CONTRACTS AND COMMERCIAL LAW REFORM COMMITTEE

Discussion Paper

PRELIMINARY TO THE PREPARATION OF A THIRD REPORT ON ASPECTS OF INSURANCE LAW

WELLINGTON

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ASPECTS OF INSURANCE LAW (3)

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ASPECTS OF INSURANCE LAW

1. Introductory

1.1 This Committee is charged with the duty of recommending changes in insurance law. It has already issued two final reports. The first led to the enactment of the Insurance Law Reform Act 1977. A bill based on the recommendations contained in the second was introduced into Parliament for recess study near the end of the 1983 session but lapsed on the dissolution of Parliament in May 1984. The Committee has now embarked on the preparation of its third report. The Committee's fragmented approach to its task reflects the fact that the Committee, as a part-time body charged with responsibilities in a number of different areas, lacks the resources to complete the whole job in one exercise. But it can also be said that a piecemeal approach has the advantage of making it easier for those affected to assimilate resultant changes in the law than would be the case if Parliament enacted a wide range of radical reforms at the same time.

1.2 The purpose of the present paper is to give notice to those interested of the topics the Committee is minded to deal with in its third report and to invite submissions in relation thereto. It needs to be emphasised that the Committee has reached no firm views on any solutions to problems suggested in this paper, or indeed as to whether in each case there is any problem at all requiring legislative intervention. It is not a question of trying to move the Committee from an already adopted position; those presenting submissions to the Committee can be confident that at present the Committee has in relation to each of these topics an open mind. What follows is entirely exploratory and tentative. Communications should be addressed to:

The Secretary
Contracts and Commercial Law Reform Committee
Department of Justice
Private Bag
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1.3 The closing date for submissions is 31 March 1985.

2. Premature Discontinuance of Life Policies

2.1 The questions we discuss under this head are (a) whether the law should confer on insured persons a right on premature discontinuance of a life policy to its surrender value or a paid up policy and (b) whether in negotiations leading up to the completion of a life insurance proposal there should be a compulsory disclosure to the insured of the financial consequences of premature discontinuance.

2.2 There is room for argument as to whether a contract of life insurance is on the one hand a contract for the whole period up to death or maturity conditional on continued payment of periodic premiums; or whether there is a series of periodic (usually annual) contracts each one conferring on the insured an option of renewal. What is beyond doubt is that (absent some contrary statutory or contractual provision) an insured has no right to anything in the nature of a refund if he chooses to abandon his contract. Reputable insurance companies recognise the unfairness of this in the case of life insurance contracts containing an element of investment and in practice permit an insured either to receive payment of an amount calculated as the surrender value of the policy or to treat the policy as paid up in respect of some amount of cover less than that originally provided for by the contract. In what follows where we refer only to surrender we should be regarded as referring to surrendering a policy or treating it as a paid up policy.

2.3 In practice in New Zealand it is not usual for life policies to spell out where the policyholder stands if he elects to discontinue his policy. Nor has there been any legislation directed particularly to his protection. Such rights at law as an insured person might have would probably depend on the general reform effected by the Contractual Remedies Act 1979 s.9. (We do not overlook the provisions of the Life Insurance Act 1908 s.64 which provides that a life policy must be kept alive by its surrender value, which is, however, a different point). The New Zealand position is in marked contrast to that across the Tasman.
A Commonwealth statute, the Life Insurance Act 1945, confers by s.97 an entitlement in the case of a policy in force for at least six years to payment of its surrender value and by s.96 an entitlement in the case of a policy in force for at least three years to a paid up policy, the amount of this surrender value and of the paid up policy to be calculated according to certain rules laid down in the statute. (These provisions do not preclude the insurer from treating the insured more generously than the statute requires). This Commonwealth legislation had been preceded by comparable enactments in Victoria and Queensland.

