# *The Duty of Good Faith in Insurance Relationships: The Decision in Gibson* v *Parkes District Hospital*

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*An insurer's bad faith rejection or denial of a valid claim can cause significant economic hardship and distress to an insured party. Such damage may go uncompensated by the eventual enforcement of the claim. One possibility for controlling such conduct is by imposing a duty of good faith on insurers, the breach of which gives rise to damages in tort. This case note discusses the decision of Gibson* v *Parkes District Hospital*[1] *where the New South Wales Supreme Court formulated such a duty in the context of a statutory worker's compensation scheme. It also considers the possibility of expanding the scope of the duty to include insurance relationships in the private sphere and those arising out of New Zealand's own accident compensation legislation.*

## I INTRODUCTION

### *A Bad Faith Conduct in the New Zealand Context: The Facts of King* v *ACC*[2]

Alistair King was involved in a motorcycle accident in November 1987. His right leg was permanently injured. Prior to the accident King had a run a successful Auckland exhaust and muffler business but his injury meant that, despite his apparent willingness, he was unable to continue with this line of work. King was eligible for earnings related compensation under the Accident Compensation Act 1982. However the Corporation refused to complete the assessment of his disability. Over a period of more than three years the Corporation sent King to three different orthopaedic surgeons who were unanimous in declaring that King was unfit for work. After a plea of urgency from his doctor, it was still another four months before the Corporation acted on these assessments. There were indications that staff had been told informally by management to stall the expensive claims until the proposed law change in 1992 made them invalid.[3] In April 1992 the Corporation sent a vocational counsellor and educational psychologist to determine if King could return to work. The counsellor concluded that King was unable to work and noted King's "justified" frustration with the handling of his claim.[4] The Corporation refused to accept the report of the counsellor and disputed whether it should even pay the bill for the consultation. In July 1992, almost five years after the

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1 (1991) 26 NSWLR 9.

2 Unreported, High Court, Auckland Registry, 15 July 1993, M1738/92.

3 *New Zealand Herald*, Auckland, New Zealand, 6 August 1993, 2.

4 Above n 2, 9.

accident, the Accident Compensation Act 1982 was replaced by the Accident Rehabilitation and Compensation Insurance Act 1992, and the Corporation then announced that it had no power to consider King's application for compensation.[5] King appealed that decision. In August 1993 Barker J delivered a thirty page judgement in the High Court damning the Corporation's "unjustifiable" decision to deliberately put off assessing King's claim until legislative change made it impossible to do so:[6]

> The argument for the Corporation is not cluttered with objective merit. It is saying in effect: "We deliberately delayed considering your application for a s 60 assessment until we knew that we no longer had the power to consider it."

King's long suffering battle with bureaucrats had caused him considerable anxiety and left him with a substantial financial loss. King's only remedy was a declaration that the Corporation assess King under the terms of the old act and an award of $2500 costs.

### *B The Facts of Gibson's Case*

In the same year that Alistair King suffered his motorcycle accident, Patricia Gibson was incapacitated by an electric shock that she suffered while operating a polishing machine in the course of her employment at the Parkes District Hospital in New South Wales. Gibson had a statutory right to compensation from her employer under the Workers Compensation Act of New South Wales 1926. Part of her compensation entitlement included a weekly payment for the period she was incapacitated based on her average weekly earnings. Average weekly earnings were to be "computed in such a manner as is best calculated to give the rate per week at which the worker was being renumerated.. ."[7] For the five weeks prior to her injury Gibson was earning between $198.00 and $216.00 a week but she was paid by her employer a weekly compensation of only $12.29 based on her earnings for the previous twelve months. Gibson was owed compensation primarily by her employer. There was a further provision in the contract of insurance between the workers' compensation insurer and the hospital making the insurer directly liable to Gibson in the event of default by the Hospital.[8]

Gibson filed a claim against her employer and the employer's insurers, the General Insurance Office of New South Wales (GIO) for breach of a duty to act in good faith in the processing of her claim.

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5 Above n 2, 1.

6 Above n 2, 24.

7 Sections 7(1)(a), 14(1)(a) of the Workers' Compensation Act 1926 (NSW)

8 Section 18(3) of the Worker's Compensation Act 1926 (NSW). For the details of the NSW scheme see Part III below.

### C *The Holding of the Supreme Court*

Badgery-Parker J in the New South Wales Supreme Court refused to dismiss the claim summarily.[9] His Honour held that the relationships between the parties were such that if the insurer or employer acted unreasonably and with knowledge of or reckless disregard for the fact that no reasonable basis existed for their conduct, then they would be liable in tort for breach of a duty of good faith. His Honour held that the duty of good faith arose out of the nature of the relationship between the parties and gave rise to an independent cause of action in tort.[10] Tort damages could be awarded over and above the compensation that was available under the statute.

### D *A Duty of Good Faith in the New Zealand Context*

A duty of good faith sounding in tort might prove an effective tool in New Zealand for controlling bad faith conduct by such bodies as the Accident Rehabilitation and Compensation Insurance Corporation. This case note will analyze the requirements of the duty as set out in the decision of Badgery-Parker J and investigate the possibility of expanding the duty of good faith beyond insurance relationships. The case note will conclude with an application of the tort to New Zealand's statutory compensation scheme.

