Newcastle City Council v GIO General Ltd

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The High Court in *Newcastle City Council v GIO General Ltd*[1] has unanimously held that the operation of s 40(3) of the *Insurance Contracts Act 1984* (Cth) ('the Act') is not confined to a 'claims made and notified' liability insurance contract, but also protects an insured under a 'claims made' policy. Both a 'claims made' and a 'claims made and notified' policy indemnify an insured against liability claims brought against the insured during the policy period, regardless of when the events giving rise to the claims occurred. These types of policies can be contrasted with an occurrence-based policy, which provides indemnity for events that occur within the policy period. The only distinction between a 'claims made' and a 'claims made and notified' policy is that indemnity under a 'claims made and notified' policy is only available if the insurer is notified of the claim against the insured prior to the policy expiring. As a result of the High Court's decision in this case, liability insurers issuing 'claims made' policies are prevented from refusing indemnity for claims brought against the insured outside the policy period — provided the insured advises of events that might give rise to the claim before the insurance contract expires.

I. The facts

A coronial inquest was held following the loss of twelve lives in the Newcastle Earthquake on 28 December 1989. At the inquest, a barrister representing the family of a victim alleged that the Newcastle City Council ('the Council') had to accept some responsibility for the collapse of certain buildings, including the Newcastle Workers' Club where a number of deaths occurred. An article on the front page of the *Newcastle Herald* reported these allegations on 18 July 1990. The Council faxed a copy of the newspaper article to its insurer, together with a note advising of the potential for liability claims to be brought against the Council.

When the earthquake occurred, the Council had in place a 'claims made' liability insurance contract with GIO General Ltd ('GIO'), pursuant to which GIO agreed to provide indemnity for liability claims brought against the Council during the policy period. The Council's policy with GIO, having been twice renewed, was in force from 31 January 1989 to 31 December 1991. During this time, GIO extended indemnity to the Council for a number of liability claims arising from the earthquake. After the policy expired, further claims in relation to the earthquake were brought against the Council, but GIO refused to indemnify the Council for any claims brought outside the policy period. The Council argued that even though the liability claims were made after the insurance policy expired, s 40(3) of the Act prohibited GIO from refusing to extend indemnity.

II. Provisions of Insurance Contracts Act

The relevant provision is s 40 of the *Insurance Contracts Act 1984* (Cth) which provides:

> (1) This section applies in relation to a contract of liability insurance the effect of which is that the insurer's liability is excluded or limited by reason that notice of a claim against the insured in respect of a loss suffered by some other person is not given to the insurer before the expiration of the period of the insurance cover provided by the contract.
> (2) The insurer shall, before the contract is entered into:
> (a) clearly inform the insured in writing of the effect of subsection (3); and

1 (1997) 149 ALR 623.

(b) if the contract does not provide insurance cover in relation to events that occurred before the contract was entered into, clearly inform the insured in writing that the contract does not provide such cover.

Penalty: $5,000.

(3) Where the insured gave notice in writing to the insurer of facts that might give rise to a claim against the insured as soon as was reasonably practicable after the insured became aware of those facts but before the insurance cover provided by the contract expired, the insurer is not relieved of liability under the contract in respect of the claim, when made, by reason only that it was made after the expiration of the period of the insurance cover provided by the contract.

Considered in isolation, subsection (3) appears to provide a statutory extension of cover to an insured under a 'claims made' policy of liability insurance. Provided the insurer is notified, before the policy expires, of an event likely to give rise to a liability claim against the insured, the insurer will be prevented from refusing the claim, even if it is made outside the policy period. The intention of subsection (3) however, is clouded by subsection (1), which provides that s 40 applies to contracts of insurance that exclude an insurer's liability if the insurer is not given notice of a claim against the insured prior to the policy expiring.

Unlike a 'claims made and notified' policy, a 'claims made' policy does not exclude or limit an insurer's liability if they are not notified within the policy period of the claim against the insured. Therefore on a literal interpretation of s 40, 'claims made' policies do not satisfy the threshold test of subsection (1), and the protection of subsection (3) is not applicable.

