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ARBITRATION AND INSURANCE CONTRACTS:
TOWARDS THE REPEAL OF SECTION 8 OF THE
INSURANCE LAW REFORM ACT 1977

LLM RESEARCH PAPER
INSURANCE LAW (LAWS 515)

LAW FACULTY
VICTORIA UNIVERSITY OF WELLINGTON

1995

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ABSTRACT

Following the recommendations of the Contracts and Commercial Law Reform Committee 1975 section 8 was included in the Insurance Law Reform Act 1977, making arbitration clauses in insurance contracts unenforceable except in a small number of cases at the whim of the insured. It is submitted that this provision is overly restrictive. The justifications offered by that committee are analysed to examine whether any fundamental misunderstanding was the cause of the restrictive provision.

The New Zealand Law Commission has proposed the repeal of section 8. This proposal, however, has been subject to some criticism. The author analyses this criticism in the context of the modern insurance climate.

The text of this paper (excluding contents, footnotes and bibliography) comprises, with permission from the supervisor, approximately 16,000 words

I INTRODUCTION

This general focus of this paper is the law of insurance. The specific discussion is of arbitration as a method of dispute resolution. The connection between these two areas in New Zealand at present is section 8 of the Insurance Law Reform Act 1977. Therefore, an examination of this remedial legislation in 1977, and the specific barrier established by that Act to the use of arbitration clauses in insurance contracts, is crucial to an analysis of insurance arbitration.

By following the historical development of the Act, and particularly the operative section 8, the author identifies the committee's justifications for the restrictive provision. It will be considered whether the arguments adopted in 1977 are sustainable. This will allow for an objective assessment of the future of the section, whether repeal is necessary, and in what form. It must be remembered that whatever flawed reasoning the 1975 committee may have adopted, the Australian insurance law reform package initiated seven years later proceeded along a path almost identical to that leading to section 8.

The justifications of the committee indicate a possible lack of understanding of arbitration, which has led to the minimising of a potentially effective resolution process. The effect of *Scott v Avery*¹ clauses, and arbitration clauses generally, will be discussed. This distinction is fundamental to understanding the concerns of the committee. It is proposed that a detailed examination of the features of arbitration and arbitration clauses may show that the justifications for a restrictive provision were unfounded, and that section 8 has an extensive and far-reaching effect which cannot be maintained in the modern insurance climate.

The paper continues a legislative analysis, and examines the process of reform initiated by the New Zealand Law Commission towards the repeal of section 8 in the context of proposed arbitration legislation. The fundamental development in this reform which has an effect on arbitration agreements is the recommendation that a specific consumer protection provision be included in any future arbitration Act.

¹ (1856) 5 H.L.C 811; The effect of *Scott v Avery*, and general arbitration clauses, will be discussed in the context of the justifications of the committee for removing these clauses.

The paper questions the appropriateness of such provisions. Specific issues raised are whether consumers require particular attention, or whether they can exist equally, in a market like insurance, with commercial insureds. This involves an analysis of how consumers are perceived and treated generally in the insurance industry. The tentative conclusion arrived at is that consumers deserve special protection in insurance. The next critical enquiry is whether insurance consumers need to be singled out from consumers in other environments, and thus whether any proposed arbitration legislation should take particular account of the differences between insurance consumers and consumers in general.

In conclusion, it is suggested that the legislative machine has acknowledged an error in its operation and is directed towards ameliorating it.

II NEW ZEALAND LEGISLATION

In New Zealand, section 8 of the Insurance Law Reform Act 1977 provides that arbitration clauses, including compulsory arbitration clauses of *Scott v Avery*-form, are unenforceable by the insurer. In Australia legislation was passed by various states,² but the most significant Australian provision now is section 43 of the Insurance Contracts Act 1984 (Cth).³ Tracing the evolution of these restrictive provisions will reveal the justification offered for enactment, and any grounds for possible future alteration.

A Contracts and Commercial Law Reform Committee

This committee, in its 1975 study of insurance law⁴ identified a number of 'problematic' areas requiring the attention of corrective legislation. The 1975 research acknowledged a number of matters worthy of urgent attention, and impliedly recognised that a broad analysis of the law of insurance might be sacrificed in the proposed remedial environment.⁵ The committee, from the

² Section 19 Insurance Act 1902 (NSW); Section 28 Instruments Act 1958 (Vic); Section 21A Insurance Act 1960 (Qld).

³ Australian and New Zealand Insurance Reporter (CCH, NSW, Australia) 19-450.

⁴ Report of the Contracts and Commercial Law Reform Committee *Aspects of Insurance Law* (July 1975).

⁵ Above n4, 1; "We have not overlooked our obligation to consider insurance law in a more general way, and we intend to issue further reports. But it seemed to us that action in respect

outset, expressed concern with the manner in which insurers commonly draw insurance contracts in a way that is potentially unfair to the insured.⁶

A primary concern of the committee was the inability of insureds to negotiate the terms of insurance contracts, and the discretion with which insurers relied on technical defences in defiance of a claim. The committee provided a useful reference to potential biases by accepting that although many New Zealand insurers were reputable and acted with integrity towards customers, "there are some insurers who are not reluctant to adopt a harsh or unconscionable attitude."⁷ Legislative reform was recognised as an integral step to controlling the activities of such insurers, with the associated notion that reputable insurers would "have nothing to fear from such legislation."⁸

In this context of concern the committee addressed five discrete areas of insurance law, which ultimately constituted the bulk of the draft Act. These were immaterial mis-statements,⁹ compulsory arbitration,¹⁰ time limits for claims,¹¹ agency issues¹² and non-causative exemptions.¹³

Of specific interest is the analysis and subsequent recommendations relating to compulsory arbitration clauses. The committee found that insurance policies commonly provided that disputes between the insurer and insured had to be arbitrated:¹⁴

"Arbitration as a means of determining disputes can undoubtedly have its merits. Matters in issue can be resolved relatively informally and where issues are technical there are

of the particular matters to which we refer should not be held up by the need for a wider study."

⁶ Above n4, 1.

⁷ Above n4, 2.

⁸ Above n4, 2.

⁹ Above n4, 3.

¹⁰ Above n4, 10.

¹¹ Above n4, 12.

¹² Above n4, 12.

¹³ Above n4, 15.

¹⁴ Above n4, 10.

advantages in selecting an arbitrator with experience in the relevant field. But motives for insisting on arbitration can be less worthy. An insurer by insisting on arbitration can defeat claims because it is more expensive to pay an arbitrator...than to employ the services of judges or magistrates who are of course paid by the state; because the process of appointing arbitrators and settling references can lead to delay; and because legal aid is not available for arbitrations. Perhaps the main attraction of arbitration for insurers is its relative secrecy, the fact that arbitrations are disposed of in private and not in open court. In the view of the committee if insurers wish to contest claims they must be prepared to do so in public and not behind the closed doors of an arbitration. The customers and prospective customers of an insurer are entitled to know how that insurer behaves towards those claiming under its policies, and in particular whether that insurer is in the habit of invoking technicalities to defeat meritorious claims."