## II THE REQUIREMENTS OF THE DUTY

Badgery-Parker J held that the relationship between Gibson, her employer and the GIO was so "close and direct" and involved features of dependence and inequality that it made it just and reasonable to impose a duty of good faith on the parties.[11] The GIO and the Hospital breached the duty when they acted unreasonably and with knowledge of, or reckless disregard for, the fact that no reasonable basis existed for their conduct.[12]

### A *Determining the Existence of the Duty. The 'Just and Reasonable' Test*

Badgery-Parker J held that the appropriate test for determining whether a duty of good faith should be imposed between the parties was whether it was "just and reasonable" to do so.[13] The proximity between the parties meant that any delay in the processing of Gibson's claim would lead not only to temporary hardship, anxiety or distress, "but also in some cases, ongoing economic loss as where during the period of delay the worker is unable to maintain mortgage or hire purchase payments and suffers

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9 Following the decision of the High Court of Australia in *General Steel Industries Inc* v *Commissioner for Railways (New South Wales)* (1964) 112 CLR 125, 129 Gibson's case would only have been dismissed if it was "so obviously untenable" that it could not possibly have succeeded. However to the knowledge of the author there is no intention to appeal this decision or take it through to a substantive hearing.

10 Above n 1, 20, 25, 35.

11 Above n 1, 25.

12 Above n 1, 20-21.

13 Above n 1, 34. See also 25, 26.

forfeiture and is forced to sell assets."[14] Furthermore the vulnerability of the plaintiff at the hands of her insurers, and her dependence on their good faith conduct meant that:[15]

> ... the situation is such that should the employer or insurer in bad faith reject, underestimate or delay payment of a worker's compensation, he or she may suffer consequences which are beyond being relieved by the ultimate successful enforcement of his rights by way of a determination of the Compensation Court ...

His Honour held that the Workers' Compensation Act 1926 (NSW) was adopted to protect workers from the potentially disastrous consequences of disabling injuries. If the insurer acted in bad faith, a claim for the insurance proceeds may not have adequately redressed the harm suffered. It would be poor policy and a subversion of the Act if an injured worker, in need of financial security and reliant on a single insurer, was required to bear the loss of the insurer's bad faith conduct.[16]

*B The Existence of Statutory Safeguards No Bar to Recovery*

Badgery-Parker J rejected the argument that the procedures set down for the enforcement of rights under the Workers' Compensation Statutes precluded the existence of a duty of good faith.[17]

If the insurer unreasonably failed to satisfy an award made by the court then there was a statutory power to terminate the insurer's licence to operate under the Act.[18] However proceedings of that nature tended to be protracted and did not secure quick redress to the worker. At the most the provision was an inducement to insurers to handle claims properly, but it offered little or no benefit to a worker who actually suffered from the bad faith failure to pay the compensation claim.[19]

The injury that arises out of a breach of the duty of good faith is separate and distinct from the amount of compensation due under the statute. The workers' compensation scheme left Gibson particularly vulnerable to pecuniary loss and emotional distress if the Defendants denied or delayed her compensation payments. The statute placed parties in a position where they were likely to suffer harm at the hands of an insurer acting in bad faith and then failed to provide an adequate remedy. While the compensation scheme purported to confer an exclusive remedy for all injuries within its scope, the injury that arises out of a breach of the duty of good faith is separate and distinct, and still remains to be compensated by tort law. Badgery-Parker J cited with approval from a passage in *Travelers Insurance Co* v *Savio*:[20]

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14 Above n 1, 25.
15 Above n 1, 25.
16 Above n 1, 26. Badgery-Parker J concurred with the observations of the Supreme Court of Colorado in *Travelers Insurance Co* v *Savio* 706 P.2d 1258, 1258 (1985).
17 Above n 1, 27.
18 Section 29(1)(a) of the Workers' Compensation Act 1926 NSW.
19 Above n 1, 28.
20 Above n 16, 1270. Cited in *Gibson*, above n 1, 28.

> The duty of an insurer under the Act to provide benefits and compensation is factually and analytically distinct from its duty to deal in good faith with claimants, even though such duties necessarily involve a common underlying physical injury. The right to compensation depends on the resolution of specific factual and legal issues between carriers and claimants. Whether in a particular case disputes involving those issues are entertained in good faith presents a related, but quite different, question, the resolution of which does not depend on the validity of the underlying compensation claim.

### C *The Relationship Between Duties of Good Faith and Duties of Care in the Exercise of Public Functions.*

The 'just and reasonable' test for determining the existence of a duty of good faith is similar to the test used for determining whether there is a duty of care in negligence.[21] Badgery-Parker J considered that negligence cases dealing with the exercise of a public function would provide a useful model for the duty of good faith because:[22]

> ... they are valuable illustrations of the approach to be taken and the considerations that may be relevant to a determination whether in any particular case a duty of care (or in this case, a duty to act in good faith) should be found to exist. They emphasise the significance of the availability of other remedies and their adequacy; the nature of the relationship between the parties; and the effect upon the public interest of allowing the existence of such a cause of action.

Counsel for the GIO cited a number cases in argument where the courts have been reluctant to impose duties of care over the exercise of public functions, unless civil liability is authorised by the statute.[23]

In the English Court of Appeal decision in *Jones* v *Department of Employment*[24] the plaintiff alleged that his claim for unemployment benefit was negligently disallowed by an adjudicating officer. The plaintiff claimed damages against the department for legal fees, personal expense and distress.

The Court of Appeal held that as the duty of the adjudicating officer was a public law duty, enforceable by the statutory appeal process and by the mechanism of judicial review, the court should not allow the broad and substantive remedies of private law to

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21 See *Governors of the Peabody Donation Fund* v *Sir Lindsay Parkinson & Co Ltd* [1985] AC 210, 240-241. In New Zealand see *South Pacific Manufacturing Co Ltd* v *New Zealand Security Consultants and Investigations Ltd* [1992] 2 NZLR 282, 305.

22 Above n 1, 33.

23 The cases relied upon by the defendants included *Jones* v *Department of Employment* [1989] QB 1; *Hill* v *Chief Constable of West Yorkshire* [1989] AC 53; *Governors of the Peabody Donation Fund* v *Sir Lindsay Parkinson & Co Ltd*, above n 20; *Rowling* v *Takaro Properties Ltd* [1987] 2 NZLR 700. See also *Curran* v *Northern Ireland Co-Ownership Housing Association Ltd* [1987] AC 718; *Murphy* v *Brentwood District Council* [1990] 3 WLR 414, 441.

