wotton kearney

Section 54: It is all in the Act

24 FEBRUARY 2016

What happened

+ Two recent decisions have clarified when section 54 is engaged.

The implications

+ Section 54 can only be engaged if the claim/occurrence is within the scope of cover.
+ The relevant act or omission is integral to engaging section 54.
+ Careful policy drafting is required with a view to avoiding section 54.

Two recent decisions of the Western Australia Court of Appeal and the NSW Federal Court show that section 54 of the Insurance Contracts Act 1984 (**the Act**) is still causing trouble over 30 years after its inception, and after what was thought to be the definitive judgment of the High Court in *Maxwell v Highway Hauliers Pty Ltd* [2014] HCA 33 (**Highway Hauliers**), which adjudicated two competing decisions (see our case note of 11 September 2014).

As a recap, section 54 provides that:

1. where the effect of the policy is that a person's act or omission (after inception of the policy) would otherwise entitle an insurer not to pay a claim;
2. an insurer is not entitled to refuse to pay that claim unless that person's act or omission caused the loss or prejudiced the insurer, in which case the insurer's liability can be reduced by the prejudice suffered.

Two recent cases involved an assessment of whether the insurer's denial of indemnity arose by reason of an act of the insured or 3rd party (in which case, what act?), or whether it was merely because the policy did not cover the risk complained of. Section 54 can remedy the former, but not the latter.

Allianz Australia Insurance Ltd v Inglis [2016] WASCA 25 (Inglis)

Inglis concerned an Allianz home insurance policy which:

1. provided cover for the homeowner's legal liability to pay compensation in respect of bodily injuries caused as a result of an accident; and
2. excluded cover for legal liability for injury to any person who normally lives in the house (**the Exclusion**).

Mr and Mrs Inglis had an Allianz home insurance policy and a son and daughter who normally lived in the home. The Inglis' children were playing at Mr and Mrs Sweeney's home and, whilst playing, the Sweeneys' son ran over the Inglis' daughter whilst driving a lawn mower. The lawn mower was owned by Mr Inglis (allegedly having been driven to the Sweeneys' home by the Inglis' son). The Inglis' daughter commenced proceedings against the Sweeneys and their son claiming damages for negligently caused personal injuries. The Sweeneys issued third party proceedings against Mr & Mrs Inglis who sought cover under their home insurance. Allianz relied on the Exclusion and declined cover on the basis that the Inglis' daughter normally lived in the home.

Relevantly, the District Court of Western Australia sought to rely on its interpretation of the Highway Hauliers decision in determining that section 54 applied and prevented Allianz from declining cover. The basis being that the relevant act for the operation of section 54(1) that was relied on for the declinature of cover was the daughter normally residing at the Inglis' home. That act relevantly occurred after the policy incepted and had not caused or contributed to the loss, such that section 54 applied to remedy that act.

Allianz successfully appealed that decision. The Western Australia Court of Appeal agreed with Allianz's argument that the District Court had erred in finding that the Inglis' daughter normally living at home was an act for the purpose of section 54. While the Court of Appeal recognised the remedial nature of section 54 and that its *"language should be construed so as to give the most complete remedy …consistent with* [its] *actual language …"*, it held that *"in its natural and ordinary meaning, an act is different from a state of affairs or the result of an act"*. As a result, the Court of Appeal determined that the Inglis' daughter normally living at home was a state of affairs, rather than an act for the purpose of triggering section 54. The relevant trigger for the Exclusion (i.e. whether the person normally lives with) was a temporal exclusion that was not dependent on any one act. Notably, on the particular day, there was no requirement for the daughter to have been living at home, only that she normally did so. Ultimately it was a question of fact, drawn from inferences and evidence over an extended period of time, rather than a particular act on any particular day. The Court said it was comparable to an exclusion regarding liability to an employee, the trigger for which required an analysis of whether an employer/employee relationship existed. Section 54 would not be invoked to alter that relationship assessment.