Some of the working paper information of the committee suggested that many New Zealand insurers were not enforcing arbitration clauses, or were including such clauses only in relation to the quantum of the indemnity. There was also evidence that certain insurers had been for some time party to an informal agreement with the New Zealand Law Society whereby insurers undertook not to insist on arbitration other than in relation to quantum. However, sustained enquiry with the NZLS has furnished no evidence of such an arrangement.

B Insurance Law Reform Bill

The Bill received 13 submissions, and was enthusiastically supported by the New Zealand Law Society and the Consumer Institute. There was some opposition from insurance interests, but not directly related to clause 8 (now section 8).

Substantial debate surrounded the relationship between clause 8 and clause 12, (now section 12) which provided that legal actions between an insurer and an insured were to be dealt with by a judge alone rather than a judge and jury. It was argued that the elimination of the jury was to be regarded as a form of compromise for the withdrawal of arbitration rights that were found almost universally in insurance policies. It was proposed that the reason for jury

removal was the belief that juries have historically been negatively and disproportionately influenced by insurance company involvement in personal accident claims.¹⁵

There is no doubt that in personal accident claims, insured defendants and their insurers may have felt vulnerable and subject to a jury prejudice towards arbitrarily high awards. Compulsory insurance ensured that the person at fault did not pay for the consequences of the wrong-doing.¹⁶ The difficulty with predicting the outcome of a damages case with any assurance was not aided by the vagaries of jury decisions, which added to the lottery-like appearance of the common law action. The fact of compulsory insurance was well known to juries, but the law said it could not be mentioned.¹⁷

How can it be argued that a movement away from a jury trial offers a compromise of this risk in a claim by an insured against an insurance company. The risk being avoided is that juries award more if a party is insured. In a claim by an insured against an insurance company, the only potential risk is that a jury may prejudicially award for the insured, as the insurer has the deeper pocket. The author suggests that if sections 12 and 8 are to be related by this type of compromise, then the proposed connection is incorrect.

C Insurance Law Reform Act 1977

This Act was passed as a direct result of the investigations and recommendations of the 1975 committee, and signified a major statutory encroachment into an area which is still principally governed by the common law. The ILRA 1977 provided specific rules relating to misrepresentation and non-disclosure. It also rendered invalid certain provisions in insurance contracts. Section 8 is the provision of interest:

"8. Arbitration clauses not binding-(1) Subject to subsection (2) of this section, a provision of a contract of insurance-

¹⁵ NZPD, vol 410, 327, 2 June 1977.

¹⁶ G Palmer *Compensation For Incapacity -A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington 1979) 27.

¹⁷ Above n16, 27.

- (a) Requiring differences or disputes arising out of or in relation to the contract to be referred to arbitration; or
 - (b) Providing that no action or suit shall be maintainable upon the contract or against the insurer in respect of any claim or difference or dispute arising out of or in relation to the contract unless the issue, claim, difference, or dispute has first been referred to arbitration or an award in arbitration proceedings has been first obtained; or
 - (c) Providing that arbitration or an award in arbitration proceedings is a condition precedent to any right of action or suit upon or in relation to the contract; or
 - (d) Imposing any reference to arbitration or to an award in arbitration proceedings any limitation on the right of any person to bring or maintain an action or suit upon or in relation to the contract,-
- shall not bind the insured
- (2) An agreement made by the parties to a contract of insurance after a difference or dispute has arisen out of or in relation to the contract to submit the difference or dispute to arbitration shall have effect as if subsection (1) of this section has not been enacted

Although the substantive effect of this provision is to eliminate the effect of arbitration clauses, an election can be made by the insured to determine whether the dispute will proceed to arbitration.

Section 8 (2) distinguishes between those agreements made to take out a contract of insurance which include an arbitration clause, and subsequent agreements made by parties to a contract of insurance after a dispute has arisen. The insured and insurer are free to enter into an agreement to resolve a dispute by arbitration which has arisen under the contract of insurance, but after the contract has been entered into.¹⁸ Once the insured and the insuring company have agreed that the dispute shall be resolved by arbitration, both parties are immediately bound by that agreement.¹⁹

¹⁸ P Green, B Hunt *Brookers arbitration Law and Practice* (Brookers, Wellington, New Zealand, 1993) I1-4.

¹⁹ Above n18, I1-4.

III ANALYSIS OF THE 1975 COMMITTEE

The paper has so far established the New Zealand legislative position in relation to arbitration clauses in insurance contracts. The author proposes a two-fold approach to the reasoning of the 1975 committee. First, it will be examined why the committee felt it was necessary to address compulsory arbitration agreements. The author suggests that arbitration agreements making arbitration compulsory were perceived as a vehicle forcing the insured involuntarily into arbitration. Whether the committee actually understood arbitration agreements, and *Scott v Avery* agreements, will be discussed. The second analysis complements the first. The committee, by rejecting the use of arbitration clauses, obviously perceived the use of arbitration as a dispute resolution mechanism in insurance contracts as detrimental to the insured. Whether the committee had an adequate appreciation of the arbitration process will also be discussed. This will involve evaluating the reasons offered by the committee for opposing arbitration.

A The Desire To Avoid A Mechanism Which Forces Insureds Into Arbitration

The committee's only explicit reference to the mode of entry into arbitration is the statement, "[I]t is common for insurance policies to provide that any disputes between the insurer and insured must be arbitrated."²⁰

The words of the committee are not particularly helpful. The implication offered is that the committee was concerned with clauses which specified that arbitration was to be the initial process of dispute resolution under the contract. The following analysis will consider the different forms in which arbitration is specified in arbitration agreements as an initial process, and will consider whether a crucial distinction, which may have affected the committee, should have been more clearly stated in their reasoning.

Arbitration agreements are a special kind of contract which prevail within the general framework of the law of contract and which in common with special contracts generally have developed distinctive features as a natural and

²⁰ Above n4, 10.

necessary incident of their province of operation.²¹ Arbitration agreements operate on two distinct levels:

1 General arbitration agreements

The essence of these agreements is procedural, providing a mechanism for the resolution of existing or future disputes. Two general characteristics are obvious:

1 Agreements are independent of and distinct from the cause of action which establishes the claim referred. Therefore, liability is distinct from the agreement, which is often described as collateral. Aside from the arbitration agreement, a discrete cause of action exists which can be pursued in the courts, and which is neither established nor modified by the agreement.

2 The existence of an arbitration agreement does not establish a defence to any action brought in disregard of the agreement to arbitrate. The failure first to arbitrate and obtain an award does not preclude the possibility of a remedy in the courts or a reference to the courts as a matter of procedure. The doctrine that the courts may not be ousted of their jurisdiction has the effect of rendering agreements void to the extent that they attempt to prevent a party from approaching the courts, even with regard to a matter which the parties have agreed to refer.²²

2 Scott v Avery clauses

In this case a policy of marine insurance specified that in the event of loss any quantitative difference was to be referred to arbitration, "provided always, that no insurer who refuses to accept the amount settled by the committee should be entitled to maintain any action in law or suit in equity on this policy", until the matter has been decided by the arbitrators and "then only for such sum as the arbitrators shall award." The obtaining of the decision of the arbitrators was declared a condition precedent to the maintaining of an action. The questions before the House of Lords focussed on the true construction and legality of such a contract.

