Recent developments

Utmost good faith in insurance contracts: CGU Insurance Ltd v AMP Financial Planning Pty Ltd [2007] HCA 36 (237 ALR 420) 81 ALJR 1551

Amongst the issues examined by the High Court in the final stage of this 'complex litigation' (as it was described in the joint judgment of Gleeson CJ and Crennan J) is the scope of section 13 of the *Insurance Contracts Act 1984* (Cth) ('the ICA') and the obligations that this section imposes upon an insurer in relation to the handling of claims by an insured. Section 13 of the ICA provides that:

> 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 or in relation to it, with the utmost good faith.

The proceedings concerned a claim by the respondent (AMP) for an indemnity under professional risk insurance policies of which the appellant (CGU) was the insurer, in respect of amounts which AMP had paid in settlement of claims that had been made against it. AMP had been under pressure from ASIC to settle these claims promptly and adequately. To this end, AMP put a protocol in place for the handling of the claims. At first instance, it was found that AMP had adopted this procedure and settled these claims for its own sound commercial reasons (including both a need to protect its relations with ASIC, its licence and goodwill its as well as a desire to avoid being placed in a position where CGU might exercise its contractual right to take over and defend any of the investors' claims in the name of AMP).

AMP initially notified CGU of the possible claims against it and thereby of its possible claim for indemnity under its professional risk policy. In due course, AMP also provided CGU with a copy of its protocol for the handling of claims and material in relation to its claim under the policies. CGU agreed in principle to the protocol but reserved its position under the policies. It repeatedly instructed AMP to act as a prudent uninsured. CGU did not at any time expressly authorise or approve any of the settlements concluded by AMP. In due course, CGU denied that it was liable under the policies to indemnify AMP in respect of both the claims against it and the settlement of those claims.

AMP commenced proceedings against CGU in the Federal Court of Australia, seeking to recover the amounts that it had paid in settlement of the various claims that had been made against it (less the policy excess for each claim). In addition to its claim for an indemnity in respect of these amounts under its policies with CGU, AMP also claimed that CGU was in breach of the duty that it owed to AMP as its insured under section 13 of the ICA and that the amounts that AMP had paid in settlement of the claims against it were recoverable as damages for that breach. (Although AMP also advanced its claim on other bases and a number of other issues arise out of these proceedings, it is only proposed to deal with AMP's section 13 claim in this case note).

At first instance Heerey J dismissed AMP's claim, including its section 13 claim. In doing so, his Honour held that an allegation of breach of the duty of utmost good faith provided for by section 13 of the ICA requires proof of some want of honesty (citing *CIC Insurance Ltd v Barwon Region Water Authority* [1999] 1 VR 683 at 689 in support of that proposition). However his Honour also found that there was no evidence of such dishonesty on CGU's part.

AMP appealed to the full court of the Federal Court. Moore and Emmett JJ allowed the appeal and set aside the orders made by Heerey J below. In their stead, they directed that the proceedings be remitted to the trial judge so that further consideration (in accordance with their Honour's reasons) could be given to the four questions posed at [144] of the judgment of Emmett J. In the course of their judgments, the majority of the full Federal Court rejected Heerey J's narrow construction of both section 13 and what was required in order to prove a breach of the duty imposed by that section. Justice Gyles dissented in the outcome and, whilst not agreeing with the reasons given in the judgment below, nevertheless found that Heerey J had come to the right conclusion and that the appeal should therefore be dismissed. But in doing so, his Honour did not discuss or express any opinion on the issue of section 13 (other than to conclude that AMP's appeal on that point had been 'misplaced').

CGU appealed to the High Court, who (Kirby J dissenting) overturned the decision and orders of the majority of the full Federal Court and reinstated the orders of Heerey J in effect dismissing AMP's claim. But in doing so, all of the members of the High Court endorsed the wider view of the requirement of good faith adopted by the majority of the full Federal Court in preference to Heerey J's view that absence of good faith was limited to want of honesty.

A number of comments may be drawn from the judgments of both the full Federal Court and High Court in these proceedings, so far as section 13 and the extent of the duty that it imposes are concerned.

First, it is clear from the terms of the section that the duty of utmost good faith that section 13 provides for is a duty that is owed by both the insured and the insurer and that it is a reciprocal and mutual duty. The latter aspect was of particular significance to the conclusion of Callinan and Heydon JJ who held that, even if there had been an absence of good faith on the part of CGU, there was not such a degree of reciprocal good faith on the part of AMP as would entitle it to relief against CGU.

Secondly, contrary to the view expressed by Heerey J at first instance, both the majority of the full Federal Court and all of the members of the High Court agreed that a breach of duty by an insurer did not require proof of a want of honesty (or proof of dishonesty) on the part of the insurer. Whilst a want of honesty (if proved) will constitute a failure to act with utmost good faith, it is not a necessary requirement.

According to Emmett J the notion of acting in good faith entails acting with both honesty and propriety. A lack of propriety alone may amount to a breach of the duty. Lack of propriety does not necessarily entail a lack of honesty. The duty of utmost good faith encompasses notions of fairness, reasonableness and community standards of decency and fair dealing. Capricious or unreasonable conduct may also amount to a breach of the duty.

