Third-party protection

A recent Federal Court decision has wide ranging impacts on insurance law, not least on a thorny question around the duties of disclosure of non-contracting insureds.

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ABN AMRO Bank NV v Bathurst Regional Council

A common question is whether an entity that is not a party to an insurance contract but is a named insured is bound by the same duty of disclosure as the contracting insured.

The Full Federal Court has provided some clarity on this issue, finding that non-contracting insureds are not bound by the duty to disclose matters which may affect an insurer's decision to accept a proposed risk prescribed by s21 of the *Insurance Contracts Act 1984 (ICA)*.

The decision stems from a dispute between investment bank ABN AMRO Bank NV and a funds administrator, Local Government Financial Services (LGFS). The latter was a subsidiary of FuturePlus Financial Services, insured by American Home Assurance Company (AHAC).

LGFS purchased $55 million in a financial product called Rembrandt notes from ABN Amro, selling most of them to various NSW councils. The value of the notes plummeted during the global financial crisis, triggering legal action against LGFS, among others.

LGFS claimed against AHAC via the FuturePlus policy. AHAC denied cover on the basis that LGFS has failed to comply with its duty of disclosure. AHAC contended that before it entered into the policy with FuturePlus, LGFS knew that its AFS licence did not permit it to deal in derivatives, such as the Rembrandt notes.

LGFS argued it not have a duty of disclosure, submitting that the term "insured" in s21 means an insured who is a party to the contract and does not extend to third-party insureds.

In the original trial, the judge rejected this interpretation, finding that LGFS did indeed hold a duty of disclosure to AHAC.

The decision

However, the Full Federal Court disagreed. It held that the obligations referred to under s48(2) were "in relation to the person's claim" and therefore not referable to the pre-contractual obligations prescribed by s21.

Their Honours interpreted the reference to "the insured" under s21 to mean a "proposed insured" who is proposing to enter into a contract of insurance with the insurer. In accordance with this interpretation, they held that the relevant "proposed insured" was FuturePlus because it had submitted the insurance proposal to AHAC.

The court observed that what is clear from s21 and s28 of the *ICA* is that the obligation to disclose is cast upon a person intending to enter into a contract of insurance and the consequences of non-compliance are visited only upon persons who actually enter into such a contract.

Importantly, their Honours held that there is no obligation imposed upon a person who is not a party to the contract (but who may have the benefit of the insurance cover provided by the policy) to disclose before a contract is entered into.

The fall-out

The outcome of the *ABN Amro* decision is that an insurer cannot impose the pre-contractual duty of disclosure on a third-party insured (s21) and accordingly avail itself of any of the s28 remedies in the case of non-disclosure. This is significant, because aside from whatever recourse might be found within the terms of the policy itself, the insurer has no other remedies outside of the *ICA* in relation to a failure by the insured to disclose before the contract was entered into.

Insurers may attempt to counteract this by including a contractual warranty under the policy obliging the contracting insured to make all reasonable inquiries of any third-party insureds as to the matters set out in s21. It is arguable that under those circumstances, damages may be available to the insurer if the contracting party fails to make such inquiries and it later emerges that those inquiries would have unveiled matters which would have affected the insurer's decision to accept the proposed risk. NTBA

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