²¹ Sir M.J Mustill and Stewart C. Boyd *The Law and Practice of Commercial Arbitration in England* (Butterworths, London 1989) 16.

²² D. Rhidian Thomas "Scott v Avery agreements" (1991) *Lloyds Maritime and Commercial Law Quarterly* 508, 509.

Lord Cranworth accepted that the clear language of the contract indicated that the parties intended any difference between the insured and the committee to be ascertained in a particular mode, and that until that mode had been adopted, no right of action existed.²³ Lord Campbell rejected the notion that a contract of this type could be declared illegal on grounds of public policy, and suggested that it would be consistent with public policy to encourage that a company avoid an action which could lead to ruination, and refer a dispute to a domestic tribunal for speedy and cost-efficient determination.²⁴

After *Scott v Avery* it is possible to contract specifically that a reference to arbitration and the making of an award shall be a condition precedent to liability, and that no action shall be brought until an arbitration has been conducted and an award made. Alternatively, and to the same effect, it may be agreed that the only obligation of a party to the contract shall be to pay such sum as may be awarded by an arbitrator. This is what is termed a *Scott v Avery* agreement.²⁵

A *Scott v Avery* agreement goes further than simply providing that disputes shall go to arbitration. Arbitration is established, not as an alternative to the courts of law, but as a condition precedent to litigation, with the consequence that the absence of an award is a defence to any action brought without first having arbitrated. "The arbitration is not a mere procedural mechanism collateral to and independent of the cause of action but, to the contrary, it is integrated into and represents an essential and crucial component of the cause of action. The award creates rights and liabilities which do not otherwise exist, and this fact in turn explains why the absence of an award provides a good defence to an action."²⁶

Scott v Avery clauses are composite agreements, and have been treated as two independent parts, one covenant to perform an obligation and the other to

²³ Above n1, 1136.

²⁴ Above n1, 1137.

²⁵ Above n21, 161.

²⁶ Above n22, 511; *Edwards v Aberayon Mutual Ship Insurance Society Ltd* (1876) 19 QBD 563, 575.

arbitrate. This creates an arbitration agreement, but also a precondition to litigation. Although the arbitral process is the method by which the condition precedent to litigation is satisfied, the two parts can be treated as conceptually distinct.²⁷

The practical effect of such clauses is that unless both parties consent to a trial, the dispute must be referred to arbitration.²⁸ It is often said that a *Scott v Avery* clause 'postpones but does not annihilate the right of access to the court',²⁹ as it does not prevent the parties from bringing a court action. An action in respect of a matter falling within the clause is not necessarily void and if a defendant waives the right to insist on arbitration, the action is not affected. The clause does not invalidate the action, but provides a defence; and since the effect of the condition precedent is to prevent any cause of action arising until an award has been obtained, the jurisdiction of the court is not ousted, since there is nothing to oust.³⁰

a Scott v Avery creates an option

The existence of a *Scott v Avery* clause favours a pro-arbitration defendant in a legal action, as it renders it virtually certain that any dispute will be settled by arbitration.³¹ Where such a clause exists the defendant in the action has two options:

The defendant can apply for a stay of the proceedings under the relevant arbitration legislation

On the hearing of the application, all issues surrounding the applicability of the arbitration provisions can be dealt with, as well as the issue whether the clause is to have effect. If the clause does apply, the action will be stayed and

²⁷ Above n22, 511; The *Scott v Avery* precondition will predominantly be incorporated into an arbitration clause or agreement, but it could exist as a distinct clause in the contract, or as a physically distinct agreement.

²⁸ Above n21, 161.

²⁹ Above n21, 162; *Freshwater v Western Australian Assurance Co Ltd* (1933) 1 KB 515.

³⁰ Above n21, 162.

³¹ P M B Rowland *Arbitration Law and Practice* (Institute of Chartered Accountants, London, 1988) 34.

the matter can proceed to arbitration without further costs being incurred in the action.³²

A condition precedent to the plaintiff's right of action is created, giving the defendant a substantive defence to the claim.

The plea of the clause in defence of the action operates as an absolute bar. A plaintiff bringing the action is met by the defence that such an action cannot be accepted until the condition precedent, the arbitration award being made, has occurred. The fact is that the plaintiff has *no cause of action*. The plaintiff will lose in the case and incur the costs of so doing. The arbitration will then have to be held unless the defendant has waived the *Scott v Avery* clause.³³

However, waiting and relying on the defence at the trial is contrary to fundamental notions of speedy and efficient justice on which arbitration is founded. The judicial approach to the stay where a *Scott v Avery* clause exists suggests that the courts would, if given an opportunity to choose between the options, favour a stay over the adoption of the defence.³⁴

*Golding v London & Edinburgh Insurance Co Ltd*³⁵ provides a useful judicial commentary on the factors involved in distinguishing between these options. That case involved an action under a policy of insurance which contained a *Scott v Avery* clause.³⁶ The court implied that the earlier decision had not considered the ramifications of the plaintiff being left to meet the defence, and considered two ways of viewing a plaintiff's action without a prior award:³⁷

³² Above n21, 166.

³³ John B Dorter. Gary K Widmer *Arbitration (Commercial) in Australia: Law and Practice* (Law Book Co., Sydney, 1979) 72.

³⁴ For instance, if the court had been involved in the case at an earlier stage, in interlocutory proceedings. When establishing whether a valid defence exists, Australian courts have created problematic distinctions between conciliation clauses modelled on *Scott v Avery*, and arbitration clauses in *Scott v Avery* form. See R S Angyal "Enforceability of Alternative Dispute Resolution Clauses (1991) 2 ADRJ 32, for a discussion of *Allco Steel (QLD) Pty Ltd v Torres Strait Gold Pty Ltd & Ors* Unreported, SC of Qld, No 2742 of 1989, 12 March 1990, Master Horton QC.

³⁵ (1932) 43 L1 LR 487, CA.

³⁶ "The obtaining of an award shall be a condition precedent to any liability or right of action against the company." The company, applying to stay the action under the arbitration clause, appealed from a decision that *Golding* was entitled to bring an action upon the policy, notwithstanding the *Scott v Avery* clause.

³⁷ Above n35, 488.

" One way of looking at it is this: 'Let him go on with this obvious defence before him and throw away all the costs of the action.' The other way is this: Act on clause 12 and stay the action. He must then go to arbitration. [Liability] will be tested in the arbitration, and if he is entitled to the money he will get it, and if he is not entitled to the money he will not get it..."

3 Stay of proceedings

The English Common Law Procedure Act 1854³⁸ and the judicial development of the discretion to order a stay established the foundation for the modern-day burgeoning of the arbitral institution.³⁹

In England the relevant legislation is s4(1) of the Arbitration Act 1950, which applies to the discretionary jurisdiction in domestic arbitration agreements, and s1 of the Arbitration Act 1975, which applies to non-domestic arbitration agreements where the jurisdiction is mandatory, except for specified exceptions.

