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Précis Paper

Implications of Non-Disclosure in the Insurance Context

A discussion of the recent decision of *Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited* [2017] NSWCA 71

Discussion Includes

- Duty of disclosure
- The facts
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- NSW Court of Appeal decision

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Implications of Non-Disclosure in the Insurance Context

In this edition of BenchTV, John Van De Poll (Partner – Holman Webb Lawyers, Sydney) and Teni Berberian (Barrister – Thirteen Wentworth Chambers) discuss the recent decision of *Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited* [2017] NSWCA 71 and its implications for non-disclosure in the insurance context.

Duty of disclosure

1. The duty of disclosure was first identified by Lord Mansfield in *Carter v Boehm* (1766) 3 Burr 1905 which stated that 'Insurance is a contract based upon speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the insured only. The underwriter trusts to his representation and proceeds upon the confidence that he does not keep back any circumstance in his knowledge to mislead the underwriter into a belief that the circumstance does not exist and induce him to estimate the risk as if it does not exist'.

2. In Australia, the duty of disclosure has been almost entirely encapsulated in the *Insurance Contracts Act 1984* (Cth). Section 21 in particular was amended and is the most significant feature of the *Stealth Enterprises* decision. Section 21 imposes upon an insured a duty to disclose to the insurer before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that either:
    a) The insured knows to be a matter relevant to the insurer whether to accept the risk, and if so on what terms, or
    b) A reasonable person in the circumstances could be expected to know it to be a matter so relevant.

3. Subsection (b) features more predominately in the current case. Since 2015, a few words have been added to this subsection to now state that a reasonable person in the circumstances could be expected to know to be a matter so relevant having regard to factors including but not limited to:
    i. The nature and extent of the insurance cover to be provided under the relevant contract of insurance; and
    ii. The class of persons who would ordinarily be expected to apply for insurance cover of that kind

The facts

4. Calliden was an insurer who specialized in, amongst other things, insuring the adult industry. As part of the target market for Calliden, Stealth was one of the businesses who they sought

as an insured. Stealth operated a brothel in the ACT where brothels can be legally operated. Stealth was originally legally registered to operate as a brothel but later became unregistered. Calliden insured the brothel for both fire and business interruption. The directors of Stealth were members of the Comanchero outlaw motorcycle gang, although this had not been disclosed to the insurer.

5. On 1 January 2012, there was a fire, and the losses that arose from that fire were ultimately agreed at $500,000.

6. The underwriting guidelines for Calliden had specified referable risks that had to be given further consideration. These included things such as prior criminal convictions, past declinature and special terms that had been imposed on policies previously. Membership of an outlaw motorcycle gang was not one of the referable risks referred to, nor was any question about membership included or asked in the proposal completed by Stealth.

7. Calliden ultimately declined to pay the claim based on the alleged non-disclosure by Stealth. As well as considering the referable risks that were referred to previously when assessing the application for insurance, the underwriter from Calliden said he would apply common sense, and believed that membership of an outlaw motorcycle gang would be a matter that would be relevant to him in deciding whether to accept the risk and on what terms.

8. Also factually relevant to the Court of Appeal decision in particular, was that the brothel had become unregistered, but this had also not been disclosed to Calliden. Calliden could not establish that either of the non-disclosures had been fraudulent. If this could have been established, Calliden would have been able to avoid the policy from inception. Calliden had to rely on section 28 of the *Insurance Contracts Act 1984* (Cth) for remedies where there has been no fraudulent non-disclosure.

Supreme Court of NSW decision

9. The trial judge in the Supreme Court of NSW has said that the duty imposed by s 21 fell on Stealth Enterprises, a corporate applicant, who could only act through its officers and employees. The need for disclosure by a corporate applicant for insurance about the private activities of its officers depends on the nature of the activities in question, and the impact those activities might have on the risk which an insurer is being asked to accept.

10. As the manager of the brothel was the Comanchero's Sergeant at Arms, the Court found that the membership of the Comanchero's was known the Stealth Enterprises. This adopted the minority view in *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* [2003]

HCA 25; 214 CLR 514 which provides an insured is imbued with the knowledge of its agents and employees.

11. The Court had to consider whether a reasonable person in the position of Stealth Enterprises would know that information about them being members of an outlaw motorcycle gang would be relevant to the decision of the insurer to accept the risk.