2.4 We suspect that for most New Zealanders the method by which surrender values are calculated is an arcane mystery. No doubt the complexities of actuarial calculation are such that the topic will never be one that is earnestly argued over in public bars or the subject of witty exposition at elegant dinner parties. But we invite consideration as to whether even so the subject is not one that should be subjected to public scrutiny; it is difficult to see why the calculation of surrender values should be the private and unsupervised activity of insurers. We do not overlook the sort of general disclosure that life insurance companies are required to make by the provisions of Part I of the Life Insurance Act 1908. But this disclosure is really directed to ensuring the general financial viability of the company's operations. The question then is whether there is any

reason why the law should not require there to be made available to a policyholder sufficient information to enable him to check for himself (with actuarial assistance if need be) the surrender value he is offered.

2.5 A connected question is whether there is any reason why the law should not require that there be disclosed to a member of the public invited to enter into a life insurance contract the surrender values he will receive if he discontinues before maturity. Surrender values in the early years of a policy invariably disappoint an insured, largely no doubt because of the expense of setting up including agent's commission. Life insurance is to some extent sold as an investment, and this being so the normal requirements of candour would seem to indicate that a consumer should be told in advance what the financial consequences can be if he cannot keep up his commitment. We observe that considerations along these lines have recently led the Law Reform Commission of Australia to recommend legislation requiring those invited to enter into insurance contracts to be given an estimate of surrender values appropriate to the relevant policy (Insurance Contracts (1982) ALRC 20, para. 259).

2.6 As emphasised in paragraph 1.2, and as indeed will be plain from the issues we pose later in this paragraph, we have come to no concluded view on any of these matters. This is an area where we are particularly anxious to hear the views of the industry and of consumer interests before doing so. The specific issues to which submissions should be directed are we think, these:

(a) should a right to be paid a surrender value or receive a paid up policy be conferred by law?

(b) assuming that such a right is conferred, what is the most appropriate formula for defining the entitlement?

(c) should the law provide that a policyholder is entitled to be told on request the amount for which he might surrender his policy and how that amount is calculated?

(d) should the law require a life insurance company when inviting a person to enter into a contract of life insurance to disclose the anticipated surrender value of the policy at various intervals before maturity?

(e) assuming such an obligation as is referred to under (d) is imposed what is an appropriate formula that will convey meaningful information to the insured but not impose a disporportionate burden on the insurer? (It may be, for example, that an appropriate sort of formula would be to state the cash surrender value at the end of each of the first five years and at five yearly intervals thereafter on certain stated assumptions as to bonus rates).

(f) assuming there is to be such disclosure what is the best machinery for bringing it to the attention of the potential insured? (It may be, for example, that the information to be disclosed should be included in the proposal, that a copy of the proposal should be left with the insured, that he should thereafter have a five day cooling off period and that the information should be repeated in the policy document).

3. Bonuses on Life Policies

3.1 It is customary in New Zealand for there to be distributed among policyholders (excluding those insured under certain types of non-participating contracts such as term assurances) shares of profits in the form of reversionary bonuses which attach to a policy but are not payable until maturity. The entitlement to a share in the profits will be determined by the terms of the policy and in some cases by the documents constituting the insurer; the usual legal position is that an insured has a legal right to a pro rata share in any distribution that may be made but the question of whether there should be a distribution and in what amount is at the discretion of the insurer. We invite submissions on the issue of whether there should not be much greater disclosure by insurers in this area. Should for example a policyholder be entitled by statute to be told not just that his policy has attracted a reversionary bonus of $X, but that as appears from the audited accounts a copy of which is appended the fund in the profits of which the particular policy is entitled to share made a profit of $Y of which the insurer has decided to appropriate to bonuses the sum of $Z? It is arguable that insurers should be required by law to distribute to every holder of a participating policy financial particulars and a report broadly along the lines (to be particularised by statute) of those required by the Life Insurance Act 1908 ss.16 and 17 and the Companies Act 1955 ss.159 and 162.