The New Zealand legislation is limited to section 5 of the Arbitration Act 1908, and no distinction exists between domestic and non-domestic arbitration agreements. However, the section does not apply to any arbitration agreement to which section 4(5) Arbitration (Foreign Agreements and Awards) Act 1982 applies. Therefore, prior to the 1977 Act, where there existed an arbitration agreement to refer a dispute to arbitration, and a dispute within the meaning of the agreement arose, the parties would be bound to the agreement. The court would seldom refuse a stay,⁴⁰ although five prerequisites had to be satisfied.⁴¹ Complementing these five

³⁸ Common Law Procedure Act 1854 introduced a statutory jurisdiction to stay proceedings brought in disregard of an arbitration agreement.

³⁹ Above n22, 516.

⁴⁰ Above n18, D-21, discussing *Codelfa-Cogefar (NZ) Ltd v A-G* [1981] 2 NZLR 153, 157.

⁴¹ Above n18, D-21, discussing *Angus Construction (Wellington) Ltd v Smart Group* 12/12/88, Davidson CJ, HC Wellington CP466/88 where it was held that there were five conditions justifying a stay: (a) There must be a valid arbitration agreement covering the disputed issue; (b) The application for stay must be made by a party to the agreement; (c) The applicant must have taken no steps in the proceeding; (d) The applicant must be ready and willing to arbitrate; (e) The court must be satisfied that there is no sufficient reason why the matter should not be referred to arbitration in accordance with the agreement.

requirements was the wide judicial discretion to decide whether the dispute should remain within the jurisdiction of the court.⁴²

Further statutory conditions operated for a *Scott v Avery* clause. Section 5(4) of the Arbitration Amendment Act 1938 gave the courts the power to annul *Scott v Avery* clauses. In most cases, however, where the courts encountered an arbitration agreement with such a clause, a stay of proceedings would be granted.⁴³ A stay would not be granted where the party attempting to invoke the clause had waived the right to rely on the provision, or where there existed a jurisdictional issue which challenged the right to arbitrate at all.⁴⁴

Therefore, in the case of a general arbitration agreement, even though the courts favoured a stay, there was no certainty that such an order would be granted, and in a specified range of situations the courts would not grant a stay. However, where a *Scott v Avery* clause existed, although the courts had the opportunity to use section 5(4), the granting of a stay was almost immediate.

The effect of *Scott v Avery* clauses on the judicial discretion to stay is critical to understanding the possible concerns of the 1975 committee. *Scott v Avery* clauses in the more positive contemporary environment have provided for the creation of a bias towards the enforcement of arbitration agreements through the affirmative use of the statutory power to order a stay of legal proceedings brought in defiance of an arbitration agreement.⁴⁵ Theoretically, where the statutory jurisdiction is discretionary, it is at least open to a court to refuse an

⁴² Above n18, D-2; B-15.

⁴³ M Gobbi and J P Gray "The Arbitration Alternative" (1991) NZLJ 270, 271; see *Jones v Eagle Star & British Dominions Insurance Co Ltd* [1922] NZLR 336.

⁴⁴ Above n18, D-23; For instance, an arbitrator has the jurisdiction to decide issues of fraud if the issue falls within the scope of the submission, or the parties have agreed to give that jurisdiction. Section 16(2) of the 1938 Amendment provides that the court may "give relief" in such circumstances. However, the court has the power to order that the agreement is of no effect and to give leave to revoke any such agreement to arbitrate. The Mackinnon Committee, *Report of Committee on the Law of Arbitration*, Cmd, 2817 (1927), considered the extent to which a *Scott v Avery* precondition has the effect of overriding the discretion established under the arbitration legislation. The effect of a *Scott v Avery* precondition would be to automatically consign the fraud to the arbitral forum. The concept of these agreements was not problematic to the Committee, but it was considered undesirable that they should impact so fundamentally on the relationship between arbitration and the courts.

⁴⁵ Above n22, 516.

order of stay and allow the action to proceed but subject to the possibility of a defence being raised. However, in practice this is unlikely. Where a *Scott v Avery* clause exists the discretion is exercised invariably in favour of an order to stay, thus indirectly forcing the parties into arbitration.⁴⁶

The reasoning behind this trend is that "an application for an order of stay is not a waiver of the defence, and it would be pointless and wasteful to allow an action to proceed when that action enjoyed no prospect of success because of an available defence."⁴⁷ A party ignoring the option to apply for a stay and relying wholly on the defence "is in peril as to costs."⁴⁸

Therefore, the real practical significance of a *Scott v Avery* clause is to emphasise the arbitration agreement and confirm the obligation to arbitrate. The court will feel even more disinclined than usual to refuse the stay if the arbitration agreement is in the *Scott v Avery* form. Any judicial discretion is structured in favour of arbitration. This is perhaps true because the parties have agreed to a 'stronger form' of arbitration agreement than one without such a clause. Where the arbitration clause is not in the *Scott v Avery* form the defendant only has the right to apply for a stay under the relevant legislative provisions. The defendant cannot rely on such a 'bare' arbitration agreement as a defence.

4 The possible effect on the committee

The committee, with a clear position in relation to arbitration, attempted to qualify the use of this dispute procedure in insurance contracts by restricting the validity of arbitration clauses. However, as it has been explained, a significant distinction exists between general arbitration clauses and those of *Scott v Avery* form.

The committee perceived compulsory arbitration clauses as the vehicle leading the insured into arbitration. The author suggests that the committee confused the distinction which can be made between the two types of arbitration clauses, and that although their probable concern was with *Scott v*

⁴⁶ Above n22, 522.

⁴⁷ Above n22, 522; *Dennehy v Bellamy* (1938) 2 All ER 262 (CA) at 264.

⁴⁸ Above n22, 522; *Woodall v Pearl Assurance Co Ltd* (1919) 1 KB 593 (CA).

Avery clauses, and the way in which those clauses favour the pro-arbitration party, the committee appears to have ignored the fact that arbitration clauses in general form do not necessarily have the same effect on the judicial discretion to stay. By attempting to avoid arbitration clauses which forced the parties into arbitration, the committee recommended a general provision which precludes the use of arbitration clauses in general, not merely those particular to that case.

B Justifications For Rejecting Arbitration In Insurance Disputes

The second point forwarded by the author is that the committee, as well as confusing the distinction between arbitration clauses, may have had an unnecessarily negative perception of the process of arbitration. The author will analyse the committee's statements on the motives behind insisting on arbitration to consider whether the arguments for rejecting arbitration are justified.

1 Costs and Delay

"An insurer by insisting on arbitration can defeat claims because it is more expensive to pay an arbitrator (or two arbitrators and an umpire) than to employ the services of judges or magistrates who are of course paid by the State; because the processes of appointing arbitrators and settling references can lead to delay;"

The fundamental contention that an arbitrator must be privately paid is unchallengeable. However, the issue for consideration must be the extent to which the costs of the arbitrator can be analysed against the costs of counsel in a protracted court proceeding. Therefore, the issues of costs and delays are inextricably linked. The author proposes that if an arbitration is conducted efficiently and in a speedy manner, it is possible that a result will be delivered sooner, and at less expense to the insured, than if the claim was pursued in court.