III. Decision of trial judge and New South Wales Court of Appeal

Confronted with this problem of construction, the trial judge and the New South Wales Court of Appeal held that s 40 did not require GIO to extend indemnity in relation to claims brought against the Council outside the policy period. They found that subsection (1) operated to restrict the benefit of subsection (3) to a 'claims made and notified' policy. As the parties in this case had chosen to enter a 'claims made' liability insurance contract, the Court of Appeal said that it did not have 'a mandate ... to alter the very basis and definition of the contract of insurance agreed between the parties.'[2]

IV. High Court decision

On appeal, the High Court unanimously held that s 40(3) applies to a 'claims made' policy. Contrary to the literal interpretation of s 40, the protection of this provision is not confined to a 'claims made and notified' policy. As GIO had been informed prior to the policy expiring of facts that might give rise to liability claims against the Council, subsection (3) prevented GIO from refusing indemnity in relation to the earthquake claims brought outside the policy period. Despite the unanimous outcome, the judges reached this decision on varying grounds.

1. Toohey, Gaudron and Gummow JJ

In their majority judgment, Toohey, Gaudron and Gummow JJ made extensive reference to relevant portions of a Law Reform Commission Report[3] and the Explanatory Memorandum. They confirmed that when interpreting a legislative provision, the Court is permitted to consider such extrinsic material in order to ascertain the mischief that the

2 *GIO General Ltd v Newcastle City Council* (1996) 38 NSWLR 558 at 571 per Kirby J.

3 Report No. 20 of the Law Reform Commission, *Insurance Contracts*, 1982.

statute was intended to cure.[4] This power is independent of the provision for the consideration of extrinsic material under s 15AB of the *Acts Interpretation Act 1901* (Cth).

In the light of such extrinsic material, the majority identified the mischief that subsection (3) sought to cure as being the ability of insurance companies to refuse indemnity for liability claims brought against the insured after the policy expires, even though the insurer is advised of facts giving rise to the claim within the policy period. In this case for example, liability claims against the Council arising out of the Newcastle earthquake would be indemnified by GIO, provided the claim was brought within the policy period. However similar claims brought against the Council after the policy expired were outside the terms of the Council's policy with GIO. The majority said that some contracts of liability insurance provided extended coverage against such claims, and subsection (3) had sought to make this additional cover mandatory.

Reading s 40 in the light of this mischief, the majority found that a 'claims made' policy, such as the policy between the Council and GIO, could be brought within the scope of subsection (1). The threshold test now satisfied, the Council could invoke the protection afforded by subsection (3), since GIO had been given sufficient notice during the policy period of the facts likely to give rise to liability claims against the Council. As a result of finding that a 'claims made' policy falls within the scope of subsection (1), the majority also extended the operation of subsection (2) to a 'claims made' policy. This subsection imposes penalties on insurers who fail to inform the insured of the effect of subsection (3) before the contract is entered.

2. McHugh J

The judgment of McHugh J, extending the operation of subsection (3) to 'claims made' policies, is based on similar rationale to the majority. However McHugh J provides a fuller account of how he believes a 'claims made' policy can be brought within the scope of subsection (1). After examining the Law Reform Commission report and Explanatory Memorandum, his Honour found s 40(3) was intended to be remedial. Applying the purposive approach to statutory interpretation, pursuant to s 15AA(1) of the *Acts Interpretation Act 1901* (Cth), he said that when the purpose of a legislative provision is clear the Court may be justified in giving the provision a strained construction. On rare occasions, the Court may even treat a provision as containing additional words if such words will give effect to the legislative purpose.

In order for a Court to be able to treat a provision as containing additional words, McHugh J[5] said the Court must:

(1) know the mischief with which the statute is dealing;

(2) be satisfied that by inadvertence Parliament overlooked an eventuality which must be dealt with if the purpose of the legislation is to be achieved; and

(3) be able to state with certainty what words Parliament would have used to overcome the omission if its attention had been drawn to the defect.