4. Fires Prevention (Metropolis) Act 1774 Section 83

4.1 This section commences with a preamble reciting that the enactment of the section is "in order to deter and hinder ill-minded persons from wilfully setting their house or houses, or other buildings, on fire, with a view of giving to themselves the insurance money, whereby the lives and fortunes of many families may be lost or endangered". It seeks to achieve its deterrent purpose by means of two provisions. One is to give "any person or persons interested or entitled unto any house or houses or other buildings" the right to require the insurance company to reinstate. The other is to confer on insurance companies an election to reinstate. Although the statute by its terms is confined in its operation to metropolitan London it has been applied (on rather dubious grounds, but the decisions are so old that it is not now conceivable that they would not be followed) to the whole of England and the

various colonies including New Zealand (see Cleland v. South British Insurance Co. (1890) 9 NZLR 177; Searl v. South British Insurance Co. Ltd [1916] NZLR 137, Auckland City Corporation v. Mercantile and General Insurance Co. Ltd [1930] NZLR 809). The section has been repealed and re-enacted in modern dress in Queensland and Tasmania. In New South Wales the section was re-enacted in 1915 and ultimately repealed in 1982. The section while applying to insurance companies does not extend to Lloyd's underwriters (see the dictum of Branson J. in Portavon Cinema Co. Ltd v. Price [1939] 4 All ER 601, 607-608).

4.2 As to the right given to insurers to elect to reinstate, it can be argued that if an insurer really believes that such a right is a deterent to arson he can and in practice usually does reserve such right by the terms of the policy. The view that this leg of the section should be repealed is expressed by the editors of MacGillivray and Parkington on Insurance Law (see 7th ed. 1981 para. 1695) and by the Law Reform Commission of Australia (Insurance Contracts (1982) ALRC 20, para. 129). New South Wales has survived without obvious ill-effect without any equivalent of s.83 for more than a century.

4.3 The view expressed in MacGillivray and Parkington is that there is still room for a statutory provision conferring a right to require reinstatement on persons interested in property, and the Australian Commission seems to accept that simple repeal of s.83 may leave problems in this area that might require statutory intervention. It needs to be kept in mind that parties can effectively contract out of the right to require reinstatement conferred by s.83 (Reynard v. Arnold (1875) LR 10 Ch. App 386; Searl v. South British Insurance Company [1916] NZLR 137; MacGillivray and Parkington op. cit para. 1692). There is such a contracting out in the provision implied in mortgages by the Property Law Act 1952 s.78 (Fourth Schedule cl.6) and in the meaning given to the expression "will insure" by the Chattels Transfer Act 1924 (Fifth Schedule cl.4). But it is not a complete answer to say that the question of a right to compel reinstatement is best left to be determined by the contract between the parties because there may be no direct contractual nexus between the interested parties. A second or subsequent mortgagee for example could presumably invoke the section to defeat the claim of a prior mortgagee to have his mortgage discharged out of the insurance proceeds. Such consequences seem a long way from the deterrence of arson which was the original purpose of the enactment of the section.

4.4 Presumably there will be general agreement that if any part of the section is to be retained it should be recast in more modern form. Subject to this the questions on which submissions are invited are whether in relation to each of the two legs of the section it should be retained or repealed.

5. Subrogation as between lessor and lessee

5.1 An insurer is entitled to stand in the shoes of an insured whom he has indemnified and it is usual for an insurer to pay the amount due to an insured in terms of the contract of insurance and then to issue proceedings in the name of the insured against any third party responsible for the loss. There is academic controversy as to whether the basis of the right of subrogation is an equitable rule or an implied term of the contract of insurance. The right of subrogation whatever its basis seems a logical corollary of the concept of indemnity and we do not seek to call it in question in any general way. We are however concerned with its operation in the context of the relationship between lessor and lessee.