The committee obviously had a clear attitude towards arbitration procedure as an alternative to traditional judicial mechanisms of dispute resolution. The author, suggesting that this perception may have been based on a fundamental misunderstanding of the arbitration process, will describe what the committee appears to have considered, and what the author considers, to be the features of arbitration practice. It is submitted that the wide use of the

term 'arbitration' could have been a primary cause of confusion and negative attitude towards the process. The absence of definition may have led to misunderstanding and the rejection of arbitration as a legitimate mechanism for dispute resolution.⁴⁹

a What is arbitration?

An arbitration is a procedure for the resolution of disputes. It is the reference of a dispute or difference between two (or more) people to a third person (or persons) nominated by the parties to decide it. It is entered into by agreement. Once entered, the parties are bound to proceed with it, unless they agree, or the court orders otherwise. In New Zealand, under the present legislation, an arbitration which is subject to the terms of the Arbitration Act 1908 and the Arbitration Amendment Act 1938 will only arise following a valid 'submission'.⁵⁰

Arbitration, although existing as an "alternative" to the traditional litigation process, is not independent of court control. In New Zealand the jurisdiction of the High Court offers a formal check on arbitration practice. The common issues which require attention in this forum relate to enforcement of awards,⁵¹ the setting aside of awards,⁵² the removal of an arbitrator⁵³ and general procedural problems which require scrutinisation of alleged defects in the arbitration process.⁵⁴ However, despite these legislative checks, there has been a definite trend in New Zealand in favour of enhanced party autonomy and, as a result, restricted judicial review of arbitration.⁵⁵

⁴⁹ F Miller "Redefining Terms of Arbitration" (1990) NLJ, 827; The difficulty with using one term to describe a variety of distinct processes can lead to confusion, which arguably occurred in 1975. See discussion at 827 that the "word 'arbitration' needs either a statutory definition to categorise the various procedures and the status of the awards or, alternatively, 'arbitration' must be treated as a *Word of Art*; where the true meaning is only clear when reference is made to the terms of the arbitration agreement."

⁵⁰ Above n18, 3; See the discussion that the wide definition in section 2 may have far-reaching consequences and be over-encapsulating.

⁵¹ Section 13.

⁵² Section 12(2).

⁵³ Section 12(1).

⁵⁴ Arbitration Act 1908, ss 5, 6(2), 10; Arbitration Amendment Act 1938 ss 10, 15, 16.

⁵⁵ The trend towards a less intrusive approach has been acknowledged and reflected by the New Zealand Court of Appeal in *CBI NZ Ltd v Badger Chiyoda* (1989) 2 NZLR 669. See also K Stein "Correspondence" (1994) NZLJ 9, where the judgements of *United Sharebrokers Ltd v*

Arbitration in England and Australia operates with greater autonomy, due to the modern legislative emphasis in those jurisdictions.⁵⁶ Prior to the Arbitration Act 1979, the English courts had the general power to review the decisions of arbitrators, and thus arbitration proceedings were rarely final. The 1979 Act removed the general powers of the courts to review awards and replaced them with a limited power to hear an appeal on a question of law.⁵⁷

Arbitration has a legitimate history as a formal institution. In fact, the use of arbitration is generally considered the rule rather than the exception for disputes relating to the quality of commodities, the building and construction industry,⁵⁸ maritime matters,⁵⁹ and commercial rent reviews.⁶⁰ Arbitration is not limited to commercial causes, and domestic arbitration occupies a significant part of the dispute market. Thousands of disputes which would otherwise flood the courts or fail to be resolved, and which deal with claims as various as defective houses, insurance wrangles, professional negligence actions and the like are dealt with speedily and economically by arbitration.⁶¹ The author suggests that, from the outset, this comprehensive acceptance of arbitration in modern society should have had a significant effect on any party considering a draconian reform like section 8.

Landborough Estates Ltd & Others (Christchurch CP 298/89, Judgement, 18 May 1990, reported in NZVF September 1990, Tipping J) and *Smale & Brookbanks v Illingworth & Anderson and Fletcher Homes Ltd* (Auckland No 1623/92, Judgement 18 December 1992, Thorp J) are presented as examples of the pro-arbitration stance of the New Zealand judiciary.

⁵⁶ R S French "Arbitration- The Court's Perspective" (1993) 4 ADRJ 279; England, Arbitration Act 1979; Australia, Uniform Commercial Arbitration Acts 1984 and 1985. A modern approach to the arbitral process in Australia was expounded in *Qantas Airways Ltd v Dillingham Corp* (1985) 4 NSWLR 113, 118: "It is now more fully appreciated than used to be the case that arbitration is an important and useful tool in dispute resolution. The former judicial hostility to arbitration needs to be discarded and a hospitable climate for arbitral resolution of disputes created."

⁵⁷ Section 1(2).

⁵⁸ Carol Powell "Alternative Disputes Resolution" Fast Track, Chapman Tripp Sheffield Young, Construction and Engineering Group Newsletter, issue 1, October 1993.

⁵⁹ For instance, the development of the Auckland Maritime and Insurance Arbitration Forum, with specialised procedures for arbitration and mediation.

⁶⁰ R Macdonald "Pendulum Arbitration-The answer to exaggeration in commercial rent review disputes" (1994) NZLJ 194.

⁶¹ M Rutherford "Arbitration-Be There Dragons?" (1987) Law Society's Gazette, 2422.

b Flexibility of procedure

Arbitration is founded on some general procedural assumptions. "(I)n the absence of express or implied terms to the contrary the arbitrator should adopt a procedure which is adversarial in nature"⁶² This is contrasted with an 'inquisitorial' system, where the tribunal is the key party in discovering the solution to the dispute.⁶³ An adversarial approach allows the parties to postulate alternative versions of the true position based on presentable material, upon which the arbitrator can make a decision. The procedure for the arbitration is often decided by the arbitrator, as long as it does not conflict with the express or implied terms of the arbitration agreement.⁶⁴ It is common for trade or professional institutions to have their own arbitration rules, but capacity always exists for suitable individual rules for particular contracts to be drafted.⁶⁵ It follows that the arbitrator can tailor the procedure to the requirements of the parties in dispute. An even wider discretion is granted where the contract makes no reference to institutions or forms.⁶⁶

Mustill and Boyd suggest that the adversarial system has three main characteristics:

The procedural initiative and the responsibility for maintaining the momentum of the reference rests with the parties.⁶⁷ The parties should

⁶² Above n21, 16.

⁶³ The parties can of course decide that the arbitrator carries out their own investigation, as is indicated below.

⁶⁴ Above n43, 271; The suggestion is that if full advantage is to be derived from the arbitration process, any arbitration agreement must be carefully drafted to meet the needs of the parties, otherwise the courts may declare the agreement invalid or may subject the parties to the statutory arbitration procedures set out in the Second Schedule of the Arbitration Act 1908.