12. Stealth argued that the reasonable person would have in mind that it was not seeking to insure the Comanchero's clubhouse, but a perfectly legitimate business conducted under the laws of the ACT. It also argued that it would take into account the absence of a relevant question about the subject in the proposal.

13. Expert evidence was called by Calliden from Mr. Macken, an Intelligence Analyst employed by the NSW Police Force in relation to outlaw motorcycle gangs, including the Comanchero's. His evidence went to the history, hierarchy, involvement in the adult entertainment industry and known criminal activities of the Comanchero's and other outlaw motorcycle gangs.

14. The Court found that a reasonable person would be expected to know that their membership was relevant, but the Court did not find that failure to be fraudulent. Justice Schmidt of the Supreme Court was satisfied that if membership to the Comanchero's of the manager and the director of Stealth Enterprises had been disclosed to Calliden, Calliden would not have insured Stealth Enterprises at all.

15. As per s 28(3) of the *Insurance Contracts Act 1984* (Cth), if the insurer is not entitled to avoid the contract, or is entitled to avoid but has not done so, the liability of the insurer in respect of the claim is reduced to an amount that would place the insurer in the position the insurer would have been in had the failure not occurred, or the misrepresentation not been made. It was held that the appropriate remedy was to reduce Calliden's liability to nil. This decision was appealed to the NSW Court of Appeal.

<u>NSW Court of Appeal decision</u>

16. The matter was listed before Justice Meagher, Justice Ward and Justice Sackville who considered four main issues:
    1. Whether a reasonable person in the circumstances of the insured could be expected to know that the association between the director and manager to the Comanchero's was relevant to the insurer's decision as under s 21(1)(b) of the *Insurance Contracts Act 1984* (Cth).

2. Whether the insurer would have renewed the policy had the disclosure been made. Had the disclosure of that association been made and the policy not renewed, the insurer would not have been on risk at the time of the fire and therefore, would be entitled to have its liability reduced to nil under s 28(3) of the *Insurance Contracts Act 1984* (Cth).
3. Whether at the time of the renewal in September 2011, the insured knew that the registration of the brothel had lapsed or had not been maintained
4. What follows from this is if the fact of that lapsed registration been disclosed to the insurer, the insurer would not have renewed the policy or otherwise insured the property. If this was the case, Calliden would be entitled to have its liability reduced to nil under s 28(3).

17. In relation to the first issue, the Court held that it was not established that a reasonable person in the circumstances could be expected to know that this association is relevant. It was held that a reasonable insured would understand that an underwriter specializing in insurance of brothels would expect that people with criminal connections were likely to be involved in the use of the premises.

18. If it was relevant to the insurer to know of the fact of any general association between the insured and any particular activity or organisation, it was held that a reasonable insured might have expected that there would be questions in the proposal. If it was common knowledge as it was found at first instance that there was a link between membership with outlaw motorcycle gangs and that was relevant to the insurer, then surely that must have been relevant to the formulation of the questions asked by the insurer.

19. Her Honour found at first instance that in 2010, it was common knowledge that Comanchero's were widely known to engage in activity which may result in property damage or personal injury. However, Justice Ward was not persuaded that a reasonable person in the position of Stealth could be expected to know that such an increased risk had not already been taken into account by the insurer when it accepted the risk of insuring the premises used for that purpose.

20. At first instance there was some argument about whether the fact that questions had not been raised specifically asking for memberships could not operate as an estoppel. For an insurer who is running business in this market where the premiums were significant, considering that they are expected to have the same common knowledge as the insured was expected to have, should have asked the question.

21. The second issue was if it was not established that the disclosure of the association has been made, the insurer would not have renewed the policy. It was important in relation to this that

there was no contemporaneous and objective evidence, other than the evidence that was called from the underwriter's assessment that she would have declined to renew the policy had the association been disclosed.

22. The underwriter's evidence was important in terms of what she would have done, given that she was an underwriter involved in this particular matter. The Court of Appeal found that the evidence as a whole did not support the finding that had the insurer been aware of the association, would have declined to renew the policy.