5.2 The general rule is that a tenant is liable to his landlord for damage negligently caused to the demised premises. This liability is founded on the doctrine of waste (Anderson v. James 28 NZLR 34). If there is room for an alternative ground of tortious liability where the parties are contractually bound to each other a similar result would follow from an application of the rules governing the tort of negligence (see Marlborough Properties Ltd v. Marlborough Fibreglass Ltd [1981] 1 NZLR 464, 466, 472). The covenant as to repair implied in leases by the Property Law Act 1962 s.106(b) excludes any obligation to make good damage caused by "fire flood lightning storm tempest earthquake and fair wear and tear" but only "without neglect or default of the lessee". Subject therefore to any provision in the lease to the contrary, where loss is caused by a tenant's negligence the tenant is liable to the landlord in damages and the landlord's insurer is subrogated to the landlord's right to make a claim against the tenant to recover such damages. (See Leisure Centre Ltd v. Babytown Ltd (unreported) Court of Appeal, CA 133/83 18 April 1984, D. G. Bullick (outfitters) Ltd v. Don Agencies Ltd (unreported) High Court, Hamilton, M 452/83, 26 July 1984).

5.3 To avoid the risk of a claim against him by the landlord's insurer the tenant may do one of three things:

(a) he may arrange for the landlord's cover to be taken out in the joint names of the landlord and tenant for their respective rights and interests.

(b) he may negotiate a term of the lease excluding such liability.

(c) he may arrange his own cover.

None of these courses is particularly satisfactory. It does not seem to be the common practice for the interests of landlords and tenants to be noted on a single policy and there must be many circumstances (for example one policy covering a large block of shops the tenants of which are continually changing) where such a solution would not really be practical. It is not always possible for the tenant to

negotiate the terms of his lease (as where he is the purchaser of an existing term of years). In the unreported case of Guthrie House Ltd v. Cornhill Insurance Co. Ltd (High Court, Dunedin, A48/79 8 March 1982) the lease did include a provision that excluded the tenant's liability and the insurer sought to avoid liability on the basis of the landlord's non-disclosure of this position. Although in that case Hardie Boys J. on the evidence before him rejected this contention on a point of materiality it can be respectfully suggested that another Judge on other evidence might well come to a contrary conclusion.

5.4 It seems wrong that a tenant should have to arrange his own cover to properly protect himself. As a matter of economic reality it can be fairly asserted that the tenant is already paying the premium of the landlord's insurance either directly where the terms of the lease specifically so provide or indirectly because the amount of rent has been assessed taking into account the landlord's need to insure. It seems unfair that the tenant should pay an insurance premium twice and it seems generally unsatisfactory that there should have to exist two policies in relation to the same property however profitable to the insurance industry such arrangement may be. In the Marlborough Properties Ltd case referred to in para. 5.1 above a majority of the Court of Appeal felt itself able to hold that there was an implied agreement that the lessor would not claim against the lessee on the basis that this was a necessary implication to be drawn from a provision expressly casting on the lessee an obligation to keep the lessor insured. It is highly unsatisfactory that a tenant's liabiltiy should turn on the chance way in which a provision in a lease has been formulated so that different provisions all having the same economic consequences in some cases will and in others will not protect the tenant.

5.5 For these reasons we pose the question of whether a lessor's insurer's right of subrogation to claims against a lessee should be taken away by statute except where the parties expressly agree that the lessee should be liable.

5.6 The way in which the Law Reform Commission of Australia dealt with this question in its report on Insurance Contracts (1982) ALRC 20, should be noted. In para. 304 the Commission rejects the suggestion of such a limitation on subrogation rights as we have suggested for consideration in the previous paragraph. But this rejection was in the context of a recommendation (in para. 127) that the insurer of a property should be deemed to be insuring all persons with an interest in that property up to the limits of the cover. Such an approach as that advocated by the Australian Commission in para. 127 of its report does not on our initial consideration of the matter commend itself to us, essentially because we believe that it is possible to correct existing anomalies without such a radical change to the law of insurance.

