

## INDUSTRY NEWS

# FOS approach to section 54 of the *Insurance Contracts Act (1984)*

FOS recently published [written guidelines](#) on how it approaches section 54.

Section 54 applies to policies which permit an insurer to refuse a claim because of the "act" or "omission" of the insured (or another person) after the policy was entered into:

- The effect of section 54(1) is that provided the act/omission could not be reasonably regarded as being capable of causing or contributing to the loss, the insurer may not refuse to pay the claim (in full or part) by reason only of that act/omission. But the insurer may reduce liability to the extent its interests were prejudiced as a result of that act/omission.
- Alternatively, the insurer may refuse to pay the claim if that act/omission could reasonably be regarded as being capable of causing or contributing to the loss (section 54(2)), subject to the exceptions in sections 54(3) - 54(5).

FOS outlines some guides to approaching section 54, stating it will ask:

1. Is there an inherent restriction or limitation in what is covered under the policy?

Section 54 does not apply to relieve a claimant of restrictions or limitations inherent in the claim.

2. Has the insured (or some other person) done some act/omission after the contract was entered into which permits the insurer to refuse the claim?

If no, section 54 does not apply.

3. If yes, could that act/omission reasonably be regarded as **capable of causing or contributing to the claimed loss**?

This does not require the insurer to show the act/omission actually caused the loss.

4. If yes, the insurer can refuse the claim unless the claimant can prove:

- a) The act/omission did not cause the loss (or part of) the loss (section 54(3), section 54(4)). The insurer is liable for the part of the loss that was not caused by the act/omission,

- b) The act/omission was necessary to protect the safety of a person or to preserve property (section 54(5)(a)), or

- c) It was not reasonably possible for the person not to do the act/omission (section 54(5)(b)).

5. If no, the insurer is liable for the claim. But the insurer may reduce its liability to the extent its interests were **prejudiced** as a result of that act/omission.

The insurer must prove the extent of its actual prejudice in monetary terms (such as the full value of the claim).

FOS provides numerous case studies. Case study 4 deals with a claim for Total Temporary Disability (TTD) benefits. The policy requires TTD to occur within 12 months of the injury. Given the hospital waiting list, the insured did not have surgery until 18 months after injury and became TTD following surgery. It was determined that section 54 applied to prevent the insurer from refusing the claim on the basis of the omission to undergo surgery. The case study recognises that the determination may be different if the claimant had not attended the hospital or sought surgery until after the 12 months had elapsed.

FOS does not provide any guidelines as to the information required to be produced by insurers in disputes involving the application of section 54, noting that it is a question of fact in each dispute. From a practical perspective, insurers should put claimants to the proof to enable an informed assessment of a claim. If a declination of the claim is disputed pursuant to section 54, insurers should be prepared to produce documents which demonstrate the claims procedures which would have been followed and these steps would have reduced its liability in monetary terms.