24 [1989] QB 1.

encroach on the remedies already available. The plaintiff's only cause of action was breach of a statutory duty:[25]

> It would be strange if a mistake which, temporarily, deprived the claimant of benefit to which he was entitled did not amount to a breach of statutory duty, but was a breach of a common law duty of care

Breach of statutory duty was the appropriate tort to use because the duty did not arise unless the legislature intended to confer a civil right of action upon the plaintiff.[26]

Badgery-Parker J reversed this assumption when formulating his test for breach of a duty of good faith. His Honour held that once the relevant proximity and dependence between the plaintiff and the statutory decision maker had been established, it was unnecessary to determine whether the statute intended that a cause of action for bad faith be conferred on the plaintiff. The duty of good faith existed unless the statute precluded the existence of such a duty.

The courts are hesitant in applying negligence liability to the exercise of public functions because it requires defendants to live up to an objective standard determined by the courts after the statutory duty has been exercised. Prior to the declaration by the courts it is often unclear precisely what is required when exercising a power under a statute.[27] The plaintiff may call expert witnesses who will, with the benefit of hindsight, testify that the statutory duty ought to have been exercised differently. This makes it relatively easy to establish on the balance of probabilities that a particular decision maker was negligent. To avoid liability there is a danger that public decision makers will engage in overkill, unnecessarily stalling decisions while they seek legal advice, or engage in unnecessary consultation.[28] Imposing liability in negligence replaces the judgement of the appointed decision maker with standards determined by the courts. The courts will be reluctant to do this when the decision calls for a determination of the public interest, or the weighing of various policy considerations which have been left to be determined by the statutorily appointed decision maker.

In contrast the duty of good faith focuses on intentionally unreasonable conduct. To establish a cause of action the plaintiff must prove a particular state of mind such as malice or intentional disregard for the plaintiff's rights. Defendants do not have to measure up to the standards of decision making in hindsight; on the contrary the

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25 Above n 24, 19.

26 R F V Heuston and R A Buckley *Salmond and Heuston on the Law of Torts* (20 ed, Sweet and Maxwell, London, 1992) 251; S Todd *The Law of Torts in New Zealand* (Law Book Co, Sydney, 1991) 327; J G Fleming *The Law of Torts* (8 ed, Law Book Co, Sydney, 1992) 124.

27 *Rowling* v *Takaro Properties*, above n 23, 710. If it is difficult for the decision maker to determine those cases in which there was a duty to seek legal advice, then that would tell against the imposition of a duty.

28 One of the factors the Privy Council took into account when imposing a duty of care was the danger of overkill in the exercise of public functions: *Rowling* v *Takaro Properties*, above n 23, 710.

plaintiff must show that the defendant was actually guilty of intentional conduct that was clearly outside the sphere of her decision making authority. The standard of conduct required is clear prior to the exercise of the decision making authority. There is no danger of overkill. The defendant need only make the decision in good faith to avoid liability. Similarly the court would not be replacing the defendant's judgement for that of its own, but simply guaranteeing that the defendant apply herself to what she considers the public interest to be.

It is submitted that the court ought to impose strong sanctions on individuals who knowingly abuse their decision making authority. It is appropriate that the substantive remedy of damages be available when a member of the executive abuses a position of power by deliberately exceeding the authority given by statute. There is a strong public interest in ensuring all statutory decisions are at least made in good faith. Liability for damages will provide incentives for making good faith administrative decisions.

Furthermore the courts should struggle to avoid the difficulties experienced in breach of statutory duty cases with inferring the intention of the legislature from the wording of statutes. Fleming[29] argues that if the statute is silent on the question of civil liability, then accepted canons of statutory interpretation point to the conclusion that the legislature either did not have civil liability in mind or did not intend to provide it. It is therefore a "bare faced fiction" to attempt to infer an intention of that nature. The role of the tort in preserving the public interest in good faith decision making will be under threat if the courts focus on the wording of the statute as a basis for liability rather than the circumstances of the case and the particular relationship between the parties. The fiction of statutory intent will lead to the court making decisions "on the basis of insignificant details of phraseology instead of matters of substance."[30] The 'duty' approach taken by Badgery-Parker J in the *Gibson* case is the more satisfactory one. By first establishing that the relationship between the parties calls for a duty of good faith and then inquiring whether the statute precludes the existence of the duty, liability for breach is based on the proximity and inherent vulnerability between the parties rather than the subtleties in statutory wording.

### *D Determining a Breach of the Duty*

Badgery-Parker J adopted the test for determining a breach of the duty of good faith from the Colorado Supreme Court decision in *Travelers Insurance Co* v *Savio*.[31] To establish that the duty had been breached the plaintiff must show both that the conduct of the defendant was objectively unreasonable, and the defendant actually knew or had reckless disregard for the fact that the conduct was unreasonable.[32]

Badgery-Parker J gave little indication of what kind of unreasonable conduct would constitute a breach of the duty. On the facts of *Gibson* itself, the insurer was held to be

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29 J G Fleming *The Law of Torts*, above n 26, 125.

