Section 54(1) of the *Insurance Contracts Act 1984* (Cth)

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Introduction

1. Section 54 of the *Insurance Contracts Act 1984* (Cth) ('*the Act*') is a remedial provision. It was introduced as a result of recommendations made by the Australian Law Reform Commission,[1] to strike a fair balance between the interests of insureds and insurers.

2. This paper will be confined to an examination of s 54(1). In broad terms, subs (1) operates to prevent insurers from refusing to pay a claim on the basis of an act or omission by the insured (or another person), after the contract has been entered into, where that act or omission did not cause or contribute to the loss suffered. Subsections (2) to (5) deal with acts or omissions which could reasonably be regarded as causing or contributing to the loss.

3. Subsection (1) will only apply where the insurer's refusal to pay the claim was based upon some act or omission occurring after the policy was entered into. Thus, as McLure P stated in *Maxwell v Highway Hauliers* [2013] WASCA 115 at [72]:

[*] Judge, Supreme Court of New South Wales. I acknowledge, with thanks, the contributions of my tipstaff for 2014, Miss Ashley Cameron BEcon LLB (Hons), to the preparation of this paper. The views expressed in this paper are my own, and not necessarily those of my colleagues or the Court.

[1] Australian Law Reform Commission, *Insurance Contracts,* Report No 20 (1982) 113.

> … s 54(1) has no application to provisions of an insurance contract that are fixed from commencement, in the sense that they are unaffected by a subsequent act or omission of the insured or another person.

4. The purpose of s 54(1) is thus to provide a remedy for the disentitling consequences of the relevant act or omission, where it did not cause or contribute to the loss. Where s 54(1) does apply, the insurer may only reduce its liability to the extent that it suffered prejudice as a result of the act or omission. Prejudice is notoriously difficult to prove, as proof necessarily deals with the counterfactual world. I will discuss this difficulty in more detail later in this paper.

5. Uncertainty has arisen in recent years in relation to what kinds of act or omission may be remedied by s 54(1). Section 54(1) will not remedy all conduct which contractually permits the insurer to refuse to pay the claim. The question becomes what will and will not be remedied by the provision. Courts have characterised this issue in a number of ways, referring to the 'scope of the claim', restrictions or limitations which are 'inherent' in the claim, and most recently to the 'effect' of the policy, to determine whether s 54(1) will apply to the facts of the particular case.

6. In this paper I will discuss the way in which this area of uncertainty has been examined by Australian courts, with particular focus on the recent decision of the High Court of Australia in *Maxwell v Highway Hauliers* (2014) 88 ALJR 841 (*'Highway Hauliers'*). I will then look at the situation where an insurer seeks to reduce its liability on the ground that it had been prejudiced by the act or omission, and what practical difficulties may arise when seeking to make this, often counterfactual, argument.

Relevant Provision

7. Section 54 appears in the 'Remedies' Division of the *Act.* I set out s 54 as follows:

> 54 Insurer may not refuse to pay claims in certain circumstances
>
> (1) Subject to this section, where the effect of a contract of insurance would, but for this section, be that the insurer may refuse to pay a claim, either in whole or in part, by reason of some act of the insured or of some other person, being an act that occurred after the contract was entered into but not being an act in respect of which

subsection (2) applies, the insurer may not refuse to pay the claim by reason only of that act but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act.

(2) Subject to the succeeding provisions of this section, where the act could reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay the claim.

(3) Where the insured proves that no part of the loss that gave rise to the claim was caused by the act, the insurer may not refuse to pay the claim by reason only of the act.

(4) Where the insured proves that some part of the loss that gave rise to the claim was not caused by the act, the insurer may not refuse to pay the claim, so far as it concerns that part of the loss, by reason only of the act.

(5) Where:

(a) the act was necessary to protect the safety of a person or to preserve property; or

(b) it was not reasonably possible for the insured or other person not to do the act;

the insurer may not refuse to pay the claim by reason only of the act.

(6) A reference in this section to an act includes a reference to:

(a) an omission; and

(b) an act or omission that has the effect of altering the state or condition of the subject-matter of the contract or of allowing the state or condition of that subject-matter to alter.

