



The evolution of the duty of utmost good faith: A principles-based approach

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The duty of utmost good faith owed by both insurers and insureds is experiencing something of a resurgence in the Australian insurance sector. Since the introduction of civil penalties in March 2019 for breaches of the duty by insurers, it has assumed a more central position in ASIC's enforcement arsenal, like the efficiently, honestly and fairly requirement in Chapter 7 of the Corporations Act. ASIC has, in recent years, pursued several insurers on grounds of breach of their duty of utmost good faith.¹

In this article, we seek to distil five core principles that constitute the duty of utmost good faith, based on judicial treatment to date. Before doing so, we first briefly outline the evolution of the duty and its inherently flexible nature.

The duty of utmost good faith and its application to insurance dealings originated in the English common law over 250 years ago. In Australia, it was subsequently codified under section 13 of the *Insurance Contracts Act 1984* (Cth) as an implied term in all insurance contracts as follows:²

A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.

Despite commercial lawyers' preference for clear and precise rules, the scope and content of the utmost good faith duty owed by parties to insurance contracts is necessarily indeterminate.³ It is certainly true that the content of the duty is capable of evolving in line with changing regulatory standards and community expectations. In this vein, Allsop CJ, a frequent commentator on the duty, commented that:

Fairness, decency and fair dealing are normative standards judged by reference to community expectations. Unfairness or a lack of decent treatment may take many forms. Arbitrary, capricious and unreasonable conduct may well inform a conclusion of unfairness sufficient to fall short of community expectations of fairness and decency. The obligation upon insurers and the content of the duty in any given case is informed, in part, by the important part insurance and insurers play in the life of the commercial community and of the general community. People rely upon it and them for their commercial and personal stability and wellbeing.⁴

Since it was recognised, the duty of utmost good faith has been a central pillar in insurance law, designed to (so far as possible) better balance the inherent asymmetries that exist in insurance contracts. However, the rapid

proliferation of other laws and codes governing insurance in Australia – including, for example, the introduction of claims handling as a financial service, the Life Insurance Code or Practice and General Insurance Code of Practice, and duty to take reasonable steps not to make a misrepresentation – have had an impact on the scope and content of the duty of utmost good faith.

Principle 1: Reciprocity

The duty of utmost good faith is a reciprocal duty owed by both the insurer and the insured.⁵ While the content of the duty must, by necessity, be different for each party, the NSW Supreme Court considers that there is no difference in the quality or stringency of the duty as owed by the insurer to the insured and vice versa.⁶ This is reflective of the inherently imbalanced nature of insurance contracts, arising from information asymmetries between the parties at various stages of the contract's performance. Specifically, the insurer relies on the insured's honest disclosure of matters material to its assumption of risk, while the insured relies on the insurer to act fairly and reasonably in honouring the policy, as well as in assessing and determining claims.

This principle of reciprocity is relevant in the context of determining liability. For example, in *ASIC v Zurich*, ASIC claimed that Zurich Australia Limited

¹ *Australian Securities Investments Commission v Youi Pty Ltd* [2020] FCA 1701 (**ASIC v Youi**); *Australian Securities Investments Commission v Zurich Australia Limited (No 2)* [2023] FCA 1641 (**ASIC v Zurich**).

² *Insurance Contracts Act 1984* (Cth) s 13 (**Insurance Contracts Act**).

³ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1 (**CGU v AMP**).

⁴ *ASIC v TAL Life Ltd (No 2)* [2021] FCA 193 (**ASIC v TAL**) at [173].

⁵ See *Insurance Contracts Act* s 13(2)–(2A).

⁶ *Camellia Properties Pty Ltd v Wesfarmers General Insurance Ltd* [2013] NSWSC 1975 (**Camellia v Wesfarmers**).



had breached its duty of utmost good faith in cancelling the insured's income protection policy on the basis of fraudulent non-disclosure of health issues. Jackman J recognised the obligation on the insured to honestly disclose these issues in the context of his Honour's ultimate ruling that Zurich Australia Limited had not breached the duty.

Principle 2: Applies to the full lifecycle of the insurance contract

The duty of utmost good faith extends through all stages of creation of the contract of insurance and its performance.