Finding the conditions satisfied in this case, McHugh J treated subsection (1) as containing such additional words as were necessary to encompass a 'claims made' policy. As in the judgment of Toohey, Gaudron and Gummow JJ, the approach of McHugh J extends the application of subsection (2) as well as subsection (3) to 'claims made' policies.

4 See *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 141 ALR 618 at 634–5.

5 Applying the decision of Lord Diplock in *Jones v Wrotham Park Estates* [1980] AC 74 at 274.

3. The alternative reasoning of Brennan CJ

Brennan CJ found that 'a literal interpretation of subsections (1) and (3) produces absurdity.'[6] He suggested that if a contract relieves an insurer of liability by reason that notice was not given to the insurer within the policy period, as required by subsection (1), it is extremely difficult to see how subsection (3) is of any assistance to such an insured. This is because subsection (3) only operates in circumstances where the insured notifies the insurer within the policy period of events likely to give rise to a liability claim. Such a literal interpretation, according to Brennan CJ, would result in subsection (3) failing in its purpose.

Unlike the other Judges, Brennan CJ found the Explanatory Memorandum to be of no assistance. Turning instead to the preamble, he pointed out that the purpose of the Act was to 'reform and modernise the law ... so that a fair balance is struck between the interests of insurers, insureds and other members of the public'.[7] Brennan CJ held that there were no grounds consistent with the preamble for distinguishing between an insurer's liability under a 'claims made' policy, and under a 'claims made and notified' policy. Therefore subsection (1), being definitional, applies only to subsection (2), while subsection (3) operates independently according to its own wording.

In contrast to the approach adopted by the other members of the High Court, the Chief Justice's reasoning renders it unnecessary to bring a 'claims made' policy within the ambit of subsection (1). It is however difficult to see why there should be a distinction between a 'claims made' and a 'claims made and notified' policy in relation to subsection (2). Given that an insured under either type of policy is entitled to the benefit of subsection (3), why should subsection (2) require that insurance companies give notice of the effect of subsection (3) to an insured under a 'claims made and notified' policy, but not a 'claims made' policy?

The judgments of Toohey, Gaudron, Gummow and McHugh JJ avoided this difficulty, by finding that a 'claims made' policy fell within the scope of subsection (1), thereby extending the operation of both subsections (2) and (3) to 'claims made' policies. This interpretation is preferable to Brennan CJ's analysis, as it requires insurers issuing either 'claims made' or 'claims made and notified' policies to comply with the notice requirements of subsection (2). As subsection (3) affords protection to an insured under both types of policy, it is logical to require that the insurance company advise the insured of the availability of that protection, irrespective of which type of policy is to be issued.

V. Conclusion

There being no logical reason for s 40(3) of the Act to distinguish between 'claims made' and 'claims made and notified' liability insurance policies, the High Court's decision undoubtedly gives effect to the intended purpose of this provision. Subsection (3) affords a statutory extension of liability cover to an insured under either type of policy. Provided the insured advises the insurer before the policy expires of facts that might give rise to a liability claim, the insurer will be prevented from refusing indemnity merely because that claim is made against the insured after the policy expires.

Four of the five Judges also held that a 'claims made' policy is within the scope of subsection (1), therefore both subsections (2) and (3) are applicable to 'claims made' policies. Importantly, subsection (2) imposes a penalty of $5,000 on an insurer who fails to provide the insured with notice of the protection offered by subsection (3) before the insurance contract is entered. This will have a significant effect on insurance companies that have issued 'claims made' policies believing s 40 not to be applicable. The High

6 (1997) 149 ALR 623 at 626.
7 (1997) 149 ALR 623 at 627.

Court's decision means that such insurers will not only have to offer the extended cover available to the insured under subsection (3), but may also be liable to the imposition of a penalty under subsection (2) for failing to notify the insured of the effect of subsection (3) before the contract was entered.