Background

8. It was thought, prior to the enactment of s 54, that exclusion clauses in insurance contracts, which had the effect of disentitling the insured to indemnity, often operated in an unfair way.

9. The 1982 Australian Law Reform Commission Report, Number 20, *Insurance Contracts*, which led to the enactment of the *Act*, referred in particular to the entitlement of the insurer to rely on a breach of contract to refuse to meet a claim, even where the breach caused no loss to the insurer. The Commission suggested that there was a need, in that respect, to *'establish a fairer balance'* between the rights of the insured and those of the insurer.[2] Section 54(1) was enacted to satisfy that need.

10. The *Explanatory Memorandum* to the *Insurance Contracts Bill 1984* (Cth) referred to the Report of the Law Reform Commission and agreed that there was a need for a more equitable remedy. The *Explanatory Memorandum* stated*,* at [182], that the rationale for the proposed s 54 was that:

> … [t]he existing law is unsatisfactory in that the parties' rights are determined by the form in which the contract is drafted rather than by reference to the harm caused. The present law can also operate inequitably in that breach of the term may lead to termination of the contract regardless of whether or not the insurer suffered any prejudice as a result of the insured's breach. The proposed law will concentrate on the substance and effect of the term and ensure that a more equitable result is achieved between the insurer and the insured (ALRC paras 228–230 and 241–242).

11. It is clear that s 54(1) was intended to be remedial in nature. It was enacted to strike what was considered to be a 'fairer' or 'more equitable' balance between the rights of the insurer and those of the insured with respect to post-contractual conduct.

12. It is now well established that s 54(1) should be given a broad, rather than a narrow or pedantic construction.[3] As the High Court stated in *Khoury v Government Insurance Office (NSW)* (1984) 165 CLR 622 at 638, the provision ought to be:

[2] Australian Law Reform Commission, *Insurance Contracts,* Report No 20 (1982) 113.
[3] *Commercial Union Assurance Co of Australia Ltd v Ferrcom Pty Ltd* (1991) 22 NSWLR 389.

> … beneficially construed so as to provide the most complete remedy of the situation with which they are intended to deal [but] restrained within the confines of 'the actual language employed' and what is 'fairly open' on the words used.[4]

13. It is in this context that s 54(1) must be considered and applied.

Whether s 54(1) will apply to particular acts or omissions

14. A leading authority on the operation of s 54(1) is the High Court decision in *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) 204 CLR 641 (*'FAI'*).[5] The case involved a claim by a hospital under a professional indemnity policy of insurance. It was a term of the contract of insurance that if the insured notified the insurer during the period of cover of an occurrence which might subsequently give rise to a claim after the period of cover, then such a claim made after the policy period would be deemed to have been made during the policy period and thus be covered by the policy.

15. During the period of cover, the hospital received a letter from a solicitor stating that a former patient was intending to make a claim. The hospital did not give notice of the possible claim to the insurer. The former patient eventually made a claim after the period of cover. FAI denied liability on the basis that the occurrence was not notified during the policy period. The question for the High Court was whether the hospital could rely upon s 54(1).

16. Earlier decisions had reasoned that in determining whether s 54(1) applied in the circumstances of the case, the court must decide whether the refusal by the insurer to pay the claim was a result of the claim not falling within the scope of the cover or because of a condition restricting the cover.[6] It had been held that s 54(1) would not apply to the former circumstance, but would apply to the latter.

17. In *FAI*, the plurality (McHugh, Gummow & Hayne JJ; Kirby J agreeing in the result but giving a separate judgment) held that s 54(1) would apply to remedy the

[4] *Khoury v Government Insurance Office (NSW)* (1984) 165 CLR 622 at 638; quoted with approval by Brennan J in *Antico v Heath Fielding Australia Pty Ltd* (1997) 188 CLR 652 at 660.
[5] *Prepaid Services Pty Ltd v Atradius Credit Insurance Nv* [2013] NSWCA 252 (*'Prepaid'*) [128].
[6] *FAI v Perry* (1993) 30 NSWLR 89; *Greentree v FAI* (1998) 44 NSWLR 706.

consequences of the hospital's failure to notify the insurer of the potential claim. The plurality held that the application of s 54(1) must be considered in the context of *'the claim on the insurer which the insured has in fact made'*.[7] In other words, the question to be determined must be assessed with reference to the claim on the insurer actually made by the insured.

