detriment because of the length of time the matter was in the hands of the insurer rather than the policyholder (although the precise character of that detriment would be uncertain). Given the year of involvement by the insurer, it was open for the first instance Judge to conclude that there was detrimental reliance.

The insurer further argued that it would suffer a disproportionate detriment from being held to an obligation to pay the claim (approximately $6 million) in circumstances where there had been a non-disclosure entitling it to deny the claim, but this was rejected on the basis that there must be a focus on the consequences for the relying party, not solely the representing party.

Dissenting judgment of Derrington J: A dissenting view was provided by Derrington J who also engaged in a detailed analysis of the law of the three doctrines. In short his Honour concluded that there was a lack of evidence of reliance and that none of the three doctrines applied. His Honours view is well summarised in the following quote:

The economic norms inherent in common law and equity respect a value-based approach to the alteration of rights and, consequentially, provide security to contractual bargains. Mere promises, in the absence a quid pro quo or detrimental reliance, generally do not alter the rights and obligations of contractual parties inter se. Were it otherwise, the security of bargained for rights would be loosened considerably.

ON APPEAL: THE INSURER'S BREACH OF THE DUTY OF UTMOST GOOD FAITH

In their joint judgment, McKerracher and Colvin JJ upheld the first instance decision that the insurer had breached its duty of utmost good faith. Specifically, their Honours rejected arguments that:

- there could not be a breach of the duty of good faith in circumstances where the insurer would have ultimately succeeded on the legal issue they sought to rely on.
- the statutory duty of utmost good faith was substantially the same as the contractual term of good faith in commercial contracts – requiring only commercial standards of decency and fairness.

In dissent Derrington J considered that the duty of utmost good faith had not been breached. His Honour's view was that the duty could rarely, if ever, require the insurer to sacrifice its actual legal rights for the benefit of the policyholder.

WHAT DOES THIS MEAN FOR POLICYHOLDERS?

By affirming the first instance decision, the case reinforces our previous observation that, when assessing the merits of a claim, policyholders should also be carefully considering the conduct and representations of the insurer following the insured event. Policyholders should also be keeping proper records of their dealings with insurers. If cover was unconditionally promised, then the policyholder may have a claim despite what the insurer was entitled to do.

In one respect the facts of the case can be seen as a precautionary story for policyholders to be very clear on the actual meaning of any representations they receive from insurers – i.e. that despite positive representations and extensive involvement insurers may subsequently seek to back-track on their position. On the other hand it may lead to insurers being even more circumspect about confirming indemnity and other matters.

This emphasises the importance of having ongoing strategic legal advice throughout the progress of a claim. Even seemingly simple interactions can give rise to technical legal considerations and it is important to have assistance to navigate these complexities.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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