Pantaenius Australia Pty Ltd v Watkins Syndicate 0457 at Lloyds [2016] FCA 1 (Watkins)

Watkins concerned a luxury yacht owned by Mr Phillips which had two separate insurance policies issued by Pantaenius Australia and Nautilus Marine (**Nautilus**). The Nautilus policy contained a clause which suspended cover from when the yacht cleared Australian customs, for the purpose of leaving Australian waters, until it cleared Australian customs on its return – importantly the yacht had to sail through Australian waters on its return in order to reach Australian customs.

The yacht cleared Australian customs on 4 May 2013 and participated in the Freemantle to Bali race. Following the race, and during the course of its return journey, the yacht ran aground near Cape Talbot – whilst in Australian waters, but prior to the yacht clearing Australian customs. The Pantaenius policy responded to the claim, but Nautilus rejected the claim on the basis that its policy was suspended at the time of the incident. Pantaenius subsequently issued proceedings against Nautilus in the Federal Court seeking an equitable contribution on the basis of double insurance. The issue was whether section 54 applied so as to prevent Nautilus from relying on its suspension of cover clause.

Pantaenius maintained that the relevant act for the purpose of section 54 was the yacht re-entering Australian waters without having cleared Australian customs. Nautilus countered that cover was not available at the time of the incident and therefore section 54 did not apply. Nautilus submitted the case fell within the ambit of *Prepaid Services Pty Ltd v Atradius Credit Insurance NV* (2013) 302 ALR 732 (**Prepaid**) which held that the reason for the denial was not that the relevant credit contracts were on different terms (which was an omission by the insured), but because the policy did not cover such contracts in the first place.

Justice Foster:

- first distinguished the Prepaid decision and determined that section 54 was applicable because the suspension of cover, pending the yacht clearing Australian customs, was akin to an exclusion rather than a temporal limit determining the scope of cover. This is an important distinction, as it allowed section 54 to be engaged because cover was generally available under Nautilus policy but was merely suspended/excluded. Justice Foster reasoned that as the purpose of the Nautilus policy was to insure the yacht whilst in Australian waters, the suspension of cover operated to exclude some Australian waters due to the Australian customs clearance requirement, rather than the Australian customs clearance defining the scope of cover. Justice Foster stated that his view may have been different if the yacht ran aground in Indonesian waters – as cover would not be available under the

Nautilus policy (as it was outside Australian waters) and section 54 would therefore not be engaged. In such circumstances, the reason why cover would be unavailable was not because of the insured's act of steering the yacht out of Australian waters (which may have been inadvertent), but because no cover was available for such a risk in any event;

- determined that the relevant act for section 54 was the yacht clearing Australian customs and departing Freemantle, rather than not having cleared Australian customs on its return to Australian waters (as submitted by Pantaenius);
- determined that the yacht first clearing Australian customs had not increased the nature of the risk regarding cover in Australian waters. For example, the Nautilus policy would have responded if the yacht had run aground off Cape Talbot while on its way to Darwin (rather than Bali), because the suspension of cover clause would not have been triggered. Section 54 was therefore engaged and Nautilus could not decline cover; and
- ordered that Nautilus pay a contribution on the basis of double insurance.

Two side notes: (1) Justice Foster also determined that it is not merely insureds that can rely on section 54; and (2) the Act was applicable rather than the Marine Insurance Act 1909 (Cth) because the yacht involved was a 'pleasure craft'.

Implications

The Inglis and Watkins cases provide further guidance on the operation of section 54 and emphasise that:

1. the relevant act or omission is integral to engaging section 54; and
2. section 54 can only be engaged if the claim/occurrence is within the scope of cover.

It is important for insurers to ensure that any clause restricting cover is consistent with the extent of cover intended to be provided, so as to avoid engaging section 54. The difficulty for an insurer is that section 54 applies as a matter of substance over form, so merely restricting cover in an insuring clause or a carefully crafted exclusion will not necessarily be effective. However, careful policy drafting is the only means to ensure that any limitation of cover arises by reason of the claim/occurrence falling outside the scope of intended cover, rather than excluding/limiting the intended cover available.

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