18. Their Honours agreed with the earlier authorities that s 54(1) could remedy the consequences of conditions restricting the cover. However, their Honours went on to say that s 54(1) would not operate to relieve the insured of restrictions or limitations which were 'inherent' in the claim. In other words, where the insured breached a condition which the court considered to be 'inherent' in the type of claim made, then s 54(1) would not apply to remedy the consequences of the breach.

19. Kirby J made a similar analysis. His Honour found that s 54(1) would not apply to acts which went to the 'substance', 'effect', 'core' or 'essence' of the policy.

20. The plurality went on to explain what types of things would be 'inherent in the claim' in certain insurance contracts. They stated, at [42], that:

> The restrictions that are inherent within a claim vary according to the type of insurance in issue. Under an "occurrence" based contract, no claim can be made under the contract unless the event insured against takes place during the period of cover. Under a "claims made and notified" policy, if no demand is made by a third party upon the insured during the period of insurance, any claim that may subsequently be made by the insured on the insurer (that is, the claim to which s 54 refers) would necessarily acknowledge that indemnity is sought in relation to a demand not of a type covered by the policy (because not within the temporal limits that identify those demands in relation to which indemnity must be given).

21. Based on this analysis, the plurality concluded that the failure to notify the insurer during the period of the policy of a potential claim was an omission which could be remedied by s 54(1) of the *Act*, as it was not 'inherent in the claim' and caused no prejudice to the insurer.

[7] *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001) 204 CLR 641, [40].

22. A different approach seems to have been taken (although it was not an essential part of either the Court's dispositive reason for allowing the appeal or of the alternative and correct basis for doing so) by the Queensland Court of Appeal in *Johnson v Triple C Furniture* [2010] QCA 282 (*'Triple C'*). The relevant reasoning in *Triple C* has been specifically disapproved by the High Court in *Highway Hauliers.* However, it is necessary to discuss the decision in *Triple C* so as to better understand the reasoning of the High Court.

23. The facts were relatively simple. Triple C Furniture owned an aeroplane. On 20 October 1999, Peter Johnson, who was a director, shareholder and employee of Triple C, flew the plane with two passengers, one of whom was Mr Johnson's wife. Shortly after take-off, the plane crashed as a result of Mr Johnson's negligence. Mr Johnson was killed and Mrs Johnson was seriously injured. Mrs Johnson brought proceedings against Triple C claiming compensation for her husband's negligence. Triple C did not dispute liability but sought indemnity under its insurance policy with Rural & General Insurance Limited. The insurer refused to pay the claim as the pilot had not satisfactorily completed an aeroplane flight review, which was an exclusion term under the insurance contract.

24. At first instance the Queensland Supreme Court found that there was insufficient evidence to show that the exclusion applied. That decision was overturned on appeal. The Court of Appeal held that there was sufficient evidence that Mr Johnson had not completed the flight review.

25. However, the Court of Appeal held that s 54(1) would not apply. There were three different reasons given for this conclusion.

26. First, Chesterman JA (with whom Holmes and White JJA agreed) said that the relevant act or omission was the failure by the pilot to satisfactorily complete a flight review. His Honour said that this could not be an act or omission under s 54(1), because the pilot could not complete the flight review without the support of his examiner. Chesterman JA stated at [72]:

> The circumstance that he had not satisfactorily completed a flight review was not an omission as the word is ordinarily understood and as it is, in my opinion, used in s 54. He may have omitted to undergo the review but what was required was that he

> complete the review to someone else's satisfaction. Obtaining that satisfaction was something Mr Johnson might achieve, or fail to achieve, but it was not something he could omit.

27. Thus, as the 'act' was not truly an 'act or omission', the Court held that it could not be remedied by the application of s 54(1).