30 W Rogers *Winfield and Jolowicz on Tort* (13 ed, Sweet and Maxwell, London, 1989) 178.

31 Above n 16.

32 Above n 1, 20. See also *Travelers Insurance Co* v *Savio*, above n 16, 1272.

in breach by refusing to pay Gibson the appropriate amount of compensation.[33] His Honour indicated that bad faith rejection, under-estimation or delay of a claim would be sufficient for the purposes of establishing a breach.[34] In *Travelers Insurance Co* a workers' compensation insurer breached the duty of good faith to an employee under a workers' compensation scheme by failing to provide vocational rehabilitation within a reasonable time.[35] The unreasonable conduct was to be determined according to the particular circumstances of the case and with reference to industry standards.[36]

Neither *Gibson* nor *Travelers Insurance Co* are explicit on what state of mind reckless disregard requires. *Travelers Insurance Co* makes it clear that a reasonable balance must be struck between the right of an insurer to deny coverage of claims and the obligation on the insurer to investigate and approve valid claims.[37] The test for recklessness must not be so low as to discourage insurers from disputing claims of doubtful merit. How the Court eventually determines this issue will depend on what it understands the underlying role of the tort to be. If it is to punish bad faith conduct by insurers then the test for recklessness should be high. If the courts are more concerned to provide a remedy to the aggrieved plaintiff then the test should be set lower. However it is submitted that under no circumstances should recklessness be equated with negligence.[38] Adoption of a negligence standard would collapse the subjective requirement of the tort into a simple objective standard.

It is not clear whether there is a requirement to prove damage as part of the tort. It is not stated as a requirement in *Gibson*, and is specifically rejected as a requirement for breach in the *Travelers Insurance Co* line of cases.[39] If the appropriate role of the tort is to supply the plaintiff with a remedy for the hardship, stress and on going economic loss that would otherwise go uncompensated by the eventual enforcement of the claim then proof of that damage should be required. A damage requirement would also fit more easily with 'the duty' analysis. It would be strange to describe the defendant as owing a duty to a particularly vulnerable plaintiff, and then to have a breach of that duty actionable per se without the need to prove any damage.

Emotional distress may aggravate an award of damages but it is not generally considered sufficient to ground an action in tort.[40] If a damage requirement is adopted by

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33 Above n 1, 12.

34 Above n 1, 25.

35 Above n 16, 1262.

36 Above n 16, 1275.

37 Above n 16, 1275.

38 The negligence standard was specifically rejected by the court in *Travelers Insurance Co* v *Savio*, above n 16, 1275.

39 *Farmers Group Inc* v *Trimble* (1984) 691 P 2d 1138, 1142. The Supreme Court of Colorado held that an Insurer owed a duty of good faith to the insured when settling a claim with a third party. The duty of good faith was actionable without proof of damage.

40 *Behrens* v *Bertram Mills Circus* [1957] 2 QB 1; *Lynch* v *Knight* (1861) 9 HLC 577, 598, para 89; H McGregor *McGregor on Damages* (15 ed, Sweet and Maxwell,

the courts as part of the criteria for establishing a breach of the duty of good faith then the plaintiff will have to suffer some pecuniary loss, or psychological harm[41] before the cause of action is complete.

### *E Other Duties of Good Faith*

The Australian courts already recognise a number of established duties of good faith binding on insurer and insured alike. Section 13 of the Insurance Contracts Act 1984 (Cth) implies into every contract of insurance a provision requiring each party to act with the utmost good faith in their dealings under the contract. Breach of the statutory duty entitles the plaintiff to damages for breach of contract.

Gibson was unable to sue the GIO for a breach of section 13 because she was not a party to the insurance contract with the GIO. Gibson's right to compensation from her employer was statutory. The statute required that the hospital insure itself with a licensed insurer against liability under the Act.[42] Thus while there was a contract of employment between Gibson and the Hospital and a contract of insurance between the Hospital and the GIO, there was no insurance contract between either Gibson and the Insurer, or Gibson and the Hospital.

A separate contract duty of good faith arises by virtue of the fact that an insurance contract belongs to a special class of contracts known as 'uberrimae fidei' which impose reciprocal requirements of good faith and fair dealing on both the insured and insurer.[43] This duty is most commonly manifested in the requirement to disclose to the other party at the time of contract formation all known material facts concerning the insurance contract. The English Court of Appeal[44] recently held that the remedy for breach of the uberrimae fideii requirement was limited to recision of the contract and could not ground a claim in damages.[45] If Gibson was to be compensated for bad faith conduct on the part of her employers and the GIO, it would have to be founded on a duty of good faith that arose purely out of the nature of the relationship between the parties:[46]

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London, 1988) 49, para 89; B Kercher and M Noone *Remedies* (2 ed, Sydney Law Book Co, 1990) 468.

41 *Hinz* v *Berry* [1970] 2 QB 40, 42. Adopted in *Jaensch* v *Coffey* (1984) 155 CLR 549, 559.

42 Section 18 of the Workers' Compensation Act 1926 (NSW).

43 For a discussion of the relationship between statute and Common Law good faith requirements see Sutton *Insurance Law in Australia* (2 ed, Law Book Co Ltd, Sydney, 1991) 100.

44 *Banque Financiere de la Cite S.A.* v *Westgate Insurance Co. Ltd* [1990] 1 QB 665.

45 Above n 44, 773. The holding of the Court of Appeal was later endorsed in obiter by the House of Lords *Banque Financiere de la Cite SA* v *Westgate Insurance Co. Ltd* [1990] 2 All ER 947, 959. In "Insurer's Breach of Good Faith - A New Tort." (1992) 108 LQR 357, 359 Fleming argues that the Court of Appeal confined its ruling to the breach of the duty to disclose, which is just one aspect of the uberrimae fideii requirement. Therefore the decision does not preclude the possibility of tort liability based on some other aspect of the uberrimae fideii requirement.

46 Above n 1, 35.

> [T]he tort may arise where the nature of the relationship brought about by the contract, as distinct from the terms of the contract, is such as to impose a duty to act in good faith. On that basis, the duty is a true tort duty, not a contractual duty and the existence of the contractual term is not a necessary foundation for it.