23. Emphasis was placed on the fact that this was an adult industry scheme. Underwriting guidelines which form part of the Calliden package business underwriting manual were in evidence and they form part of the broking arrangements which were in place, none of which would have excluded cover on that basis alone.

24. The main underwriter's evidence, Ms. Shepherd, was only made aware of the matter just days before, therefore when asked in a hypothetical setting whether she would have taken on the risk and issued the policy, she said she would not.

25. His Honour held that Courts have repeatedly warned about the dangers of evidence as to the likely conduct in hypothetical situations where the evidence is given through the prism of hindsight. His Honour drew similarity between what occurred in this case from the underwriter giving evidence in hindsight as to what happens in personal injury cases where plaintiffs give evidence about what they would or would not have done if it was aware of certain risks.

26. Sackville J held this was evidence given in the interests of the underwriter's employer with the benefit of knowledge that the insured risk had eventuated. Information had come to light which if known at the time might have justified Calliden in declining the risk. It was held that evidence of this kind needs to be assessed, not simply on the basis of credit of the witness, but also by reference to the objective probabilities. The underwriter's evidence needed to go further than just being the evidence of a truthful witness, it needed to be assessed by reference to the objective probabilities.

27. The issue was that had Ms. Shepherd been inclined to decline risk, she would have raised the issue with her superior, Mr. Addison. It was her evidence that if Mr. Addison disagreed with her, she still would have decline to renew the policy if the decision was within her authority.

28. Mr. Addison did not appear in Court. His absence may not have mattered if Ms. Shepherd would have made the renewal decision on her own, or if it was clear she would not have

accepted Mr. Addison's advice. Mr. Addison's absence from the witness box made it more difficult for Calledin to establish on the balance of probabilities that if Stealth's Association with biker gangs had been known, that Calledin would have declined to renew.

29. His Honour was of the view that the evidence did not support the finding that is more probable than not that Mr. Addison would have recommended against the renewal of Stealth's policy, or that if Mr. Addison recommended that the policy be renewed, that Ms. Shepherd would have refused to act on that recommendation.

30. In relation to the third issue, the non-disclosure of the fact that registration had lapsed, it was held that the insured was aware of this lapse. The trial judge did not err in inferring that the insured was aware that its registration had lapsed.

31. The court found that it was not established that had disclosure of the lapsed registration been made, the insurer would not have renewed or otherwise insured the premises at the time of the fire. Had the insured advised the insurer that the registration had lapsed, all Stealth Enterprises needed to do was pay $160 and fill in a form to be reregistered. In those circumstances the policy could've been renewed potentially a month or so later, therefore the second aspect of non-disclosure would not have helped the insurer.

32. Calliden filed a special leave application which was refused on the papers on the 14th of September, 2017.

BIOGRAPHY

John Van De Poll

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John is an experienced litigator specialising in all areas of insurance and is an Accredited Specialist in Commercial Litigation (Insurance). Within Holman Webb, John leads the Recoveries team and co-leads the Litigation group. He is extensively involved in the representation of professionals particularly before disciplinary bodies. John is also an experienced advocate, regularly appearing for clients in court while also participating in alternative dispute resolution programs in those matters identified as unsuitable for litigation. In 2016, John was awarded Law Partner of the Year: Insurance in The Lawyers Weekly Awards and was included in Best Lawyers 2017 & 2018 (Insurance).

Teni Berberian

Barrister – Thirteen Wentworth Selborne, Sydney

Teni was admitted in 1998 as a solicitor and was called to the bar in 2005. Teni has been listed in the 2018 edition of Best Lawyers in Australia in the practice area of Insurance Law. She was also previously listed in the 2015 Edition in the same area of practice. Since 2007, Teni has also been a guest lecturer in the subject "Legal Principles" at the University of Sydney School of Medicine, Department of Obstetrics, Gynaecology and Neonatology. Teni is a member of the Australian Insurance Law Association, Association of Women in Insurance and Society of Construction Law Australia.

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Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited [2017] NSWCA 71

Benchmark Link

Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited [2017] NSWCA 71

Judgment Link

Stealth Enterprises Pty Ltd t/as The Gentlemen's Club v Calliden Insurance Limited [2017] NSWCA 71

Cases

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Legislation

Insurance Contracts Act 1984 (Cth), s 21, s 28, ss 28(3), ss 21(1)(b)