28. In the Western Australia Court of Appeal decision in *Maxwell v Highway Hauliers Pty Ltd* (*'Maxwell'*),[8] McLure P said in effect at [84] that this approach did not give proper effect to the true meaning of "omission", and failed to consider the relevant question in accordance with that meaning. I respectfully agree.

29. Further, as Meagher JA pointed out in the decision of the New South Wales Court of Appeal in *Prepaid Services Pty Ltd v Atradius Credit Insurance Nv* [2013] NSWCA 252 (*'Prepaid'*) at [130], the construction of a contract of insurance is a matter of form rather than substance:

> [130] The effect of the contract of insurance must be determined as a matter of construction, unconstrained by distinctions between provisions which define the scope of cover and conditions or exclusions which affect the entitlement of an insured to claim. It is not controversial that s 54 is concerned with the effect of the contract as a matter of substance: *East End Real Estate Pty Ltd v CE Heath Casualty & General Insurance Ltd* (1991) 25 NSWLR 400 at 403–4 (East End) per Gleeson CJ, cited with approval in *Antico* at CLR 660 and 668–9; ALR 389 and 395–6 and *Australian Hospital Careat* [35] and [50]. It is necessary to consider the effect of the contract in the way in which it responds to the claim actually made by the insured. It is at this point that difficulties may arise in applying s 54(1) in circumstances where it is said by the insured that the act or omission is the reason why the insured's claim is not with respect to a risk or event covered by the policy.

30. In the alternative, should the conclusion in relation to an act or omission be incorrect, Chesterman JA stated that the claim was outside the scope of the contract of insurance. His Honour said at [77]:

[8] [2013] WACA 115.

> … The policy did not offer indemnity in circumstances where the aircraft was flown by a pilot who had not satisfactorily completed a flight review within two years previous to the loss.

31. That conclusion appears to be based on the reasoning in [80]:

> [80] From the description essayed in *Antico*, and endorsed in *FAI Insurance* (652), for the purposes of s 54 an act or omission is the performance, or non-performance, of some activity which the contract of insurance requires, allows or contemplates and which may affect its operation. The act or omission is not something which can bring about or alter the circumstances which give rise to a claim for payment or indemnity under a policy of insurance. This understanding of "act or omission" seems to follow from its designation as something which is not necessarily an obligation contained in the contract of insurance but may be the "exercise (of) a right, choice or liberty which the insured enjoys under the contract of insurance". The acts or omissions by reason of which the insurer may refuse to pay a claim are not acts or omissions which change the facts on which a claim is based.

32. That analysis led his Honour to reason at [82], [83] that the "act" was outside the policy:

> [82] By contrast where the act or omission was not something which the contract provided for but, on the hypothesis that the act or omission had not occurred, was something which would make the policy answer the claim, the section was held not to apply. In *Greentree v FAI General Insurance Co Ltd* (1998) 44 NSWLR 706 an insured made a claim on its insurer for indemnity against a liability to which the insured had become exposed. The policy promised indemnity for claims made against the insurer in a defined period. The claim was made on the insured outside that period. An argument that "some other person" had omitted to make a claim on the insured in the period of insurance was rejected. *Permanent Trustee Australia v FAI General Insurance Co Ltd* (1998) 44 NSWLR 186 was to the same effect.
>
> [83] The appeal, in my opinion, is of the second type. It is not a case in which the omission gives rise to a right in the insurer, the appellant, to refuse the claim by reason of something in the policy. It is an omission which is relied on to give rise to a claim which the insured could not otherwise make. Because Mr Johnson had not satisfactorily completed the flight review, the respondent's claim for indemnity under the policy was excluded. The omission cannot change that, and is not of the kind with which s 54 is concerned.

33. Thus, his Honour considered that the effect of the contract of insurance was only to insure the aircraft whilst operated by a pilot who had completed the necessary flight review. Using the language of the *FAI* decision, he held that the satisfactory completion of the flight review was 'inherent' in the claim. Therefore, s 54(1) could not apply in that situation to remedy the failure by the pilot to complete the flight review.