⁶⁵ R Coulson "Avoiding Litigation with Alternative Dispute Resolution" (1993) Risk Management 20, 24. This can allow the parties to control aspects such as the appointment of the arbitrator, procedural rules, any provisions like *Scott v Avery* clauses, what national law is to apply and other related issues. Arbitration in this sense is an exercise of the parties' contractual free will.

⁶⁶ Above n21, 15; In the absence of agreement the arbitrator is bound to follow the implied agreement of the parties, which involves taking into account the nature of the contract, its express terms, the commercial background, common trade practices of dispute resolution, the choice of tribunal and any preliminary procedures undertaken by the parties.

⁶⁷ Above n21, 17.

elicit evidence and present alternatives from which the arbitrator can make a choice.⁶⁸

Although evidence is usually documented and communicated to the other parties and the arbitrator, evidence and argument are presented in a single hearing, at the conclusion of which the arbitrator will reach a decision on the basis of what has been presented and nothing else.⁶⁹

The adversarial system is predominantly oral, with the majority of the evidence arising from witnesses attending in person, particularly where the dispute is complex.

These general statements provide a useful platform from which to analyse the variety of procedures which may operate as alternatives or exceptions to the traditional understanding of arbitration. It is possible that the 1975 committee did not have the benefit of such an analysis.

It has been traditionally considered that, unless otherwise prescribed, arbitration should proceed on broadly the same lines as a High Court action.⁷⁰ The author submits that this may have been the assumption on which the 1975 committee approached arbitration. As a general principle, this assumption is unsustainable. The perception that arbitration is identical to trial at law arises not from any express obligation to make the reference imitate a common civil action, but from the fact that lawyers often represent parties, and legally-trained professionals act as arbitrators,

Clearly, an arbitration may involve a lengthy and formal procedure resembling a court proceeding,⁷¹ with attendant counsel and accompanying exchange of formal pleadings. However, this is merely a threshold from which more flexible procedures can be developed. For instance, in a commodities dispute, the arbitrator can look at the commodity in question and then, based on personal knowledge, issue the award.⁷² This quality

⁶⁸ Above n21, 17.

⁶⁹ Above n21, 17.

⁷⁰ Above n21, First Edition generally.

⁷¹ Above n18, 3.

⁷² This is termed "look-sniff" arbitration.

analysis is the most informal type of arbitration and often involves "the mystic operations of smelling, tasting, touching and handling."⁷³ The award is made on a judgement based upon this type of physical analysis. The scope for implementing an adjudication method more formal than this type of 'summary justice' is extremely broad, qualified only by the requirement that any procedure must be consistent with the express or implied terms of the arbitration agreement.⁷⁴ Therefore, it is possible that an appropriate dispute could be adjudicated on documentary evidence alone, with the possibility of dispensing entirely with a hearing. Alternatively, a decision could be based on such documents and written representations, pleadings and submissions, or documentary evidence incorporating a site visit. It is possible to hold a hearing with an agreed bundle of documents and no discovery; a hearing with prior exchange of expert reports, or joint reports on points of agreement and contention. Parties may also request a qualified party to simply offer an opinion on a matter in dispute to allow clarification of feasible issues for resolution, or merely to ascertain the likely result of a prospective action.⁷⁵

All these mechanisms have the capacity to limit the procedural formality mentioned above, and may improve the common perception of a process often considered a "wigless trial".⁷⁶ The issue to be emphasised at this stage is that the procedural control of the arbitration can rest entirely with the parties. There is no requirement that parties must comply strictly with the formalities of court proceedings to ensure a valid arbitration. The arbitration statutes by which the flexible procedures described above are governed are the same statutes on which the committee based its reasoning in 1975.

The author suggests that the recommendations of the 1975 committee may have been founded on the insular traditional assumptions of arbitration, and did take into account the potential for procedural flexibility in the arbitral

⁷³ *Naumann v Nathan* (1930) 37 L1 L Rep 359.

⁷⁴ Above n21, 18.

⁷⁵ H Astor and C Chaykin *Dispute Resolution in Australia* (Butterworths, Sydney, 1992) 242; The parties may not strictly consider this an arbitration, and the distinction between a reference to an arbitrator and to an expert is that an expert is not bound by statutory provisions, an opinion is not binding, and immunity is unavailable. However, depending on the definition of 'submission', the distinction may become blurred, as a reference to an expert may inadvertently become subject to Arbitration legislation.

⁷⁶ Above n61, 2423.

forum. The author has attempted to emphasise the disparity between what the committee may have assumed arbitration to be, and what in fact the process of arbitration involves, to allow an analysis of the specific justifications offered for the rejection of arbitration in insurance.

The particular concerns relating to costs and delay are credible if it is assumed that arbitration is effectively a formal trial without a judge. However, the author has shown that such an assumption cannot, and has not, existed as a prescribed rule.

Arbitration can produce speedy and cost-effective resolutions if the parties are willing to part with formality and arrange proceedings which allow unnecessary procedures to be bypassed. If the parties choose to conduct the arbitration as if it were a litigation, the hearing preparation will cost the same as that for litigation, but the hearing cost would be greater once the arbitrator's fees and additional support staff were met.⁷⁷

It is suggested that arbitration is a cheaper process than litigation where technical issues require resolution and lawyers are not involved, or if involved, as specialists chosen to narrow the substantive issues down, or present documentary evidence.

Although considerable effort has been made to reduce court delays, the judicial forum will always struggle to avoid the impediment of mounting case loads. Ethical constraints on arbitrators operate to discourage the acceptance of references if a timely result is not anticipated. This restriction is not available in the courts.

The specialist role of the arbitrator may remove the need to rely on expert counsel in an arbitration. If counsel are used, the need to labour initial and fundamental issues is lessened than if the adjudicator is a generalist.⁷⁸

Therefore, it is suggested that the concerns in 1975 as to costs and delay may have been ill-founded. Certainly, these issues are problematic in arbitration law, but not to the extent suggested in 1975. The author submits that the

⁷⁷ W P Jeffries "Alternative Dispute Resolution: The advantages and disadvantages from a legal viewpoint" (1991) NZLJ 156, 157.

⁷⁸ Above n18, 7.

overly restrictive approach to arbitration, manifested in the report of 1975, was based on an inability of the committee to approach arbitration as a flexible process, and on general assumptions arising from archaic traditions.

2 Legal aid

"and because legal aid is not available for arbitrations."

This justification of the committee is convincing, but only to a certain extent. Section 8 is an encompassing remedial provision which restricts the use of arbitration clauses in all contracts of insurance. It should follow that an argument adopted to implement such a reform should relate to all parties affected by the section. However, legal aid is not readily available to every party involved in a court proceeding.⁷⁹ The author submits, therefore, that such reasoning is not persuasive in the argument that arbitration should be categorically restricted in insurance contracts.

3 Privacy

"Perhaps the main attraction of arbitration for insurers is its relative secrecy...if insurers wish to contest claims they must be prepared to do so in public and not behind the closed doors of an arbitration. The customers and prospective customers of an insurer are entitled to know how that insurer behaves towards those claiming under its policies.. "

The committee suggests that the motives of insurance companies in relation to their customers are often dubious and dishonourable. However, it involves a significant conceptual progression to achieve this implication from the common practice of insisting on arbitration.

