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How Smart: Court Confines the Statutory Duty of Utmost Good Faith

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Introduction

In *Smart v Westpac Banking Corporation* [2011] FCA 829, Jagot J of the Federal Court considered whether the statutory duty of utmost good faith in section 13 of the **Insurance Contracts Act 1984 (Cth) (ICA)** extended to an “insured person” under a directors & officers policy where that person was not a party to the insurance contract. The decision affirmed the decisions in *Zurich Australian Insurance Ltd v Metals & Minerals Insurance Pty Ltd* (2009) 240 CLR 391 (**Zurich**) and *Hannover Life Re of Australasia Ltd v Sayseng* [2005] 13 ANZ Ins Cas 90-123 that the statutory duty does not extend to persons who are not parties to the contract.

This is presently good news for insurers as it confines the class of persons who are legally entitled to bring claims for damages for breach of the statutory duty strictly to the parties to the contract (and should therefore contain potential litigation costs). However, it is worth noting that if the proposed amendments to section 13 of the ICA are enacted, the duty is unlikely to be so confined.

Facts

Mr Fitzgerald was a former officer of Westpac who was joined as cross-defendant by Westpac to proceedings brought against Westpac by its former employees. Mr Fitzgerald sought indemnity under Westpac’s D&O policy for his defence costs. He also sought to bring a second claim against the insurers for breach of section 13 of the ICA, being the implied duty of parties to a contract of insurance to act towards each other with utmost good faith.

The insurers argued that Mr Fitzgerald should not be granted leave to plead his section 13 claim on the basis that as a matter of law Mr Fitzgerald’s claim was futile.

Finding

There was no dispute that Mr Fitzgerald was an officer of Westpac and therefore an insured person within the meaning of the policy. There was also no dispute that insurers had to act towards Mr Fitzgerald in “utmost good faith” in accordance with their common law duty to named insureds.

However, if insurers were found to have breached that common law right, that breach would not have granted Mr Fitzgerald a remedy in damages. This is because the common law duty does not operate to imply a term of “utmost good faith” into the insurance contract in the same manner as section 13 (*Khoury v Government Insurance Office (NSW)* [1983] 165 CLR 622). In short, in the absence of implied term in the contract, there is no basis to bring a claim in damages for a breach of the duty of utmost good faith (merely a right to force an insurer to act with utmost good faith in accordance with the common law duty).

This meant that in order to be entitled to claim any damages for breach of contract, Mr Fitzgerald had to argue that section 13 applied to him, despite the fact he was not a party to the insurance contract.

In finding against Mr Fitzgerald, Jagot J affirmed the reasoning from **Zurich** saying that:

- + section 48 does not deem a non-party insured to be a party to the contract of insurance; and
- + not being a party to the policy Mr Fitzgerald could not rely on the provisions of section 13 of the ICA.

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Future?

Cases on section 13 are rare. Here, the Court's role was fairly simple - to affirm that the statutory duty of utmost good faith did not extend beyond the parties to the insurance contract and consequently did not allow Mr Fitzgerald leave to so argue (meaning the Court did not need to even consider the conduct of the insurer).

However, a proposal put forward in the *“Review of the Insurance Contracts Act 1984, final report on Second Stage: Provisions Other than Section 54”* prepared by Alan Cameron AM and Ms Nancy Milne AM and adopted in the proposed amendments to the ICA (still pending) provides third party beneficiaries access to section 13. It is an amendment which has attracted some criticism, particularly from insurers who believe it may result in further disputes and increased legal costs.

If the proposed amendments had applied to this case they would probably have given Mr Fitzgerald a statutory right against the insurers for damages (in the same way a party to the contract has a contractual right for damages implied by operation of statute). Accordingly, while Mr Fitzgerald could not pursue that claim here, that position is likely to change in the future if/when the proposed amendments to the ICA are enacted. Insurers should therefore be on notice of the likely shift and be comfortable that they understand the impact that such an amendment presents on the potential for a further class of persons (third party beneficiaries) to seek damages for an alleged breach of the duty of utmost good faith.

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