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Client Update

Shaping the future of insurance law

NZ Court of Appeal upholds insurers' right to cancel the policies of fraudulent claimants

***Taylor v Asteron Life Limited* [2020] NZCA 354**

28 AUGUST 2020

AT A GLANCE

- In 2019, in *Taylor v Asteron Life* [2019] NZHC 978, the High Court found for the insurer in a matter involving a fraudulent total disability claim made by an insurance broker.
- The decision was significant as it was the first time the High Court relied on the *Contracts and Commercial Law Act 2017* to address the breach of the utmost good faith duty, rather than the principles of common law.
- The decision was appealed on a number of grounds, including that the insurer was not entitled to cancel the policy. On 19 August 2020, the Court of Appeal allowed the appeal in part, but mostly found for the insurer.
- This decision was significant as it is the first time the Court of Appeal has applied the common law fraudulent claims rule.
- The decisions by the High Court and the Court of Appeal in *Taylor* uphold insurers' rights to cancel policies and seek damages when there are fraudulent claims.

BACKGROUND

In December 2009, Mr Taylor, a self-employed insurance broker, suffered an illness and made a claim for total disability under the income protection policy he held with Asteron. Under the policy, he was entitled to total disability benefits if he worked less than 10 hours a week or for partial disability benefits if his income was equal to or less than 75% of his insured income due to his illness.

From 2009 to 2014, Mr Taylor received regular payments under the policy for total disability and provided the insurer with updates about his health and income. In September 2014, Asteron suspended payments when it did not receive adequate, accurate information about Mr Taylor's work hours and income.

Mr Taylor commenced proceedings in the High Court, seeking continuing benefits under the policy and arrears. In response, Asteron counterclaimed that he had breached his duty of utmost good faith by making false statements in the claim forms. The insurer sought to cancel the policy and to receive restitution for all payments made under the policy. Mr Taylor tried to defend the counterclaim by arguing a "change of position", which caused him to rely on the payments.

THE HIGH COURT DECISION

The High Court held that Mr Taylor had made deliberate, material false statements about how much he was working and that he had falsified his income accounts. The court dismissed Mr Taylor's primary claims as it found he did not meet the thresholds for receiving either total disability benefits or partial disability benefits. Mr Taylor's "change of position" argument also failed as the evidence did not establish that he relied on the claim payments when making decisions about his lifestyle expenditure, which had included the purchase of a Maserati and long-distance flights. The Court also said there was an absence of good faith here, which is required in a defence of change of position.

In the counterclaim, Asteron had relied on common law principles for assessing its available remedies. Mr Taylor, however, had relied on an application of the *Contract and Commercial Law Act 2017* (CCLA). As the parties eventually agreed the Act addressed all of the issues, the Court proceeded on the basis of that legal framework. In applying contractual analysis, the High Court found that the duty of good faith was an implied term of the insurance contract.

Accordingly, he was found to have breached his obligation of utmost good faith under the insurance contract and was liable to repay more than $371k, which had been paid out under the policy. Adding interest, costs and disbursements, the net judgment figure against Mr Taylor came to $666k.

ON APPEAL

Mr Taylor appealed the decision arguing, among other things, that Asteron was not within its rights to cancel the policy as dishonesty was not an issue in these proceedings and because Asteron had not given written notice of the cancellation.

Mr Taylor was successful in having Asteron's counterclaim damages reduced by approximately $51k to reflect the initial period in which his claims were honest. The Court of Appeal otherwise upheld the High Court's decision that Asteron was entitled to damages for all payments made due to Mr Taylor's dishonest claims.

The Court also acknowledged Asteron operated under the influence of a mistake in paying the initial claims of approximately $51k, as Mr Taylor earned enough to cancel out any payments due.

It noted that, had Asteron pled a claim for recovery of overpayments, it would have been entitled to recover the mistaken payments in a restitution claim.

The Court stated that, as Asteron did not seek leave to amend its pleading, "it cannot now complain that it is unable to pursue a claim that it chose not to seek to pursue". The Court of Appeal also found the policy was effectively cancelled in April 2016 by way of notice in Asteron's plea.