34. It is this aspect of the reasoning in *Triple C* that has been specifically disapproved.

35. Thirdly, Chesterman JA said that in any event, the "act" could reasonably be regarded as having caused or contributed to the loss. Thus, the facts fell with s 54(2) and by definition outside s 54(1). That aspect of the reasoning is, with respect, impeccable. I note that the High Court refused special leave to appeal.

36. The approach taken to s 54(1) in *Triple C* was put in doubt by the Western Australia Court of Appeal decision in *Maxwell* (which was later approved by the High Court in *Highway Hauliers*) and by the New South Wales Court of Appeal in *Prepaid* (an appeal from my decision in *Prepaid Services Pty Ltd v Atradius Credit Insurance Nv* [2012] NSWSC 608).

37. In *Maxwell*,[9] McLure P dealt with this issue at [85]. Her Honour said, in effect, that the approach taken by Chesterman JA did not properly reflect the language of the subsection:

> [85] I turn now to the insurers' submission based on their understanding of Chesterman JA's reasoning in [80] of his judgment. The insurers rely on the judge's reference to the relevant act or omission being in relation to an "activity which the contract of insurance requires, allows or contemplates". There is nothing in the statutory text, statutory purpose or binding authorities for concluding that this is an essential element of s 54(1). Even if it is applicable on the facts of this case, the result of the application of the test depends upon the identification of the content of the relevant "activity". It should be confined to the particular activity to which the failure relates: in *Antico* the activity was incurring legal costs; in this case, driving nominated

[9] *Maxwell v Highway Hauliers Pty Ltd* [2013] WACA 115.

> vehicles on the east-west run; and in Johnson, flying the aircraft. The relevant omission in each case relates to that activity. There is no warrant for widening the content of "activity" to include the relevant omission with the consequence that the compound activity (incurring legal costs without consent; driving the nominated vehicles on an east-west run without having satisfactorily completed the PAQS test; or flying an aircraft in breach of the civil aviation regulations) is not what the contract "requires, allows or contemplates". This latter approach to narrowing the scope and application of s 54(1) is not consistent with either *Antico* or *FAI* and in my respectful opinion is wrong. If that is how the test was applied in Johnson, I would decline to follow it.

38. Pullin and Murphy JJA gave separate reasons, concurring (with McLure P) in the result. Their Honours did not find it necessary to criticise the relevant reasoning in *Triple C*. See Pullin JA at [119] to [122] and Murphy JA at [147] to [149].

39. In the Court of Appeal decision in *Prepaid*, Meagher JA (with whom Macfarlan and Emmett JJA agreed), specifically declined to follow the reasoning in *Triple C*, stating:

> In my respectful opinion … [the Court in *Triple C*] … proceeded other than in accordance with the principles and approach stated in *Australian Hospital Care* and applied in *Maxwell v Highway Hauliers* [referring to the Court of Appeal decision].

40. The facts in *Prepaid* involved a contract of insurance to provide trade credit cover with respect to contracts entered into between Prepaid and Bill Express Ltd (BXP) on terms that provided for payment within 28 (or later 30) days. The only contract between Prepaid and BXP was not on those terms. The main issue in the case involved misrepresentations by Prepaid under s 28 of the *Act* in relation to the terms of the contract with BXP. However, Prepaid also made a claim for relief under s 54(1), claiming that the reason that Atradius refused to pay the claim was that Prepaid had contracted with BXP on different terms. This argument was rejected both by me at first instance and on appeal.

41. Meagher JA analysed the concept of restrictions or limitations inherent in the claim, with reference to the characterisation of 'the effect of the contract and the identification of the event insured'.[10] His Honour reviewed the case law on this issue,

[10] *Prepaid Services Pty Ltd v Atradius Credit Insurance Nv* [2013] NSWCA 252, [136].

before concluding that the payment defaults, in relation to which Prepaid made its claim for indemnity, were 'not covered by the policy'.[11] This was because the contracts which were covered by the policy of insurance were identified by a description of their terms. The particular contracts in question, being the contracts with BXP, did not meet that description as they were made on different terms. Therefore, the contracts with BXP fell outside the scope of the cover, and the restriction in the insurance contract, that only debts incurred under contracts which had the specified terms would be covered, constituted a restriction inherent in the claim. Thus, the consequences could not be remedied by s 54(1).