That is, the parties are required to act in utmost good faith throughout the formation stage of the contract of insurance, its duration, and all aspects of claims and claims handling/settlement.⁷

Principle 3: Not avoidable by contract

It is not possible for the insurer or insured to contract out of their duty of utmost good faith. As set out in section 14 of the Insurance Contracts Act:

If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision.

Principle 4: More than mere honesty

As mentioned above, the content of the utmost good faith duty in insurance contracts is not fixed and will depend on all the circumstances of the relevant matter, including the capacity of each respective party.⁸ In the seminal case

of *CGU v AMP*, the High Court provided some guidance on the content of the duty, and confirmed that it encompasses more than mere honesty and includes notions of fairness, reasonableness and community standards of decency and fair dealing.⁹ Further, to comply with the duty, the insurer would be expected to act with due regard to the insured's interests and to do so with "affirmative or positive action".¹⁰ It is important to bear in mind, however, that the duty is not a fiduciary one that requires the insurer to prioritise the interests of the insured over its own.

We consider each of these elements below. Each element is essential to the duty of utmost good faith. That is, the absence of any one of the elements of honesty, fair and reasonable dealing, and conduct in accordance with community standards of decency and fair trading could be sufficient to trigger a breach.¹¹

Honesty

In his dissenting judgment in *CGU v AMP*, Kirby J recognised (and the High Court accepted) that "a want of honesty is a universal feature of a want of the utmost good faith".¹² Classically, the need to act with honesty rests on the insured; though the honesty of the insurer in its dealings with the insured (such as in disclosures or the claims assessment process) is clearly also relevant.

Honesty is a generally well understood concept. In the context of the duty of utmost good faith, it does not take its meaning from the criminal standard of dishonesty, but rather adopts the standard under the law of contract for the exercise contractual discretions honestly; namely, dishonesty is judged by commercial standards.¹³ This is similar to the standard of honesty

adopted under the efficiently, honestly and fairly obligation, "which is not criminal but which is morally wrong in the commercial sense".¹⁴

Even the concept of honesty does not exist in a vacuum and is capable of evolving. It must be considered in the context of the insured's other statutory obligations. For example, for an insured, honesty traditionally requires full and frank disclosure of information relevant to the insurer's assumption of risk under the insurance contract.¹⁵ However, recent reforms to the duty of disclosure under the Insurance Contracts Act means that in the case of consumer insurance contracts, the insured's duty of disclosure has been replaced by a less stringent duty to take reasonable steps not to make a misrepresentation – meaning that the onus on disclosure has, in part, shifted from insured to insurer. This, in turn, means that it is likely that an insured will be taken to have acted honestly (from an utmost good faith perspective) with respect to their disclosure obligations where they have complied with the duty to take reasonable steps not to make a misrepresentation, as opposed to the predecessor duty of disclosure.

Acting fairly and reasonably

In *APRA v Youi*, acting fairly and reasonably in the context of the utmost good faith duty was recognised as involving full and frank disclosure, clarity, candour and timeliness.¹⁶ We consider that the hallmarks of this element overlap with that of decency and fair dealing addressed below. Our view is that it is best captured in terms of acting with due regard to the interests of the other party. For example, the parties should not act capriciously¹⁷ and should not be motivated to pursue ulterior

⁷ *CGU v AMP*.

⁸ *ASIC v TAL* at [173]; *CGU v AMP*; *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* (2005) 146 FCR 447 (**AMP v CGU**).

⁹ *CGU v AMP* at [15], [257], [130]–[131], [139].

¹⁰ *CGU v AMP* at [257].

¹¹ See *AMP v CGU* at [87]; *Kelly v New Zealand Insurance Co Ltd* (1996) 130 FLR 97 at 111–12.

¹² *CGU v AMP* at [130].

¹³ *Allianz Australia Insurance Ltd v Delor Vue Apartments CTS 39788* [2022] HCA 38; (2022) 97 ALJR 1 at [95]–[96]; *McArthur v Mercantile Mutual Life Insurance Co* [2001] QCA 317 at [11].

¹⁴ *ASIC v Camelot Derivatives Pty Ltd (In Liq)* (2012) 88 ACSR 206 at [69]–[70].

