HERBERT SMITH FREEHILLS

AUSTRALIAN COURT REJECTS INSURANCE DECLINATURE, HIGHLIGHTING COMPLEXITY OF NON-DISCLOSURE ISSUES

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Legal Briefings – By **Mark Darwin, Travis Gooding and Samara Cassar**

A recent decision of the New South Wales Supreme Court[1] demonstrates the scepticism with which courts will view insurers who say they would have acted differently had certain material been disclosed to them.

The insurer had denied cover to a policyholder on the basis that their responses to a renewal form were either incomplete (non-disclosure) or misleading (misrepresentation). However, the Supreme Court thoroughly rejected the insurer's declinature:

- disbelieving that there was an 'invariable practice' (or even a 'usual practice') for what the insurer would have done had disclosure been made;
- considering that a reasonable person in the position of the policyholder could not be expected to know that the relevant information was relevant to the decision about cover for the premises; and
- finding that, in certain aspects, the insurer had in any event waived compliance with the duty of disclosure.

The case provides a good example of how issues of non-disclosure and misrepresentation are multi-layered with several hurdles insurers have to overcome in order to be successful in avoiding or reducing coverage based on alleged non-disclosure.

BACKGROUND

The policyholder was the Civic Hotel. The Hotel was a mixed-use property consisting of three floors:

- a restaurant and bar on the top floor;
- a public bar and gaming area on the ground floor; and
- a function room in the basement (which included a bar and dance floor).

The function room could be rented out for private functions but also for live bands and DJ's who would host dance parties or discos. The room did not normally have any charge for admittance, but bands and DJ's could charge an entry fee to the events they hosted in the room.

When the policy was entered into the insurer sent a form asking the following questions:

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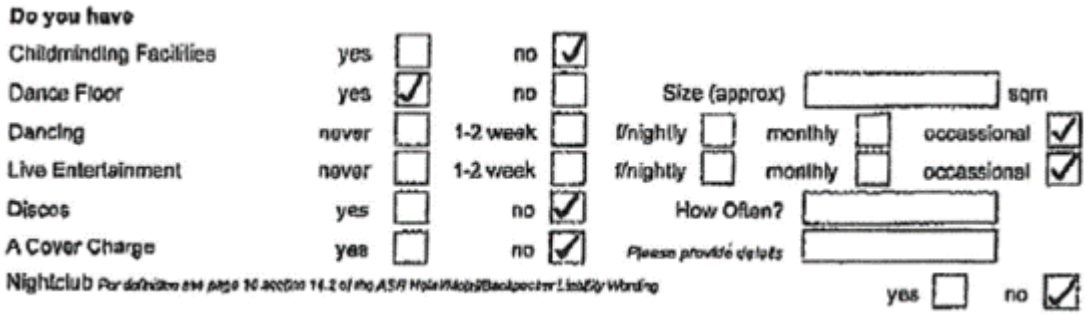

A ‘Nightclub was defined as either a venue licenced as a night club or a venue *‘where dancing is regularly undertaken and the venue is arranged in such a manner as to offer permanent dancing and musical entertainment*.’ The definition further provided that a venue was a Nightclub if it conducted 3 of a list of 7 activities (including for example charging an entrance fee, having a permanent sound system, and employing bouncers). The policy excluded liability for injuries arising from a nightclub.

During the policy period, a patron of the Hotel fell down some stairs (not in the basement) and suffered severe spinal injuries. The patron sued the Hotel, which lodged a claim for indemnity with its public liability insurers.

The insurer alleged that the basement room was a nightclub as defined, and declined the claim. Although the injury did not occur in the basement, so the exclusion did not apply, the insurer argued that the policyholder had misrepresented the risk by:

- answering ‘no’ to ‘*do you have… nightclub’;*
- answering ‘no’ to ‘*do you have… discos’*; and
- answering ‘occasional’ to ‘*do you have dancing’.*

Further, they argued the policyholder had breached their duty of disclosure by failing to specify the size of the dance floor.

If any of these arguments were valid, then pursuant to s28 of the *Insurance Contracts Act 1984* (Cth) (**ICA**) the insurer would be entitled to reduce its liability by the amount which represented any prejudice it suffered from the misrepresentation or non-disclosure. On that, the insurer alleged that it would not have insured any part of the Hotel at all, and on that basis claimed that it was therefore entitled to avoid all liability under the policy.