42. The High Court agreed with that approach in *Highway Hauliers*. That decision explained clearly and concisely how s 54(1) should be interpreted and applied.

43. In that case the respondent, Highway Hauliers (HH), operated a freight transport business. HH entered a contract of insurance with Lloyd's Underwriters (insurer). An endorsement, which formed part of the contract of insurance, excluded indemnity unless the driver of the vehicle had achieved a PAQS profile score of at least 36 (or an equivalent approved test score). Two of HH's vehicles were damaged during the period of insurance. Those vehicles were driven at the time of the damage by drivers who had not undertaken the PAQS testing. The insurers refused to indemnify HH with respect to the claims made because the drivers were untested.

44. Relying on the reasoning in *Triple C*, the insurer argued that the failure to achieve minimum test scores was an inherent limitation in the claim and could not be remedied by s 54(1). This was because the words of the endorsement that "no indemnity was provided" unless the driver had satisfactorily completed the PAQS test, meant that the two accidents were outside the scope of the cover. The High Court unanimously rejected the insurer's interpretation stating, at [17], that '[t]heir argument reduced to the proposition that the "claim" to which s 54(1) refers is limited to a claim for an insured risk'.

45. Their Honours went on to say that the insurer's interpretation equated restrictions or limitations inherent in the claim with any restriction or limitation on the scope of cover

[11] *Prepaid Services Pty Ltd v Atradius Credit Insurance Nv* [2013] NSWCA 252, [144].

in the contract. Instead, their Honours said, at [23], a restriction or limitation inherent in the claim:

> is a restriction or limitation which must necessarily be acknowledged in the making of a claim, having regard to the type of insurance contract under which that claim is made.

46. In applying this reasoning, their Honours said at [26] that s 54(1) was engaged in that case because the insurer had only refused to pay the claim by reason of the "act" of the insured, relevantly the omission by HH as the insured party to ensure that each driver had undertaken the appropriate PAQS test (or equivalent):

> Here the fact that each vehicle was being operated at the time of the accident by an untested driver is properly characterised as having been by reason of an "act" that occurred after the contract of insurance was entered into. There was an omission of the Insured to ensure that each vehicle was operated by a driver who had undertaken a PAQS test or an equivalent program approved by the Insurers.

47. In relation to the application of s 54(1) more generally, their Honours said, at [27], that:

> … it is sufficient to engage s 54(1) that the effect of the Policy is that the Insurers may refuse to pay those claims by reason only of acts which occurred after the contract was entered into. Precisely how the Policy produced that effect is not to the point.

This 'effect of the Policy' approach is analogous with the approach taken by the New South Wales Court of Appeal in *Prepaid*. It is clear from that passage of the High Court that it will now be the effect of the contract of insurance which is relevant when determining whether or not s 54(1) will be enlivened.

48. Finally, their Honours said that the decision in *Triple C* in the respects summarised at [30] to [33] above should not be followed.

49. The concise and unanimous character of this decision should avoid much of the uncertainty of the previous divergence of opinion as to s 54(1). It is now established that the question to be determined by the courts will be whether the effect of the

policy is that the insurer may refuse to pay only by reason of the acts which occurred after the contract was entered into. This applies irrespective of how that effect is produced by the contract of insurance or the type of contractual term relied upon to deny liability to the claim. This appears to be significantly wider reaching than the *Triple C* approach.

50. The High Court has emphasised, in *Highway Hauliers*, that contractual stipulations should be analysed in a purposive way by examining what those provisions actually do, or the effect of such provisions, rather than how they are labelled in the contract. Further, 'claim' as it appears in s 54(1) is not limited to a claim for an insured risk. Thus, the ways in which an insurer may avoid the application of s 54 appear to have been significantly limited by the decision.