Section 41 of the CCLA requires notice of cancellation before the cancellation will take effect. While Asteron did not write to Mr Taylor cancelling the policy, the Court of Appeal found that Asteron expressed its intention in its pleading dated 11 April 2016 and found the contract to have been validly cancelled in April 2016.

> **Both the High Court & Court of Appeal decisions uphold an insurers' rights to cancel policies & seek damages when there are fraudulent claims.**

It confirmed Asteron was entitled to cancel the policy under the CCLA if, and only if, Mr Taylor breached the implied essential term that the insured must act honestly when making a claim. Mr Taylor argued that dishonesty was not an issue in these proceedings and was never squarely pled or put to Mr Taylor by Asteron.

The Court disagreed, stating that Asteron's allegation that Mr Taylor had breached the duty of utmost good faith was synonymous with an allegation of dishonesty. Asteron's pleadings were found to be sufficient to put in issue the honesty of Mr Taylor's statements in the insurance forms. As Mr Taylor knew Asteron was alleging dishonesty, it was considered he had fair opportunity to respond.

IMPLICATIONS FOR INSURERS

This matter is significant for insurers as both the High Court and the Court of Appeal decisions uphold an insurers' rights to cancel policies and seek damages when there are fraudulent claims.

The first instance decision was the first time the High Court relied on the CCLA to address the breach of the utmost good faith duty. Similarly, *Taylor* was the first time the Court of Appeal had applied the common law fraudulent claims rule.

Policy cancellation

An insurer's right to cancel an insurance policy is governed by section 40 of the CCLA. Cancellation due to a claim depends on:

- the terms of the policy – express or implied – governing the making of claims
- whether the insured has breached a relevant term of the policy, and
- whether that breach entitled the insurer to cancel the contract – that will be the case if, and only if, the contract expressly provides for a right to cancel in the circumstances that have occurred, or the test of cancellation in section 37 of the CCLA is met.

The Court of Appeal explored the process under the CCLA regarding an implied term. It found, in the absence of an express term providing for cancellation, the insurer will be entitled to cancel if a term is breached and either that term is essential or the consequences of the breach are substantial.

The Court of Appeal said that ability to rely on the implied term is essential to the insurer, as no insurer would be willing to contract with an insured who is not willing to promise to act honestly regarding claims.

Therefore, if an insured makes a dishonest claim, the insurer is entitled to damages for any loss caused by that breach and is entitled to cancel the contract under s 37(1)(b) and (2)(a) of the CCLA. Such a cancellation should operate prospectively (section 42).

Previous use of the fraudulent claims rule in NZ Courts

In this case, the Court of Appeal referenced the English authorities on the common law fraudulent claims rule.

Under the rule, if an insured acts fraudulently in making a claim, the whole of the fraudulent claim is disallowed. Its purpose is to dissuade fraudulent insured from thinking: "if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing".

The fraudulent claims rule has not previously been considered in any detail in New Zealand's Court of Appeal or Supreme Court.

It has been considered in a number of first instance decisions, where it was used to apply a standard of dishonesty regarding claims made. However, it has not been used to consider the more demanding standard of disclosure that applies before an insurance policy is entered into.

Importantly, none of the first instance decisions looked at the source of the fraudulent claims rule and whether or not it can be characterised as an implied term of the policy.

Implied term in all contracts of insurance

In *Taylor*, the Court of Appeal decided that the fraudulent claims rule should be seen as a term implied by law in all insurance contracts so that:

- the insured must act honestly when making a claim, and
- if the insured dishonestly makes a claim that is false in some material way, the whole of the fraudulent claim will be disallowed.

The implied term is reinforced by the *Fair Insurance Code 2020,* which advises insureds that they should act honestly when making a claim. This implied term should not go beyond the well-established common law fraudulent claims rule – if an insurer wants to contract on more stringent terms then they can do so expressly.

In summary

Taylor confirms that when a fraudulent claim is made the insurer can cancel the policy, which is terminated from date of cancellation. The insurer is not obliged to pay the fraudulent claim by virtue of the implied term of the fraudulent claims rule.

It is also worth noting, where a policy can be cancelled, the cancellation does not affect other valid claims made under the policy before the date of cancellation.

NEED TO KNOW MORE?

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