DECISION – THERE WAS NO MISREPRESENTATION OR NON-DISCLOSURE

The Court held that *‘on close lawyerly hindsight analysis’* it could be concluded that there was a ‘nightclub’ at the Hotel according to the definition. However, the Court held that that was not the issue. The issues were whether the policyholder:

- thought that the Hotel had something which corresponded to the definition of a ‘nightclub’; and

- believed (or whether a reasonable person would believe) that it was relevant to the basis upon which the insurer would offer insurance.

The Court considered that the definition of 'nightclub' was '*bizarre*' and complex. Although the policyholder was strictly incorrect to consider that the basement did not fall within the policy's definition of a 'nightclub', they had a genuine and reasonable belief that there was not a nightclub at the premises. Further, given the policy excluded liability arising from nightclubs, a reasonable person would not believe the question to be relevant to the insurer's decision on whether or not to offer cover for the Hotel.

Similarly, the Court was not satisfied that any misrepresentation had been made by stating that the premises did not have a disco, or having occasional dancing.

In relation to the failure to state the size of the dance floor, the Court held that s21(3) of the ICA applied. That section provides that where there is a failure to answer, or an obviously incomplete or irrelevant answer on a proposal form (which the insurer does not follow up), then the insurer shall be deemed to have waived compliance with the duty of disclosure. Here the insurer renewed anyway, despite the obviously incomplete answer, so the insurer had therefore waived its rights to know the answer.

FURTHER MATTER – IT WAS NOT CLEAR THAT THE INSURER WOULD NOT HAVE INSURED

In any event, the Court concluded that – even if there had been a misrepresentation or non-disclosure – the insurer had not persuaded the Court that it would have refused to cover the Hotel.

The insurer was in London. The renewal form was provided to the insurer's local agent ASR Underwriting Agencies Pty Ltd (**ASR**). In support of their arguments that the insurer would not have insured a nightclub, the insurer tendered the agreement between the insurer and ASR. That agreement set out the circumstances in which a matter would be referred to the insurer for approval to underwrite the risk (and when referral was not necessary). The agreement contained a heading called:

- 'Declinatures' which listed 'Nightclubs'; and
- 'Referral to insurers before binding' which listed 'Any venue with a dance floor exceeding $20m^2$.'

The agreement also noted that '*Where the items above are not complied with, the coverholder must first obtain [the insurer's] agreement to the terms and conditions for such insurance prior to any terms being indicated or bound.'* The quotation for renewal terms also indicated in relation to a list of excluded activities, including use of the premises as a nightclub, that *'Underwriters may agree not to exclude such activities listed above provided full details are submitted to them and an additional premium (if any) is paid to cover these activities.'*

The evidence of two representatives from ASR was that

- they had an invariable practice of refusing to underwrite any nightclub risks; and
- their usual practice would be to follow up an incomplete answer about the size of a dance floor in order to determine whether a referral to the insurer was needed.

The Court was extremely sceptical of this evidence, noting it was 'opportunistic' and simply not supported by the documents (which showed that their practice towards nightclubs was not invariable, and they would not always ask about the size of the dancefloor). On this basis, the Court held that the insurer had not fulfilled its burden of proving that, had disclosure been complete, it would have refused to insure the Hotel. In other words, even if there had been non-disclosure or misrepresentation, the insurer had no remedy.

CONCLUSION

The case provides an excellent example of both the complexity and problems that can arise in relation to issues of non-disclosure and misrepresentation. It is notable that, other than the agreement between ASR and the insurer, the insurer does not appear to have tendered any actual underwriting guidelines by which it would have decided whether to take on a 'nightclub' risk in circumstances where the local agent referred the risk to it. The case therefore highlights the importance of underwriting guidelines to prove prejudice in non-disclosure cases, and the scepticism with which courts will approach insurers who do not have clear underwriting guidelines or at minimum, a consistent approach to underwriting a risk they claim (after the event) that they would not have insured.

The case also highlights for policyholders the importance of having in place a robust approach to disclosing risks at insurance renewal. In any major claim, insurers will understandably closely scrutinise the disclosure/s made (and not made) at the point the insurance was entered into or renewed. While there exists an array of legal arguments that can be used to defeat declinatures based on alleged non-disclosure, the best defence remains a robust and well documented approach to disclose risks prior to the policy's inception.

Please get in touch with Mark.Darwin@hsf.com or Travis.Gooding@hsf.com if you have any questions about this article.

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1. *Legge v Universal Hospitality Group Ltd (No 3)* [2022] NSWSC 709

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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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