Proving the hypothetical

51. Another area of concern raised by s 54(1) is the issue of proof of prejudice to the insurer. This arises because the insurer may, under s 54(1), reduce the amount of the claim 'by an amount that fairly represents the extent to which the insurer's interests were prejudiced' by the relevant act or omission.

52. The question of prejudice caused necessarily requires an examination of the counterfactual situation to determine what the insurer would have done, had the act or omission not occurred.

53. The effect of s 54(1), where it applies, is to impose a prima facie liability upon the insurer to pay the insured's claim. This liability will be reduced to the extent that the insurer can show it suffered prejudice as a result of the act or omission. Thus, the burden of proof will fall upon the insurer to establish that prejudice was suffered and to quantify the extent of that prejudice.

54. It is well established that in determining the 'prejudice' caused to the insurer, the court must have regard to the actual insurer, rather than some hypothetical insurer in the same or similar circumstances. This was discussed in *Ferrcom Pty Ltd v Commercial Union Assurance Co of Australia Pty Ltd* (1993) 176 CLR 332. The Court (Brennan, Deane, Dawson, Gaudron and McHugh JJ) said, at 340:

> As liability imposed by s. 54(1) is a liability which, but for the relevant "act", would have arisen under the contract of insurance, the "insurer" in s. 54(1) must be taken to be the actual insurer and "the insurer's interests" must be taken to be the interests which it would have had but for the relevant "act", leaving out of account the liability imposed by s. 54(1).

Thus, the court must compare the position that the actual insurer would have been in but for the act or omission of the insured, to the position that the insurer is in fact in as a result of the act or omission.

55. In *Ferrcom* the insurance policy covered an unregistered mobile crane. The crane was later registered by the insured, without notice being given to the insurer. The trial judge found that, had notice been given, the insurer would have cancelled the policy and offered other cover designed for registered cranes.

56. The High Court held that the 'loss of the opportunity to cancel the policy was the material prejudice suffered'. The 'value of that lost opportunity [was] … equivalent to the liability imposed on [the insurer] by s 54(1) of the Act'. Thus, the insurer's liability was reduced to nil.

57. The High Court went on to say that that determination must necessarily be based upon the hypothesis that the insurer would have cancelled the policy and issued a new policy, without the relevant endorsement. They stated that:

> The hypothesis is not an historical fact; the Court must form an estimate of the likelihood of (the insurer) having acted in that way…

58. Therefore, in order to determine the prejudice caused, the court must consider the counterfactual situation, asking what the insurer is most likely to have done, had the act or omission not occurred.

59. The High Court discussed the issue more recently in *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149. The case involved a claim by an employer in relation to an injured employee. The insurer sought to deny the claim as the

insured did not notify the insurer of the injury within the timeframe required in the insurance contract.

60. As a general proposition, established by the authorities, the High Court stated that the amount for prejudice caused, when applying s 54(1), was similar to the amount allowed for compensatory damages. They stated at [16]:

> … like an amount allowed for compensatory damages for breach of contract, the amount of which s 54(1) speaks, as fairly representing the extent to which the insured's interests were prejudiced, will be the actual financial damage that has been or will be sustained as a result of the relevant act or omission.

61. After stating, with approval, the principles discussed in *Ferrcom*, the Court went on to say at [17]:

> Thus, although relevant prejudice may be found to consist in the existence of a liability which would not have been borne if there had not been the relevant act or omission, the quantification of the amount representing the extent of the insured's prejudice as a result of the act requires the identification of what are the financial consequences that, in fact, have been, or will be, caused by that act or omission.

62. Nevertheless, in that case the Court found that the insurer had not discharged its burden of proof, as it could not establish what would have been done, had the act or omission not occurred. Thus, the Court upheld the decision of the trial judge, agreeing that a comparable case or some other evidence should have been provided to prove what the insurer would have done. At [24], their Honours said:

> … the amount that fairly represented the extent to which the respondent's interests were prejudiced was not established by pointing to what might have been done; in this case, it was necessary to prove, to the requisite standard of proof, what would have been done.