In the High Court, Gleeson CJ and Crennan J accepted that utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the legitimate interests of an insured, as well as to the insurers' own interests. This

is in the same way that the insured's obligation of utmost good faith requires the insured to pay regard to the legitimate interests of the insurer. Callinan and Heydon JJ also agreed that a lack of utmost good faith was not to be equated with dishonesty only. In their joint judgment they indicated that an absence of good faith may have elements in common with an absence of clean hands (although conceded that the analogy should not be taken too far). Their Honours also stated that utmost good faith will usually require something more than passivity; it will usually require affirmative or positive action on the part of the person owing the duty.

Kirby J agreed that a want of honesty was not a necessary requirement of the duty of utmost good faith and that the criteria of dishonesty, caprice and unreasonableness more accurately expressed the ambit of what constitutes a breach of the duty imposed by section 13. Kirby J also emphasised that this duty was 'an affirmative' one and like Emmett J below agreed that the emphasis must be placed on the word 'utmost'.

Thirdly, it is clear from the judgments both of the majority of the Full Federal Court and of the High Court that the duty imposed upon an insurer by section 13 extends to the manner in which the insurer handles claims made by its insureds, including the time taken to consider and respond to such claims.

For example, in the full Federal Court, Emmett J stated that a failure to make a prompt admission of liability to meet a sound claim for indemnity and to promptly pay the claim may amount to a failure to act with the utmost good faith on the part of an insurer. The position would of course be different where the insurer is awaiting details that are necessary for the making of a decision whether to accept liability or to determine the quantum of its liability. But a failure by an insurer to make and communicate within a reasonable time a decision of acceptance or rejection of a claim for indemnity, by reason of negligence or unjustified and unwarrantable suspicion as to the *bona fides* of the claim by the insured, may constitute a failure on the part of the insurer to act towards the insured with the utmost good faith in dealing with the claim and thereby in breach of its duty under section 13. There may also be a breach where the insurer fails to proceed reasonably promptly to deal with a claim, where all the relevant material is to hand, sufficient to enable a decision on the claim to be made and communicated to the insured.

In the High Court, Gleeson CJ and Crennan J acknowledged that the insurer's obligation to act with utmost good faith 'may well affect the conduct of an insurer in making a timely response to a claim for indemnity'. The discussion at paragraphs [258] to [261] of the joint judgment of Callinan and Heydon JJ also proceeded on the premise that the duty imposed upon an insurer by section 13 extended to the manner in which it handle its insured's claims and that an insurer's conduct in handling such claims may amount to a breach of that duty. In this context, their Honours noted (at [259]) that temporising by an insurer can be just as damaging to an insured as outright rejection of a claim.

Kirby J observed that the duty imposed by section 13 governed the conduct of insurers. It was more important than a term implied in the insurance contract giving rise to remedies for a breach, although by its express provisions it was also that. According to Kirby J:

> the duty imposes obligations of a stringent kind in respect of the conduct of insurer and insured with each other, wherever that conduct has legal consequences.

His Honour acknowledged that the duty imposed on an insurer by section 13 extended to its handling of claims, including an obligation to make timely decisions as to whether or not a claim would be accepted. In doing so, Kirby J quoted with approval (at [135]) the dicta of Ambrose J in *Gutteridge* which his Honour noted that the majority of the Full Federal Court had 'correctly endorsed'. At [139] his Honour also stated:

> In particular, the broad view which the full court [of the Federal Court] majority took concerning the operation of s13 of the Act is one that this court should endorse. It sets the correct, desirable and lawful standard for the efficient, reasonably prompt, candid and business-like processing of claims for insurance indemnity in this country.

As to what this might entail of an insurer, his Honour concluded that this case stood for the principle that an insurer should not act in the manner in which his Honour had thought CGU had acted here (the details of which are set out in paragraph [179] of his Honour's reasons for judgment). Whilst the remaining members of the High Court may not have shared his Honour's conclusion that CGU were guilty of the conduct there described, this paragraph nevertheless provides a useful catalogue of the type of conduct by an insurer that Kirby J has in mind as amounting to breach of section 13.

Fourthly, in their joint judgment Gleeson CJ and Crennan J concluded that the ICA did not empower a court to make a finding of liability against an insurer as a punitive sanction for not acting in good faith. This is especially where, as on the facts found here, the insurer was not liable under the terms of the insurance policies to indemnify AMP for the amounts that it had paid in settlement of the investor claims. As their Honours stated (at [16]):

> If there is found to be a breach of the requirements of s13 of the Act, there remains the question how that is to form part of some principled process of reasoning leading to a conclusion that the insurer is liable to indemnify the insured under the contract of insurance into which the parties have entered. … Between a premise that CGU's delay constituted a failure to act with the utmost good faith, and a conclusion that CGU is liable to indemnify AMP in respect of the settlement amounts, there must be at least one other premise. What it might be has never been clearly articulated.