¹⁵ See *Webber v Mutual Community Ltd* (1991) 6 ANZ Insurance Cases at 61-079; *Camellia v Wesfarmers*.

¹⁶ *APRA v Youi* at [9].

¹⁷ *AMP v CGU* at [88]–[89].



advantage.¹⁸ They should also operate at all times diligently in accordance with the spirit of the insurance contract and cooperate in its performance. To this end, the insured is expected to take reasonably necessary steps to minimise their loss and not make fraudulent claims.¹⁹ Insurers, when dealing with sound claims for indemnity for example, should make timely decisions to accept or reject, and not delay unreasonably in making payment when they hold all relevant information. This requirement was explained by Sackar J in *Lawcover v Muriniti & Newell*:²⁰

One reason for the requirement that the insurer must act with the utmost good faith is that in the assessment of a claim under a policy the insurer is in a very real sense acting as a judge in the insurer's own cause. ... In these circumstances the duty of good faith must extend to a duty to act fairly and reasonably in the assessment and determination of the question whether the insured has made out a claim under the policy which the insurer is bound to indemnify.

Once again, the concepts of acting fairly and reasonably have continued to evolve, particularly in recent years. Clear examples of this can be seen in the use of outdated medical definitions and the timeframes for assessing and settling claims, with the Life Insurance Code of Practice and the General Insurance Code of Practice now informing what is reasonable and expected with respect to these matters. Importantly, the Life Insurance Code of Practice and the General Insurance Code of Practice now operate with contractual force in respect of its signatory members – meaning that it is conceivable that one or more breaches of the relevant code could give rise to a breach of the duty of utmost good faith.

Upholding community standards of decency and fair dealing

In *CGU v AMP*, the High Court recognised that, in the context of insurance, the concept of utmost good faith encompasses “community standards of decency and fair dealing”. This phrase was considered by Allsop CJ in *ASIC v Youi*, who considered that it involved acting with clarity, candour and timeliness.²¹ In that case, his Honour held the view that Youi had failed to exhibit decency and fairness in handling the insured's claim. This was reflected in the fact that repairs and “make-safe works” were completed around 22 months after a claim was made in January 2017.

To comply with this element, the case law indicates that insurers should:

- draft policies which are easily understandable and draw the insured's attention to unusual terms, a concept that will now, no doubt, be impacted by the application of the unfair contract terms regime to insurance contracts. An insurer may also be in breach of the utmost good faith duty if the contract of insurance and the insurance policy are not consistent and it has not drawn inconsistencies to the insured's attention;
- notify the insured of important obligations;²²
- respond to claims for indemnity and make payment in a timely manner.²³ What is timely will of course be impacted by the timeframes stipulated in the Life Insurance Code of Practice and the General Insurance Code of Practice;
- avoid delaying acceptance or rejection of a claim because of negligence or unwarranted

suspicions regarding its bona fides.²⁴ For example, an insurer should not extend an investigation by making enquiries which are not legitimate attempts to determine whether the insurance policy responds to a claim;²⁵

- where it elects to pursue a right of subrogation and assume an insured's defence under a contractual right, conduct that defence in the insured's interests and not solely its own;²⁶
- exercise discretion under terms of an insurance policy in accordance with its purpose, honestly, reasonably and bona fide having given all the material before the parties real and genuine consideration;²⁷ and
- ensure any claims rejected are rejected on the basis of reasonable inquiry in the interests of determining the correct position. The introduction of a claims handling and settling service as a designated financial service will also inform the content of the duty of utmost good faith, as key Australian financial services licensee obligations will be imported into the operation of the relevant insurance contract.

Principle 5: Does not require surrender of commercial advantage

Notably, the duty of utmost good faith recognises the commercial reality of the insurance contract and does not require the insurer to surrender its commercial advantage to ensure compliance. That is, the insurer is not expected to subordinate its interests to that of the insured – a key differentiator between the duty of utmost good faith and, for example, the fiduciary duty of a trustee.

¹⁸ *Zurich Australian Insurance Ltd v Metals & Minerals Insurance Pte Ltd* [2007] WASC 62.

¹⁹ *Orica Australia Pty Ltd v Limit (No 2) Ltd* (2011) 16 ANZ Insurance Cases at 61-877.