### *F Liability in Tort*

Tort liability thus gave the court the flexibility to enforce a good faith conduct between parties who might otherwise have escaped the technical statutory and Common Law requirements. It also opened up the possibility of parties who stand in similar relationships of proximity and dependence being able to sue for breach of a duty of good faith.[47] Badgery-Parker J clearly contemplated that the duty would extend beyond the ambit of insurance relationships. His Honour noted that tort remedies had been awarded in the Californian courts for breach of an implied covenant of good faith in ordinary commercial contracts.[48] His Honour held the effect of the Californian authority to be that:[49]

> ... the duty of good faith and fair dealing is imposed by contract, but it is only a breach of that duty in a case (at least) where a special relationship exists that gives rise to tort liability. Whatever might ultimately be seen to be the relationships that attract such a duty, the American Courts that recognise it at all, clearly do so in respect of contracts of insurance and in respect of contracts of employment.

#### *1 The Californian Authority*

Under Californian law the duty of good faith takes the form of an implied covenant that exists in every contract:[50]

> There is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement.

Ordinarily breach of the covenant would give rise to damages in contract but if there is a 'special relationship' between the parties, such as exists between an insurer and insured, there will also be liability in tort.

In fact the ambit of this 'special relationship' has been restricted by the Supreme Court of California. In *Foley* v *Interactive Data Corporation*[51] the Supreme Court

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47 Above n 1, 20.

48 The Californian courts had awarded tort damages for breach of the implied covenant between a banker and depositor: *Commercial Cotton Co Inc* v *United California Bank* 163 Cal App 3d 511; 209 Cal Rptr 551 (1985) and arising out of a supply contract: *Seaman's Direct Buying Service Inc* v *Standard Oil Company of California* 36 Cal 3d 752, 686 P 2d 1158, 200 Cal Rptr 354 (1984).

49 Above n 1, 20.

50 *Communale* v *Traders General Insurance Co* 328 P.2d 198 (1958).

51 47 Cal 3d 654; 765 P 2d 373; 254 Cal Rptr 211.

refused to apply tort liability to breach of the covenant in an employment contract. The majority of the Court expressed disfavour with the special relationship test.

The relationship between the parties gave no justification for the imposition of tort liability for conduct which would otherwise give rise to contract remedies.[52] The concept of 'special relationship' inadequately defined the scope and application of the tort duty which led to uncertainty in commercial contracts. It was even suggested that:[53]

> The fundamental flaw in the 'special relationship' test is that it is illusory. It provides a label to hang on a result but not a principled basis for decision... The qualifying contracts cannot be identified until the issue has been litigated, which is too late.

The Supreme Court held that the relationship between the parties in an employment contract was different to that of an insurance contract. In the event of breach, plaintiffs could mitigate their loss by seeking alternative employment. Insurers, unlike employers, were involved in the quasi-public role of distributing the risk for an individual's loss amongst its subscribers, and in the event of a claim against a company the insurer's and the insured's interests were fundamentally at odds, whereas in the employment context the interests of the employee and the employer intersect to a certain degree.[54]

### 2 *Application of the Californian Authority to the Decision in Gibson*

Badgery-Parker J was apparently unaware of the Supreme Court's criticism of the special relationship test in *Foley* and the confinement of the test to insurance cases. While this would not have affected the outcome of the decision in *Gibson*, as the relationship between Gibson and her employer's insurer would be within the ambit of the special relationship as limited by the *Foley* decision, the limitation of the special relationship model in *Foley* indicates that the Courts should be cautious in extending the duty beyond relationships of insurance.

Insurance relationships are unique in that insurers are only called upon to perform their obligations under the contract when the insured is in a weakened or vulnerable position, and the insured is relying on the protection offered by the terms of the contract. The insured enters into the contract to protect herself from the potentially damaging financial and emotional effects of some future accident.[55] The original purpose of entering into the insurance contract is subverted if insurers are permitted to deny, or delay claims in bad faith with impunity.

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52 Above n 51, 395. See Cohen "Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort" (1985) 73 Cal L Rev 1291, 1300.

53 Above n 51, 395.

54 Above n 51, 396.

55 *Travelers Insurance Company* v *Savio*, above n 16, 1273.

Insurance companies serve a quasi-public function, redistributing the cost of their risk on the contract, amongst their other policy holders. If the insurer fails to perform its contractual obligations, the insured can turn to no other body, to bear that loss.[56]

The court may consider that the insured's vulnerability and the high standard of conduct required by bodies exercising this 'quasi public' function demands that insurance companies are held to the terms of their bargain. Unreasonable delay in the payment of compensation, bad faith denial of coverage and the like may cause harm to the plaintiff that is beyond being compensated by the successful enforcement of the contract, and may constitute conduct so reprehensible that it justifies an award of tort damages.

This is not commonly the case with ordinary commercial contracts, where agreements are made for commercial advantage rather than financial security. It is not assumed that one party bears the risk. The promisor does not perform the quasi-public role of distributing the cost of the promisee's risks amongst other parties with whom it makes contracts. While some supply contracts are certainly vital for particular businessess, commercial parties are generally competent to negotiate who should bear the cost in the event of a supply failure. If the contract is breached the plaintiff can turn to another supplier or seek re-employment to mitigate the loss. The court should move cautiously before imposing a higher standard of conduct than appears on the face of the contract. This will rarely be justified other than when the contract creates a relationship of vulnerability analogous to that created by an insurance contract.

### *G Compensation in Tort*

Tort liability also enabled Badgery-Parker J to avoid the limitations of contract damages. Following the decision *Addis* v *Gramaphone Co Ltd*[57] the Australian courts have been hesitant in awarding damages in contract for non-pecuniary loss.[58] The financial hardship and personal distress suffered by the plaintiff in *Gibson*[59] is typical of the harm suffered when insurers frustrate the payment of a valid claim. Damages for emotional distress[60] and financial loss[61] are more freely available for actions in tort.

A new and expanded form of tort liability may not be necessary if the courts take a flexible approach to the range of remedies available for breach of contract. The

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56 The Majority in *Foley* v *Interactive Data Corporation* distinguished an employment contract from a contract of insurance on these grounds. Above n 51, 396.

57 [1909] AC 488.

