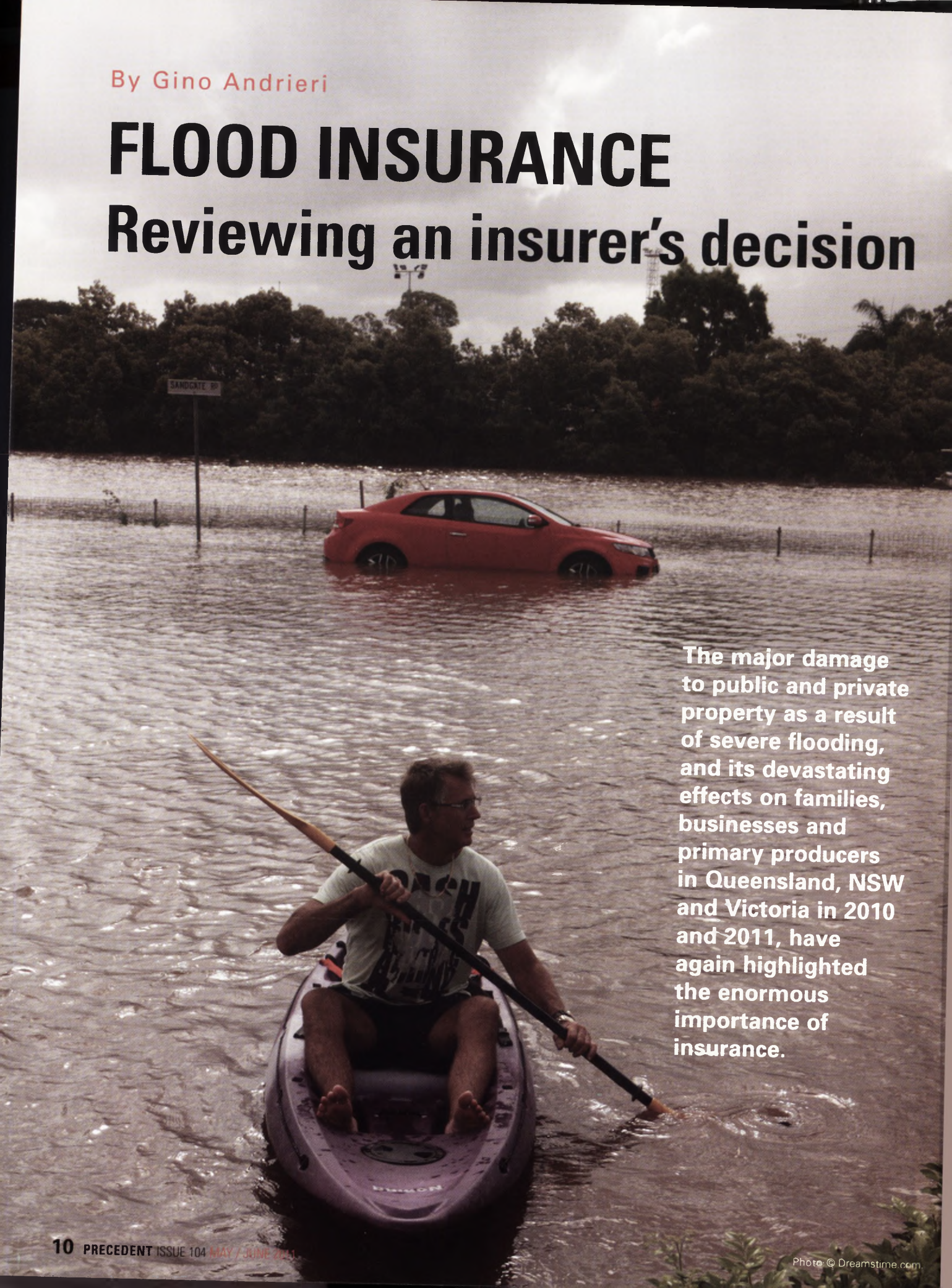


By Gino Andrieri

# FLOOD INSURANCE

## Reviewing an insurer's decision

A man in a purple kayak is paddling through floodwaters. In the background, a red car is partially submerged in the water. A sign on a pole is visible in the distance. The sky is overcast.