63. If an insurer is to reduce its liability, it must do more than point to possible alternatives. It must demonstrate, on the balance of probabilities, what it would actually have done if the act or omission had not occurred, and from that, what prejudice it has actually suffered.

64. As a practical matter, it necessarily will be difficult for the insurer to establish by way of evidence what prejudice was caused. The cases show that contemporaneous evidence, rather than evidence with the benefit of hindsight, will be preferred.[12] The cases further refer specifically to comparable cases as one possible method of establishing what the insurer would have done in the counterfactual world.[13] Nevertheless, this type of evidence is difficult to obtain.

65. The question of proving the hypothetical arises also in relation to s 28, which similarly allows a reduction in liability for non-fraudulent non-disclosure or misrepresentation 'to the amount that would place the insurer in a position in which the insurer would have been if the failure [to disclose] had not occurred or the misrepresentation had not been made'. Thus, a similar analysis of the evidence will need to be applied.

66. The Court of Appeal decision in *Prepaid* discussed the burden of proof in relation s 28. The Court remitted the determination of the 'counterfactual' issues to me to determine. Meagher JA said at [91]:

> This evidence [summarised in earlier paragraphs] is relevant to whether, on the balance of probabilities, Atradius would not have issued a policy. While the appellants had the evidentiary burden of establishing that they would have provided further information which sought to explain the position in relation to the payment plans, the onus of proving on the probabilities that such a policy would not have issued remained on the respondent. Whether that burden had been discharged required consideration of the evidence referred to above. The primary judge has not done that. I do not read his Honour's observation at [242] as a finding that the probabilities were that no satisfactory explanation would have been forthcoming and resulted in the issue of a policy. His Honour's statement that what might have happened "is a matter of speculation" is inconsistent with the making of such a finding.

67. I dealt with the remitted question in the decision of *Prepaid v Atradius (No 2)* [2014] NSWSC 21, where I ultimately found:

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[12] See, eg, *Ferrcom Pty Ltd v Commercial Union Assurance Co of Australia Pty Ltd* (1993) 176 CLR 332; *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149; *ABN AMRO Bank NV v Bathurst Regional Council* [2014] FCAFC 65, [929].

[13] *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, [24].

on the balance of probabilities, that if the proposal had given truthful and complete answers in respect of the payment plans, Atradius would not have issued the policy.

68. I reached this decision because the evidence showed what further information would have been requested and provided had the misrepresentation not been made, and how Atradius would have responded to such further information. I found, based on that evidence, that BXP was a 'most unappealing credit risk' and that anything that Prepaid could have said truthfully about BXP, would not have been sufficient to alleviate the concerns the insurer would have had about that company. Thus, on the balance of probabilities, I found that had the misrepresentation not occurred, Atradius would not have issued the policy. There was no evidence as to whether some alternative policy would have been issued, or the terms of any such policy. Thus, judgment was entered in favour of Atradius.

69. Nevertheless, the decision highlights the difficulties associated with counterfactual questions. It requires an assessment of what the particular insurer would have done, which of course is difficult to determine after the fact. In some cases, extrinsic evidence may be available of how that insurer ordinarily responds to the given situation. However, in most cases, this type of evidence does not exist. Thus, the court is forced to rely upon more or less speculative evidence given by interested parties as to what they would have done in the past had the act or omission not occurred. Again, the court must be careful of hindsight, which may understandably skew the evidence of either party.

Conclusion

70. The decision in *Highway Hauliers* has provided significant clarity with respect to s 54(1) and to what acts or omissions it will apply. Insurers and practitioners in the insurance field should familiarise themselves with the decision so as to provide accurate advice. It is important to recognise that it will be the effect of the policy which is examined, in the context of the actual claim made, to determine whether or not s 54(1) will apply to remedy the act or omission.

71. The practical difficulties associated with proving prejudice will continue to arise, and will continue to cause problems for courts. Parties to insurance disputes of this nature should be conscious to attempt to provide the best, if possible extrinsic and

contemporaneous, evidence of what they would have done in different circumstances. Of course, this will often not be available. However, where it is, it would greatly improve the prospects of the insurer proving to the requisite standard the prejudice caused.