58 Other than in situations where the purpose of the breached term was to provide specifically for that loss suffered, or the loss was in contemplation of the parties at the time of contract formation. Kercher and M Noone *Remedies* (2d Sydney Law Book Co. Ltd 1990) 149. *Flamingo Park Pty Ltd* v *Dolly Dolly Creation Pty Ltd* (1986) 65 ALR 500, 523-5; *Cox* v *Phillips Industries* [1976] 1 WLR 638, 644.

59 Above n 1, 13.

60 *Campbelltown City Council* v *Mackay* (1988) 15 NSWLR 501.

61 *Minister Administering the Environment Planning and Assessment Act* v *San Sebastian Pty Ltd* [1983] 2 NSWLR 268, affirmed (1986) 162 CLR 340.

enforcement of the contract will adequately compensate parties in a position of inequality and dependence for any harm they might suffer through a bad faith breach.

### *H Remedies in New Zealand Law*

There is an increasing range of remedies that are available for breaches of statutory, common law and equitable duties. The Court of Appeal held in *Aquaculture Corporation* v *New Zealand Green Mussels* that:[62]

> For all purposes now material, equity and common law are mingled or merged. The practicality of the matter is that in the circumstances of the dealings between the parties the law imposes a duty of confidence. For its breach a full range of remedies should be available as appropriate, no matter whether they originated in common law or equity.

Recent decisions of the New Zealand High Court[63] and Court of Appeal[64] suggest that damages for mental distress following a breach of contract are available, provided such damage is within the reasonable contemplation of the parties at the time of contract formation.[65] While it is expected that parties to a commercial transaction will bear the stress caused by breach with a measure of fortitude,[66] the circumstances of vulnerability that give rise to a duty of good faith in tort will also put the contracting parties on notice that any breach would cause consequential pecuniary loss and emotional distress.

Furthermore section 9 of the Contractual Remedies Act 1979 has provided the New Zealand courts with broad powers to confer relief where "it is just and practicable to do so", following a cancellation of the contract pursuant to the provisions of the Act. Recent decisions in the High Court[67] and Court of Appeal[68] have indicated that orders for payments to be made under section 9 of the Act, are not subject to the same strict constraints as are damages at Common Law.[69] Principles such as remoteness of damage will be applied only when it achieves the just and practical result according to the requirement of the section.[70]

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62 [1990] 3 NZLR 299.

63 *Whelan* v *Waitaki Meats* [1991] 2 NZLR 74; *McKaskell* v *Benseman* [1989] 3 NZLR 75, 90; *Hetherington* v *Faudet* [1989] 2 NZLR 224.

64 *Horsburgh* v *NZ Meat Processors Industrial Union* [1988] 1 NZLR 698; *Mouat* v *Clark Boyce* [1992] 2 NZLR 559.

65 The trend towards awarding damages for mental distress for breach of contract can be seen as part of a wider attempt by the courts to protect the reasonable expectations of the parties. D W McLauchlan "The 'New' Law of Contract in New Zealand" [1992] Recent L Rev 436, 459.

66 *Rollands* v *Collow* [1992] 1 NZLR 178.

67 *Newmans Tours Ltd* v *Ranier Investments Ltd* [1992] 2 NZLR 68.

68 *Brown* v *Langwoods Photo Stores* [1991] 1 NZLR 173, 177; *Thomson* v *Rankin* [1993] 1 NZLR 408.

69 *Gallagher* v *Young* [1981] NZLR 734, 740.

70 *Newmans Tours Ltd* v *Ranier Investments Ltd*, above n 67, 88.

This increasing flexibility in the range of remedies available means that the New Zealand courts are better placed to compensate the expectation loss suffered by a plaintiff who is in a situation of vulnerability.[71] There will be no need to impose a duty of good faith over contractual duties, if a bad faith breach can be adequately compensated by enforcing the benefit of the agreement between the parties. If equivalent damages are available in contract for an expectation loss then parties to litigation will found their remedy on the contract rather than a duty that has to be separately established.

## III THE ACCIDENT REHABILITATION AND COMPENSATION INSURANCE ACT 1992

If the duty of good faith was applied by the New Zealand Courts it would provide a remedy to individuals such as King who suffer the anxiety and financial loss of having their entitlement to compensation deliberately frustrated by the Accident Rehabilitation Compensation and Insurance Corporation (the Corporation). Indeed a worker who brings a compensation claim against the Corporation in New Zealand would in many respects be in a situation of greater inequality and dependence than her counterpart in New South Wales.

### *A The Act*

The New Zealand statute replaces the common law right to damages for personal injury with a set of statutory rights to compensation from the employer and the Corporation.[72] Under the New South Wales scheme Gibson retained the right to sue at common law.[73] She could choose whether to pursue a cause of action at Common Law or to pursue a remedy under the statute. Gibson was owed compensation primarily by her employer, with a further statutory requirement that each employer be privately insured with a licensed insurer.[74] The policy between the hospital and GIO had to contain a provision making the GIO directly liable to Gibson, and if the hospital became insolvent Gibson could have claimed compensation directly from the GIO.[75] Thus Gibson could enforce her rights under the legislation against both the hospital and the GIO. Under the New Zealand statute the employer is liable for 80% of lost wages in the first week of incapacity; thereafter compensation is paid directly by the

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71 Note that not every intentional breach will be in bad faith; the breach must amount to 'unreasonable conduct'. For the purposes of the tort it is assumed that any unjustified intentional breach of a contract covered by the duty of good faith will amount to a breach of the duty.

72 Section 14 of the Accident Rehabilitation and Insurance Compensation Act 1992 bars all independent proceedings for damages "arising directly or indirectly out of personal injury covered by this Act". Sections 38-39 provide for earnings related compensation.

73 Section 63(1) of the Workers' Compensation Act 1926 (NSW). Gibson would not however be entitled to retain both damages and compensation.