The major damage to public and private property as a result of severe flooding, and its devastating effects on families, businesses and primary producers in Queensland, NSW and Victoria in 2010 and 2011, have again highlighted the enormous importance of insurance.



**F**ollowing the floods, a broad question as to who should pay when disaster strikes prompted the Australian government to announce an independent review into disaster insurance in Australia. The National Disaster Insurance Review will focus on insurance arrangements for individuals and businesses for damage and loss associated with floods and other natural disasters.<sup>1</sup>

One of the reasons the review was deemed necessary is that consumers often lack any real understanding of their insurance policies and may be oblivious to the different approaches taken by various insurance companies to cover water damage, including by flood.<sup>2</sup> Flood-affected Queenslanders are a case in point – many of those people are now discovering that although they have home and contents insurance policies, their insurers are not prepared to accept their claims for damage, destruction or loss of property.

### FLOOD DEFINITIONS

Most home and contents insurance policies operate by firstly stating that certain property (usually identified in a schedule to the policy) is insured against, say, destruction, loss or damage caused by some means. The policy then goes on to carve out or exclude certain things from cover. Many policies specifically carve out damage arising as a result of 'flood' or 'flood water'.

The term 'flood' varies from policy to policy and is usually defined along the following lines: 'water that has escaped from the normal confines of a watercourse, river lake or dam'. This may be contrasted with inundation by water from fixed apparatus, fixed tanks, fixed pipes or run-off of surface water from surrounding areas, all of which are often covered.

Although there is currently no single standard definition of flood in household insurance contracts, attempts have been made over the past few decades to find a common definition, and those attempts continue.<sup>3</sup>

### THE FINANCIAL OMBUDSMAN SERVICE (FOS)

A person dissatisfied with the way their flood insurance claim has been handled by their insurer may be able to make a complaint to FOS. FOS is an important industry-based dispute resolution scheme created by the merger of three predecessor alternative dispute resolution schemes.<sup>4</sup> It began operating on 1 July 2008, and is now the largest external dispute resolution scheme in Australia.

To resolve a dispute, FOS may use negotiation, conciliation, mediation or it may decide the dispute itself by way of a written recommendation or determination.<sup>5</sup> In deciding disputes, FOS is not bound by any legal rule of evidence.<sup>6</sup> Under its new Terms of Reference dated 1 January 2010, when deciding a dispute and whether a remedy should be provided, FOS will 'do what in its opinion is fair in all the circumstances', having regard to legal principles; applicable industry codes or guidance as to practice; good industry practice; and previous relevant decisions of FOS or a predecessor scheme (although FOS will not be bound by these).<sup>7</sup>

The process for deciding disputes is set out in clauses 8.5 and 8.6. After giving the parties an opportunity to make submissions and provide information about the matters in dispute, FOS makes a recommendation.<sup>8</sup> If both parties accept the recommendation within 30 days the dispute is resolved.<sup>9</sup> If, within 30 days, either the member does not accept the recommendation, or either party asks FOS to proceed to a determination, FOS will do so by either an ombudsman or an FOS panel. Before the determination is made, the parties will be given an opportunity to make submissions and to provide any further information in response to the recommendation.<sup>10</sup>

While the length of time it can take FOS to resolve individual complaints is an important practical consideration, FOS has several advantages from the point of view of the average consumer. These include that it is a free service and there is no fee to lodge complaints; legal representation is generally allowed; a decision of FOS is binding on the insurer but not the insured; and FOS is a costs-neutral jurisdiction so there is no adverse costs risk to the insured.