²⁰ [2017] NSWSC 1557, quoting Malcolm CJ in *Beverley v Tyndall Life Insurance Co Ltd* [1999] WASC 198.

²¹ *ASIC v Youi* at [9].

²² *Associated Motor Insurers Ltd v Ellis* (1990) 54 SASR 61; *Matton Developments Pty Ltd v CGU Insurance Ltd (No 2)* [2015] QSC 72.

²³ *CGU v AMP*; *Moss v Sun Alliance Australia Ltd* (1990) 6 ANZ Insurance Cases at 60-967.

²⁴ *AMP v CGU* at [72].

²⁵ *Protean Holdings Ltd v American Home Assurance Co Ltd* (1985) VR 187.

²⁶ *Re Zurich Australian Insurance Ltd* (1999) 10 ANZ Insurance Cases at 61-429.

²⁷ *Wyllie v National Mutual Life Association of Australasia Ltd* (1997) 217 ALR 324; *Baulderstone Hornibrook Engineering v Gordian Runoff* (2006) 14 ANZ Insurance Cases at 61-701 [1109].



For example, a breach of the utmost good faith duty will not arise where the insurer:

- seeks proof from an insured if it is genuinely suspicious of a claim or is of the view that it is not bona fide;²⁸
- relies on an assumption which is contrary to the insured's interests where it makes inquiries and does not receive any information;²⁹ and
- does not disclose to a potential insured matters which are peculiarly within the insurer's knowledge and may be influential on the potential insured's decision-making. That is, the insurer is not expected to surrender commercial advantage during the negotiation phase of an insurance contract in the potential insured's favour.³⁰

Relationship with the efficiently, honestly and fairly obligation

There is considerable overlap between the content of the duty of utmost good faith and the efficiently, honestly and fairly obligation under section 912A(1)(a) of the *Corporations Act 2001* (Cth) (**EHF Obligation**). Specifically, both duties require honest and fair dealing in the provision of financial services.

However, the duties are not coextensive. The obligation to act efficiently, honestly and fairly sits with Australian financial services licensees when providing financial services and so, it will not apply to many insureds. In contrast, the duty of utmost good which extends to both insurer and insured. Further, the "efficiency" limb of the EHF Obligation connotes a requirement of competence in providing financial services, whereas the utmost good faith obligation is largely concerned with the parties' bona fides and ethical conduct.

The practical result is that for Australian financial services licensees, breach of the utmost good faith obligation could indicate or trigger breach of the EHF Obligation and vice versa.

Such breaches may arise in the context of systemic problems (e.g. a flawed

claims process producing unfair results) as well as individual instances of egregious misconduct (e.g. pressure selling).

Final remarks

It is perhaps not surprising that the duty of utmost good faith continues to evolve. The very purpose of foundational and normative conduct obligations, like an AFS licensee's efficiently, honestly and fairly obligation, or a trustee's best interests duty, is to continue to effectively regulate conduct in an evolving community and regulatory environment. For this reason, while the principles underpinning the duty of utmost good faith are relatively stable, the content of the duty is ever-changing, as Allsop CJ commented extra-curially:

I think it very valuable that the duty of utmost good faith has not been over-articulated.

....

It is beyond doubt that, along with other members of the commercial community, insurers will have to face questions of values in how they behave, as well as in how their insureds behave. This is hardly new; nor is it to be feared...as long as the business of insurance is approached by insurers, brokers, and insurance practitioners as one that is relational, human and built on decency, fairness and honourable conduct.³¹

It is clear from the principles distilled above that the duty of utmost good faith can apply to an infinite range of circumstances, whether they be systemic failures on a large scale, or egregious misconduct in individual cases.

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²⁸ *CGU v AMP* at [72];

²⁹ *Sagacious Legal Pty Ltd v Wesfarmers General Insurance Ltd (No 2)* [2010] FCA 275.

³⁰ *Banque Keyser Ullmann & Ors v Skandia (UK) Insurance Co Ltd & Ors* (1987) 4 ANZ Insurance Cases at 60-759.

³¹ James Allsop, *The changing manifestation of risk: Comments on innovation, unconscionability and the duty of utmost good faith* (FCA) [2020] FedJSchol 4.