74 Section 18 of the Workers' Compensation Act 1926 (NSW).

75 Sections 18(3), 49 of the Workers' Compensation Act 1926 (NSW) respectively.

Corporation.[76] Thus if the claim is handled in bad faith, the worker has no enforceable rights against any other body and no alternative mode of enforcement other than that laid down by the Act itself.

Under the New Zealand Act a compulsory premium is levied on employers according to an experience rating,[77] adjusted according to the costs of work injuries that occur in the employment of that employer.[78] There is an incentive for the employer to underestimate the amount of compensation owed for lost wages, in order to indirectly reduce the cost of the premium.[79]

Under the New South Wales legislation it was possible for Gibson to apply to have the insurer's license revoked[80] on the grounds of bad faith conduct. The New Zealand legislation offers no similar deterrent against the handling of compensation claims in bad faith.

The New Zealand statutory scheme thus deprives plaintiffs of their right to seek compensation at Common Law, and replaces it with a right to compensation from a single statutory insurer. The injured worker has no access to compensation other than by the procedure laid out in the Act. The right to compensation is determined at first instance by the Corporation, which may wait up to one month before reaching a decision.[81] If the claim is rejected or there has been no response to the claim by that time, the claimant is entitled to a review of the decision.[82]

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76 Sections 38-39 of the Accident Rehabilitation and Compensation Insurance Act 1992.

77 Sections 101, 104 of the Accident Rehabilitation and Compensation Insurance Act 1992. A large company paying $35 000 000 in wages will ordinarily pay around $966 000 in accident compensation premiums a year. If that company has around $80 000 worth of claims made in one year then it will receive a $330 694 discount on its premium. If its employees make $1 100 000 worth of claims in one year then it will receive an extra loading of $523 250 on top of the premium it already pays. Accident Rehabilitation and Compensation Insurance Corporation *Employer Guide to Experience Rating* (July 1992) 22.

78 For a discussion of the effect of the experience rating on employer behaviour see D A Rennie "Accident Compensation Reform: The Financial Incentive to effectively manage for Occupational Safety and Health" July 1992, Safeact, Vol 5 No 2, 22; D A Rennie "ACC Experience Ratings : The Real Impact" July 1992, Safegaurd, No 15, 9; *The Dominion*, Wellington, New Zealand, 11 August 1993, 17.

79 Some employers have threatened workers with the sack or offered them compensation up front in order to dissuade them from reporting work related accidents. *The Waikato Times*, Hamilton, New Zealand, 5 June 1993, 4; *The Northern Advocate*, Whangerei, New Zealand, 5 June 1993, 5.

80 Section 29(1)(a) of the Workers Compensation Act 1926 (NSW) see above n 1, 27.

81 Section 66 of the Accident Rehabilitation and Compensation Insurance Act 1992 (NZ).

82 The costs of these proceedings may be awarded against the Corporation. Sections 89-90 of the Accident Rehabilitation and Compensation Insurance Act 1992 (NZ).

The Act provides no incentives for the Corporation to avoid making unreasonable decisions in bad faith. This is despite the fact that claimants clearly stand in a relationship of proximity and dependence with the Corporation in regard to the processing of their compensation claim. If the duty of good faith were to arise in this context, it would impose upon the Corporation a duty to avoid intentional or recklessly unreasonable conduct in the processing of claims. Such a duty would also attach to the conduct of employers exercising their statutory functions under the Act.[83]

### *B An Alternative Remedy: Public Misfeasance*

The development of a duty of good faith might be stifled by the existence of the tort of misfeasance in a public office. This tort attaches a parallel duty to public officers not to deliberately act outside the limits of their statutory powers.

Badgery-Parker J acknowledged that an action for misfeasance in a public office was available for the malicious exercise of a statutory power, although his Honour did not directly consider the point and no further argument was heard on it.[84] The tort is established in New Zealand,[85] and has recently been discussed in detail by Anderson J in *Garrett* v *Attorney General*[86]. His Honour was led to the view that the tort consisted of:[87]

1. A public officer causing damage to a plaintiff
2. By -
   (a) a deliberate act or omission actuated by malice; or
   (b) a deliberate act knowingly in excess of official powers
3. In circumstances where such officer knew or ought reasonably to have foreseen that the deliberate conduct would cause damage to the plaintiff.

It is the second limb of this tort that imposes requirements similar to those for the breach of the duty of good faith laid down by Badgery-Parker J in *Gibson*.[88] Unreasonable conduct in the exercise of a statutory duty will almost never be intra vires

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83 This has particular significance in light of provisions in the Act which allow an approved employer to be directly responsible for compensation in respect of an employee who suffers a work related injury. Sections 105-107 of the Accident Rehabilitation and Compensation Insurance Act 1992 (NZ). A pilot scheme for this procedure has already been established. *The New Zealand Herald*, Auckland, New Zealand, 10 July 1993, 4.

84 Above n 1, 31.

85 *Takaro Properties Ltd* v *Rowling* [1978] 2 NZLR 314, 338; *McKenzie* v *MacLachlan* [1979] 1 NZLR 670; *Hydra Cold Storage* v *NZ Milk Board* Unreported, 28 February 1985, High Court, Auckland Registry, 28 February 1985, A 123/81.

86 Unreported, High Court, Wellington Registry, 23 February 1993, CP 1118/91.

87 Above n 86, 4. This formulation would appear to have the support of the English Court of Appeal. See *Bourgoin SA* v *Ministry of Agriculture Fisheries & Food* [1986] QB 716, 777; *Jones* v *Swansea City Council* (1989) 3 All ER 162, 175.

88 Above n 1, 20.

the statute.[89] Knowledge that no reasonable basis existed for the conduct therefore becomes equivalent to the misfeasance requirement that the public officer has knowledge that the act is ultra vires. If the parties stand in a relationship of proximity and dependence sufficient to satisfy a duty of good faith then the requirement that the officer know or ought reasonably to have known that there would be damage to the plaintiff will inevitably be satisfied on the facts.