FOS is able to hear matters up to the value of \$500,000 but is limited to awarding \$280,000. Important time-limits also apply when lodging a complaint to FOS. The time-limit expires on the earliest of two years from the date a letter is received rejecting the claim from the insurer's Internal >>

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The advantages of FOS for consumers include that it is a free service and there is no fee to lodge complaints; legal representation is generally allowed; the FOS decision is binding on the insurer but not the insured; and FOS is a costs-neutral jurisdiction.

Dispute Resolution department, or six years from the date a claimant should have been aware of the loss (for our present circumstances, this is often six years from the date of the flood event).

### REVIEW BY THE COURTS

It is also useful to consider how courts have dealt with flood insurance disputes in the past and the circumstances in which they have intervened where an insurer has denied liability. A good example is the case of *Max Hams & Anor v CGU Insurance Limited*.<sup>11</sup> In that case, the insurer refused to indemnify Mr and Mrs Hams in respect of damage caused to their rural property (including a homestead and a hangar) by water inundation. The insurer's case was that the inundation constituted a 'flood' as defined in the policy, which was an excluded event.

In a 90-page, 43,000 word judgment, Einstein J considered, among other things, whether the water inundation in fact constituted a flood and what the insurer was required to do to clearly inform the Hams in writing of the flood exclusion in the policy, within the meaning of s35(2) of the *Insurance Contracts Act* (ICA).

The term 'flood' was defined in the Hams' policy as follows:

'Flood means inundation following the escape of water from the normal confines of any lake, reservoir, dam, river, creek or navigable canal, as the result of a natural phenomenon which has some element of violence, suddenness or largeness about it but does not mean inundation by water from fixed apparatus, fixed tanks, fixed pipes or run-off of surface water from surrounding areas.'<sup>12</sup>

Mr and Mrs Hams argued that the sources of the water that damaged their property and possessions were rainfall and run-off from surrounding areas, with the consequence that the flood exclusion did not apply.

They also put forward an alternative case – if the insurer was otherwise entitled to rely on the flood exclusion to refuse indemnity under the policy, then by force of s35 of the ICA and the *Insurance Contracts Regulations 1985*, the insurer was precluded from relying on the exclusion, as it did not clearly inform the Hams in writing that the policy excluded destruction, loss or damage caused by flood.

The burden of proving that the flood exclusion clause applied lay with the insurer, and after hearing extensive evidence from the Hams and a number of expert engineers, hydrologists and surveyors as to the probable timing and causes of the water inundation, His Honour was left unsatisfied that, on the balance of probabilities, the insurer had discharged its onus of proof that the damage to the homestead had been caused by 'flood'. His Honour subsequently held that the Hams' claim was made out in that respect.

But the other part of the Hams' claim concerned a hangar located near the homestead, and in relation to that part of the claim the situation was different.

### THE DOCTRINE OF PROXIMATE CAUSE

Relevant to the Hams' claim in respect of the hangar were the following two principles:

- (a) If a loss has two or more proximate or effective causes, and at least one cause is excluded from cover, the insurer is not liable: *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corporation Ltd* [1974] QB 57; *Petersen v Union des Assurances de Paris IARD* (1997) 9 ANZ Ins Cases 61-366 ('the Wayne Tank principle'); and
- (b) If a loss has two or more causes, and loss from one is insured against and none of the others is expressly excluded, the insured is entitled to recover: *HIH Casualty & General Insurance Ltd v Waterwell Shipping Inc* [1998] NSWSC 436; (1998) 43 NSWLR 601 at 612B.<sup>13</sup>

In *Hams*, Einstein J found that Mr and Mrs Hams had not succeeded in establishing an entitlement to indemnity under the policy in respect of the hangar, because the damage to the hangar had two proximate or effective causes, one of which was excluded from cover – in which circumstance the insurer was not liable because of the *Wayne Tank* principle.<sup>14</sup>

### CLEARLY INFORMED

Subject to some exceptions, s35(1) of the ICA and Regulation 10 of the ICR have the combined legal effect that a home and contents insurance policy provides cover for flood, even if the insurance policy itself does not provide it. The exception relevant for the purposes of this article is contained in s35(2), which states, relevantly, that s35(1) does not have effect where the insurer proves that, before the contract was entered into, they clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or relevant provisions, of the proposed contract or otherwise) that the contract would not provide cover in respect of that event.