The extensive party control over arbitration procedure referred to above would include the opportunity for parties to specify for representatives and support networks to become involved in the reference. Therefore, any party not wishing to attend arbitration alone would not have to.

⁷⁹ For instance, although the Legal Services Act 1991, section 19 provides that civil legal aid is prima facie available in most proceedings, eligibility is tested by stringent personal and financial qualifications (ss 29-32). There is also a further restriction on the eligibility of corporate and unincorporate bodies (s 27). General restrictions also operated in 1975 under the Legal Aid Act 1969, with the scope of assistance limited in specified circumstances (s15), and always subject to a means tested threshold (s19).

The privacy of arbitration avoids unfortunate publicity and preserves issues of commercial sensitivity. This of course is lost on appeal, but the relatively minor number of cases proceeding that far (and the capacity to include no appeal clauses) make this a less significant consideration.⁸⁰

In contrast to a litigated proceeding, where a party will almost always require counsel,⁸¹ arbitration places no significant constraints on representation. Parties can 'have their day in court' without the restrictions of civil procedure. This will also have significant implications for costs.

Arbitration may be particularly attractive to disputing parties wishing to preserve their relationship. The flexibility of the arbitration presents the parties with an opportunity to create an hearing far removed from the confrontational and aggressive courtroom forum. This is significant for commercial entities operating in a competitive environment where the option of categorically rejecting association with specific parties in the market is unavailable. The nature of insurance relationships precludes simple disassociation on dispute. Often parties will have a history of transactions prior to a dispute, and it cannot be expected that such a relationship will be ignored. The adoption of an arbitration model suited to the needs of the parties has a greater chance of 'patching things up' than a journey through the courts.

The author submits that the privacy of an arbitration may actually operate as a fundamental benefit to insurance disputants, rather than a feature favouring clandestine and dishonest insurers.

If the committee was genuinely concerned with informing insurance customers of the claims-paying practices of insurers, it is not difficult to anticipate that a mechanism in the form of a standardised rating scheme, which would be available to all parties,⁸² would have served this purpose far more effectively than a comprehensive ban on insurance arbitration.

⁸⁰ Above n31, 15; This is especially so under the English 1979 Act and the guidelines in regard to granting leave to appeal laid down in *Pioneer Shipping Ltd v BTP Tioxide Ltd. The Nema* [1982] AC 724.

⁸¹ Above n31, 18.

⁸² This could operate as a rating of the claims-paying practices of all insurance companies, with an emphasis similar to the Insurance Companies (Ratings and Inspections) Act 1994.

C Conclusion

The author has attempted to show that many of the justifications offered in 1975 for reform are based on fallacy and misunderstanding.

The tenor of the report suggests that an element of urgency surrounded the research and subsequent recommendation. The speed with which the report was transformed into draft legislation is greeted in parliamentary debate with an element of surprise.⁸³ The remedial climate favoured specific reform which may have led to the sacrifice of a wider perspective. The language adopted by the committee indicates that the recommendations were clouded by the questionable activities of a small number of insurers.⁸⁴ The desire to neutralise the perceived 'unfair' bargaining position between insurers and insureds appears to have arisen out of some subjective assumptions about arbitration as a discriminatory dispute resolution process.

The operating powers of section 8 are significantly wider than simply abrogating the effect of a *Scott v Avery* clause. It also overrides a fundamental stipulation that disputes will be referred to arbitration. An acceptance that section 8 is useful thus requires not only an acceptance that *Scott v Avery* clauses are a vice, but also that arbitration as an institution is a vice. This of course depends on the proponents perspective of dispute resolution, but nevertheless results in quite a significant conceptual leap.

The author respectfully submits that the committee showed a significant lack of judgement in its recommendation of clause 8. It is desirable that the law be cast in a way that alternative dispute resolution is encouraged. This is particularly the case with arbitration, where the processes involved are hallowed by time and experience, and are tried and accessible. Any rule of law restricting access to these, or which creates a barrier to party autonomy, should be regarded with suspicion.

However, when identifying the fundamental deficiencies in the reform commenced by the 1975 committee, it must be considered that seven years after the remedial legislation was passed in New Zealand, the insurance law

⁸³ Above n15, 326.

⁸⁴ Above n4, 2.

reform package initiated by the Federal Law Commission in Australia in 1976 contained a provision which imposes even wider restrictions than section 8.

That commission also emphasised a concern with equality of bargaining power and the relative fairness of insurance contracts. The result of the commission enquiry was the emergence of two reports,⁸⁵ both of which contained draft Bills which were accepted and passed into law in 1984 as the *Insurance (Agents and Brokers) Act 1984* and the *Insurance Contracts Act 1984*. The investigation emphasised the problems and difficulties faced by consumers, with the common perception that arbitration had the capacity to seriously disadvantage consumers.⁸⁶ However, criticism was aimed at an investigation which identified consumer concerns but ultimately recommended little or no difference in the treatment of consumer and commercial insurance. It was suggested that this could create major problems for commercial insurers and their customers, and careful monitoring was expected.

The recommendation adopted similar reasoning to the 1975 committee in New Zealand,⁸⁷ highlighting increased cost, delay in payment, the avoidance of meritorious claims, and the avoidance of bad publicity as reasons to reject compulsory arbitration. It was suggested that the insurance industry raised no objection to the abandonment of arbitration clauses.⁸⁸

⁸⁵ Australian Law Reform Commission Report 16 *Insurance Agents and Brokers*; Australian Law Reform Commission Report 20 *Insurance Contracts*.

⁸⁶ Richard Thomas *Guidebook to Insurance Law in Australia and New Zealand* (CCH, NSW, 1981), 80.

⁸⁷ A Tarr, K Liew, W Holligan *Australian Insurance Law* (2ed, The Law Book Company, Sydney, Australia) 235. In fact, the limited reference to the arbitration reform in this text, which spans 1 1/2 pages, quotes the relevant passage from the 1975 committee as authority for the development of section 43.

⁸⁸ Above n85, Report 20, 204; The wording of the report is almost identical to that of the 1975 committee: "Arbitration of disputes may have value in certain areas of the law. In the context of insurance, however, there is a widespread view that reliance on compulsory arbitration clauses leads to cost, delay in payment and even to the avoidance of just claims. Legal aid is not usually available in arbitration proceedings. Yet these may be more costly than proceedings in court. An insurer which wishes to rely on a technically valid but unmeritorious defence may, by insisting on arbitration, avoid the damaging publicity which would attend such a tactic if it were employed in court. The presence of an arbitration clause may discourage a claimant from pressing his claim and may equally discourage an insurer from offering settlement on a claim which it regards as being in the least doubtful. Even where the insurer is bound to meet the costs of the arbitration, it would be preferable to allow the insured to take his dispute straight to court. The insurance industry has raised no objection to the abandonment of arbitration clauses. They should be rendered ineffective."