This raises the potentially important question as to the appropriate remedy for an insurer's alleged breach of the duty imposed upon it by section 13 in relation to the handling of claims (especially where the complaint is one of the insurer's prevarication or delay in determining whether to accept or reject the insured's claim) and more particularly whether the breach of the duty can give rise to a liability on the part of the insurer to indemnify its insured in respect of payment of a claim made against the insured in circumstances where such an indemnity is not otherwise available to the insured under the terms of the policy.

On the facts here Gleeson CJ and Crennan J found that it could not. In the full Federal Court Gyles J made an observation to similar effect (at [162]).

Finally, there were two respects in which it had been asserted in these proceedings that CGU had been in breach of the duty imposed on it by section 13 of the ICA. The first was based on CGU's failure to provide an indemnity in respect of each claim made on AMP within the time period after the provision of information in respect of each of claim contemplated by the protocol (established by AMP for the handling of the claims). This was the argument advanced at first instance and dealt with by Heerey J. It is also in relation to a breach of this nature that both the comments that a failure to handle claims in a timely fashion may amount to a breach of the section 13 duty and the difficulty in granting an indemnity for such claims as relief for the breach alleged (identified in the joint judgment of Gleeson CJ and Crennan J) are apposite.

The second respect in which it had been asserted that there had been a breach of duty by CGU was identified by Emmett J in the context of the appeal to the full Federal Court. It was a failure to act with the utmost good faith in relation to the policies in the manner in which CGI conducted itself in its defence of the proceedings instituted against it by AMP for the recovery of AMP's claimed indemnity under the policies. In particular, it was by taking a stance in the proceedings that AMP was required to establish by admissible evidence that it was legally liable to any investor whose demand had been settled in order to recover an indemnity under the policies for that liability and any amounts paid in settlement of it. It was for the purposes of reconsidering inter alia this argument (which was also bound up with AMP's claim based on estoppel) that the majority of the full Federal Court directed that the proceedings be remitted. It was to this argument that the first three of the four questions that the majority of the full court directed the trial judge to reconsider were directed. However, the majority of the High Court held (Kirby J dissenting) that it was not appropriate for the proceedings to be remitted for the further consideration of any of these issues. Accordingly, the effect of the decision of the majority of the High Court was that to the extent that AMP may have been able to advance a claim that CGU had been in breach of its section 13 duty on this second basis, in the end that claim also failed.

By Greg Nell SC

No tortious duty of good faith: CGU Workers Compensation (NSW) Limited v Garcia [2007] NSWCA 193

This recent judgment of the New South Wales Court of Appeal deals with whether there is a tortious duty to act in good faith at common law and more particularly whether such a duty is owed by an insurer of a workers compensation policy in respect of the handling of claims under that policy or whether such a duty is to be implied into the statutory workers compensation policy, as an implied term of that policy. In addition, this judgment also provides guidance as to the approach that a court should take when issues arise as to the existence or scope of a novel tort as well as to the circumstances in which a term imposing a duty of good faith may be implied into a contract.

The underlying claim

The appeal arose out of proceedings in the District Court of New South Wales in which the respondent (Mr Garcia) had claimed damages from his employer's workers compensation insurer for its alleged breach of a duty to act in good faith in dealing with a claim for workers compensation that the respondent had made on the insurer in respect of injuries that the respondent was said to have sustained in August 1999 in the course of his employment.

Initially, the respondent's claim was accepted by the insurer, who made weekly compensation payments to the respondent whilst he was unable to work. But in January 2000, the insurer terminated these weekly payments, based on medical evidence said to indicate that the respondent's then symptoms were due to a degenerative condition and any aggravation of that condition caused by the events of August 1999 had by that time ceased. The respondent brought proceedings against the insurer in the Compensation Court claiming (inter alia) reinstatement of his weekly compensation payments. Those proceedings were fixed for hearing in April 2001. However, on the day of the hearing, the insurer indicated that the respondent's claim for compensation had been re-accepted.

The respondent claimed to have suffered both economic and non-economic loss (extending beyond the amounts recoverable in the Compensation Court proceedings) as a consequence of the insurer's decision to terminate his weekly compensation payments and commenced proceedings against the insurer in the District Court for the recovery of damages in respect of that loss.

The respondent's claim in those proceedings was put in two ways. The first was that the insurer was in breach of an implied term of the statutory workers compensation policy that it would 'deal fairly and in good faith with' the worker. Secondly, the insurer was also alleged to have been in breach of a tortious duty of good faith that it owed the worker, being a 'duty to act in good faith towards the plaintiff [worker] in relation to any claims made under the [Workers Compensation] Act by the plaintiff'.

The judgment in the District Court

The proceedings in the District Court were heard by Goldring DCJ who upheld the respondent's claim on the second of the above two bases and awarded the respondent damages of $ 451,317.50 (including $ 50,000 exemplary damages).

In doing so, his Honour acknowledged that this tortious duty of good faith which he found the insurer to be in breach of was a novel one under Australian law and one that did not arise under principles of negligence. In particular, it was not just a duty of care within the framework of the existing law of negligence or an action for a breach of a specific statutory duty. Rather, it was said to be a completely new tort. However, both this decision and this new tort were confined to