One unsettled aspect of the tort of misfeasance is the extent to which there must be a relationship of proximity between the public officer and the plaintiff. However at least in New Zealand it appears that it is not necessary for the decision maker to owe the plaintiff a Common Law duty before an action can be taken.[90] An action can be brought by anyone who is closely affected by that exercise. The duty is to be owed to all those who were proximate enough to the exercise of the power to suffer foreseeable harm at the hands of the defendant.[91] Some writers have indicated that mere foreseeability of harm is not enough and that proximity remains to be determined by a similar approach to that used for determining a duty of care.[92] Neither of these tests require the plaintiff to demonstrate the inequality or dependence necessary for establishing a duty of good faith. The tort of misfeasance is specifically tailored to protecting the public interest in fair administration, whereas the duty of good faith also arises between private bodies, where such standards must be imposed with more hesitancy. It is clear however that if liability for breach of the duty of good faith arises in the processing of a compensation claim then there will also be liability for misfeasance.

Misfeasance is only actionable on proof of damage.[93] In *Garrett* v *Attorney General* Anderson J held that emotional distress on its own was not sufficient to establish actionable damage for the purposes of the tort.[94] This aspect of the duty of good faith appears to be unsettled; however, it will have very little effect on plaintiffs who bring actions against the Corporation for misfeasance or breach of the duty of good faith with regards to the processing of claims. Any delay of a significant period is likely to cause some pecuniary loss sufficient to ground a claim in damages.[95]

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89 In a small body of cases where the discretion is unreviewable at administrative law, the decision may be valid despite the unreasonable motives on the part of the official. See S Dench "The Tort of Misfeasance in a Public Office." (1981) 4 Auck L Rev 182, 190.

90 Above n 86, 9.

91 Above n 86, 9.

92 R Sadler "Liability for Misfeasance in a Public Office" 14 Syd L Rev 137, 147; S Dench "The Tort of Misfeasance in a Public Office" above n 89, 201.

93 *Farrington* v *Thomson and Bridgland* [1959] VR 286, 293.

94 Above n 86, 13.

95 If a claimant receives his compensation in a single lump sum then he may automatically suffer a pecuniary loss. The claimant's earnings related compensation is assessed for tax purposes as if he had earned the entire lump sum in one year. He will be taxed at a higher rate than he would have had he received his compensation on a regular basis since his injury. *Taxation Review Authority Case 89* (1987) 10 TRNZ 631.

Reckless disregard will suffice to establish a breach of the duty of good faith, whereas actual knowledge of the ultra vires act is necessary to establish the tort of misfeasance.[96]

## IV CONCLUSION

The duty of good faith as formulated by Badgery-Parker J can be seen as a response to concerns that arose out of the New South Wales Compensation Scheme. The Scheme created a situation where the claimant was left particularly vulnerable to pecuniary loss and emotional distress if the GIO or the hospital delayed or denied the benefits owed to Gibson under the statutory duty. Any harm which Gibson suffered as a result of such a delay would not be compensated by the eventual enforcement of her statutory rights.[97] The defendant's bad faith conduct was also a clear breach of the standard of behaviour required from the exercise of the statutory duty. The decision reflects a perceived need to punish the reprehensible conduct of the defendant insurer and employer, who, conscious of that vulnerability, intentionally frustrated the valid claim of a deserving plaintiff.

The New Zealand courts should not hesitate in addressing similar concerns raised about the weaknesses in our own accident compensation legislation by the decision in *King* v *ACC*.[98] Vulnerable plaintiffs should not be required to bear the loss for the reprehensible conduct of the Corporation in the handling of their claims under the Act. In such circumstances the Court should move to punish the Corporation and redress the harm suffered by the plaintiff. If the Corporation were held liable to the Common Law standards of a duty of good faith or the tort of misfeasance, it would shift the burden for socially unreasonable conduct onto those who were best able to guard against it, and provide a deterrent against such conduct by exposing the Corporation to liability in excess of the statutory limits to compensation.

In a wider context the duty of good faith is ideally placed to control parties who intentionally exceed the limits of their legal relationship when other parties to the relationship are reliant on those limits to protect themselves from damage.

In "The Fiduciary Principle"[99] Finn identifies the good faith standard of conduct as providing a common thread "to some number of seemingly disparate developments in all of the common law systems"[100] where courts are struggling to formulate a standard of conduct that promotes cooperation between the parties, the curtailment of the use of power and the development of 'neighbourhood' principles in a relationship. To date the law has only developed "an eclectic collection of specific doctrines through which we can exact what I have called the good faith standard... The consequence is that if one is to make a good faith claim one has first to find an available doctrine through which to

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96 S Dench "The Tort of Misfeasance in a Public Office", above n 89, 198.
97 Above n 1, 25.
98 Above n 2.
99 P Finn "The Fiduciary Principle" in T Youdan *Equity, Fiduciaries and Trusts* (1989, The Law Book Company Limited, Toronto) 27.
100 Above n 99, 11.

contrive it...".[101] If the good faith doctrine does not provide the plaintiff with an adequate remedy "the lure to fiduciary law becomes almost irresistible."[102]

A general tort duty that recognises the need for good faith conduct applied with an appropriate degree of flexibility and according to needs could provide the law with a unifying good faith standard and a remedial flexibility that would halt the encroachment of fiduciary standards into commercial transactions.

The duty of good faith does not require the insurer to act entirely in the interests of the insured. Insurance companies can dispute claims, or negotiate lower settlements provided they do so in good faith. The duty appropriately takes account of the insurers' interests but requires that the insurer respect the legitimate interests of the plaintiff and subordinate the pursuit of its self interest to the maintenance of standards of reasonable conduct.

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101 Above n 99, 23.
102 Above n 99, 24.