6. Compulsory Provision of Copy Documents

6.1 There seems to be increasing, a practice of issuing to policyholders not a complete copy policy but a document incorporating by reference the terms of a master policy document held by the insurer. The State Insurance Office seems to have adopted in recent years a practice of issuing policies prepared as carbon copies of an original held by the insurer and those copies are not invariably as legible as one would like. Often a policy if issued is held not by the owner of property but by some other party such as a mortgagee. It would be consistent with other modern consumer protection legislation if the law were to confer on insured persons a legal right to call for a copy of the policy document. We have no doubt that even without such a provision reputable insurers readily accede to requests made by their insured for copies of policies so that such a provision would do not more than bring the law into line with what is already accepted as sound insurance practice.

7. Double Insurance

7.1 The concept that an insurance contract is one of indemnity would be defeated if it were legally possible for a person to insure the same risk with two or more insurers and recover from each of those insurers the whole amount of his loss in the event of the insured-against contingency occurring. It is to guard against this type of situation that it is common for policies of insurance to provide for notice of the existence of other insurance as a condition of the obligation to indemnify. There can be no reasonable objection to insurers protecting themselves against fraud in this way. Problems arise however where the double insurance is not fraudulent but inadvertent. The law it is suggested should ensure that provisions having their origin in the legitimate anxiety of insurers to protect themselves from fraud are not invoked to defeat the equally legitimate expectations of the innocent. The complexities of modern insurance contracts make it surprisingly easy for there to be overlapping insurance as a consequence of oversight. We refer, as just one of many possible instances, to the growing practice of setting up one cover for building owner, head contractor, sub-contractors and suppliers on a large building contract. It is highly likely that instances will arise where such a contractor or sub-contractor is doubly insured under both the site policy and an ordinary policy. The recent case of Petrofina (U.K.) Ltd and Ors v. Magnaload Ltd and Ors (1983) 3 All ER 35 is a recent example of a near miss in this area.

7.2 Examination of the decided cases suggests that the Courts have been astute to protect insured persons in double insurance situations, particularly in the sort of Catch 22 situation where each policy provides for forfeiture of all

benefits as a result of non-notification of the other (see for example The Steadfast Insurance Co. Ltd v. F. and B. Trading Co. Pty Ltd (1971) 125 CLR 578). The matter is expressed in MacGillivray and Parkington in these terms: "It is difficult to extract any general principle from the cases except that a Court will strive to uphold the legitimate expectations of the assured, unless the wording of the policy clearly prevents this; but each case must, of course, depend on the precise terminology of the contract". (MacGillivray and Parkington on Insurance Law (7th ed. 1981) para. 1725).

7.3 The issue then is whether it is sufficient to rely on the ingenuity of the judges to ensure justice in double insurance situations, or whether statutory reform is not desirable. Attention is drawn to the recommendation of the Law Reform Commission of Australia (Insurance Contracts (1982) ALRC 20, Ch.11) broadly to the effect that in cases of double insurance the insured may claim from whichever insurer the insured elects with that insurer then having a statutory right to contribution from any other insurer.

8. Reservation by Insurer of Right to Cancel

8.1 It is possible and in the case of policies other than life policies common, for a contract of insurance to confer on the insured a peremptory right to cancel the contract without assigning any reason for so doing. There occurred in recent years an incident where members of the public paraded outside the offices of an insurance company protesting against such a cancellation which it was claimed resulted from an anonymous threat of arson. The very fact of a cancellation may make it hard for an insured to obtain alternative cover and cancellation may leave him exposed until he can do so. There is something unattractive in an insurer having the right to snatch away the umbrella just as the rain-clouds appear. The issue on which comment is invited is whether there should be some statutory abrogation or limitation of such contractual rights of cancellation.

For the Committee

Chairman

Wellington
1 November, 1984