As mentioned, one of the issues in *Hams* concerned the operation and effect of s35(2). In that case, Einstein J referred to the decision of *Suncorp General Insurance*



*Limited v Cheikh*<sup>15</sup> and, at paragraph 42, His Honour said as follows:

'In my view the words in parentheses in s35 (2) "whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise" are likely in most circumstances to result in the provision of such a document in and of itself satisfying the requirement to clearly inform. There may, however, be special circumstances in which the complexity of or confusions within the document containing the relevant provisions (which one would expect would usually be the insurance policy itself) could be such that the mere provision of the policy did not establish that the insurer had effectively informed the insured of relevant limitations. This was effectively the substance of the submission put to the court by ASIC.'

The *Hams* decision was subsequently followed by the Northern Territory Court of Appeal in *Marsh v CGU Insurance Limited t/as Commercial Union Insurance* [2004] NTCA 1. In that case, Mildren J (with whom Thomas J agreed) said, at paragraph 11:

'Whether the policy wording in fact "clearly informed" the insured that there was no cover for flood is a question of fact to be determined by an examination of the document in question. I do not consider that it is necessary for the relevant exclusion to be predominantly displayed in bold capitals over the front cover in order for the insurer to succeed on this question ... Furthermore, the language of s35(2) suggests that the proposed insured can be clearly informed merely by providing the insured with a copy of the policy that shows the exclusion in clear and unambiguous terms ... Even though s35 is plainly beneficial legislation, a fair reading of s35(2) does not warrant the conclusion that the result need go further than provide for the relevant exclusion in the policy wording in clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding if that person reads the policy in question.'

## LESSONS FROM HAMS

The decision in *Hams* is a good example of the complexity that can be involved in litigating a flood insurance dispute. As mentioned, extensive evidence was required to be adduced on both sides of the dispute from a number of expert engineers, hydrologists and surveyors, several of whom disagreed with each other on crucial points and altered their opinions as the case progressed. However, where there is such complexity and uncertainty, the discharge of the insurer's burden of proving that a flood exclusion applies becomes more difficult and may, as it did in the case of Mr and Mrs Hams, present the insured with a distinct forensic advantage.

Further, where a Product Disclosure Statement or insurance policy is poorly constructed or is difficult to understand, there may be some scope for an insured to challenge the denial of a claim on the basis that the document did not clearly inform them of the exclusion. This

may be particularly so if the definition of 'flood' is unusual or prohibitive.

In summary, a decision to reject a claim on the basis of a 'flood' exclusion is not final. Avenues of appeal do exist. Given the extent of losses some people have suffered because of the floods, it is critically important that such people understand their rights under their policies and, where appropriate, take steps to challenge an insurer's decision if it is unfavourable to them. ■

**Notes:** 1 See *Reforming flood insurance – Clearing the waters*, Consultation paper, April 2011. 2 *Ibid*, at p2. 3 See above, note 1; also, 'Clearing the Muddied Waters of Flood Insurance' (2011) 26(4) *ILB* 50. 4 The Banking and Financial Services Ombudsman Limited (BFSO), Financial Industry Complaints Service Limited (FICS) and the Insurance Ombudsman Service Limited (IOS). The Insurance Brokers Disputes Limited (IBDL) and the Credit Union Dispute Resolution Centre Pty Limited (CUDRC) later joined FOS on 1 January 2009. 5 FOS Terms of Reference dated 1 January 2010, clause 7.1 6 Clause 8.1. 7 Clause 8.2. 8 Clause 8.5 a). 9 Clause 8.5 b). 10 Clause 8.5 c). 11 [2002] NSWSC 273 (12 April 2002). 12 See *Hams*, at para. 7. 13 See *Hams*, at para. 9. 14 *Ibid*, at para 262. 15 [1999] NSWCA 238.

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