As a result of these recommendations section 43 was introduced. Section 43(1) provides that a provision in a contract of insurance which requires, authorises or otherwise provides for differences or disputes in connection with the contract to be referred to arbitration, or limits rights conferred by the contract on the insured by reference to an agreement to submit a difference or dispute to arbitration, is void.⁸⁹

The section does not apply to an agreement to submit a dispute or difference to arbitration if the agreement was made after the dispute or difference arose (s43(2)).

IV SECTION 8 IN PRACTICE

The author is aware that some parties involved in the insurance industry consider section 8 to exist as a barrier to arbitration in only a very small number of cases where arbitration is desirable. The perception is that the section 8 obstacle is anomalous, as most insurers are never particularly anxious to proceed to arbitration.⁹⁰ However, it appears to be a circular argument to suggest that arbitration does not occur because insurance companies are not interested in pursuing it as an option, when the possible reason for this lack of interest is that insurance arbitration has been effectively rejected by statute. To suggest that repeal will not alter this situation because arbitration is not presently in favour seems to commence this circular argument again.⁹¹ It is difficult to understand the reasoning that arbitration is not commonly used because disputes simply cannot be aligned to that form of dispute resolution. The lack of use must surely not be primarily for that reason, but the fact that a legislative barrier to arbitration clauses has been created.

⁸⁹ J Morgan *The Insurance Contracts Act 1984* (Longman Professional Statute Guide, Sydney, 1986) 2.

⁹⁰ Correspondence with Mr Trevor Roberts, Gillespie Young Watson, 04-07-95.

⁹¹ Correspondence with Mr Alan Deerness, Manager, Claims Technical, State Insurance, 20-07-95, where it was indicated that section 8 has had little effect on the practices of that company as they rarely receive requests for disputes to be arbitrated in a formal manner. Arbitration conditions in State policies require agreement between both parties. The suggested problem was that it was difficult to find a significant number of disputes meeting the criteria to fit within options between litigation and negotiation. It was accepted that this could change as options developed and became more widely accepted.

There are two areas where the operation of section 8 may be particularly relevant:

A Choice of Law

The ILRA 1977 applies generally to all contracts of insurance. Section 15 of the Act prohibits contracting out, but the Act does not contain a specific prohibition against the parties choosing some law other than the law of New Zealand to govern their contract. The effect of this may be to avoid the operation of the Act.⁹² It is common for remedial legislation like the 1977 Act to counter specific loopholes of this type by specifying for conflict of laws. This particular Act did not do this.

As a general comment, it would appear that choice of law clauses could be adopted by insurers to avoid the restrictive effects of section 8.

It is possible to contract out of a provision by stipulating that the contract be subject to the law of another country.

The general principle guiding which systems of law govern a contract of insurance is the intention of the contracting parties. If the contract expressly states that it is to be governed by a particular system of law, then that law will generally be applied to the contract. There is, however, some authority to the effect that the parties may only select a system of law which has a substantial connection with the contract.⁹³ Where the contract is silent, the proper law of the contract is for judicial determination. This can involve ascertaining the unexpressed intention of the parties, or, alternatively, accepting the system with which the transaction has the greater connection.⁹⁴

Choice of law clauses are common where a contract is of an international nature, in particular where the parties are not all present in NZ. However, it is not uncommon for parties to attempt to avoid particular statutory provisions which regulate contracts by choosing some other system of law.⁹⁵

⁹² D St Kelly and M L Ball, *Principles of Insurance Law in Australia and New Zealand* (Butterworths, Australia 1991) 19.

⁹³ Above n92, 20.

⁹⁴ Above n92, 20.

⁹⁵ Above n92, 20; For instance section 8 ILRA 1977.

Generally, the courts of most countries will give effect to a provision in a contract selecting the system of law to govern that contract if the parties have so selected, it is bona fide and legal, and there is no public policy reason for avoiding the choice.⁹⁶ The clause will not be invalid merely because the proper law of the contract would have been different if the clause had not been included. Nor will it be invalid merely because there is no factual connection between the contract and the country whose law is selected.⁹⁷ For instance, many contracts are governed by English law even though none of the parties is based in England and the contract itself has no connection with England.

However, the courts of a forum will almost certainly not permit a choice of law clause to be used to circumvent provisions in domestic statutes which cannot otherwise be contracted out of, where there is no other commercial justification for the choice of law."⁹⁸

The potential to invoke choice of law clauses to avoid section 8 has been recognised above. The scope of the 1977 Act may allow for this to occur. However, the remedial legislation in Australian insurance law did not overlook this point.

Section 8 of the Insurance Contracts Act 1984 (Cth) ensures that it is not possible to avoid restrictive provisions like section 43 by stipulating for a

⁹⁶ NZLS Seminar "Conflict of Laws- The International Element in Commerce and Litigation" (November 1991) 63 ; see also *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277 (PC) at 290.

⁹⁷ Above n96, 63.

⁹⁸ Above n96, 63; The implication is that if a New Zealand insurer wanted to get around section 8 and give effect to an arbitration clause by specifying for another system of law, it might get caught by the 'no other commercial justification' qualification.

particular system of law.⁹⁹ Section 8(1)¹⁰⁰ extends the scope of the Act to contracts or proposed contracts of insurance, the proper law of which is the law of the State or Territory to which the Act applies. "Section 8(2) provides that where the law of a State or Territory would, but for a contrary 'express provision', be the proper law of the contract, then the proper law is the law of the State or Territory. The 'express provision' is rendered ineffective."¹⁰¹

This provision does not strictly affect the choice of law itself, which may be effective, in accordance with general contractual rules, in relation to issues not covered by the Act.

However, a recent Australian decision¹⁰² has undermined the effect of section 8 by holding that an English choice of law clause, an 'express provision' within the meaning of section 8(2), was to be disregarded but that the inclusion of an arbitration provision which specified for arbitration in England was sufficient to provide that the law of England was the proper law of the contract. The arbitration clause was held to indicate that the parties intended English law to apply, and was not an express provision which had to be disregarded under section 8(2).

⁹⁹ Above n85, Report 20, para 15; The commission clearly described the potential problem it was attempting to address: "If nothing were said concerning the territorial extension of legislation altering the law relating to insurance contracts, the effect of that legislation might possibly be avoided by the expedient of inserting a choice of law clause in the relevant contract. There are two ways in which such an attempt to evade the operation of the legislation might be avoided. The intended territorial application of the Act might be set out in terms. Alternatively, the insertion of a choice of law clause might be rendered ineffective. The latter is the method which was chosen..[in the] Trade Practices Act 1974. For the sake of consistency, that is also the method which has been adopted in the draft legislation.."

¹⁰⁰ Section 8(1) [Proper Law of Contract] Subject to section 9, the application of this Act extends to contracts of insurance and proposed contracts of insurance the proper law of which is or would be the law of a State or the law of a Territory in which this act applies or to which this Act extends.

8(2) [Where express provision does not apply] For the purposes of subsection (1), where the proper law of a contract or proposed contract would, but for an express provision to the contrary included or to be included in the contract or in some other contract, be the law of a State or of a Territory in which this Act applies or to which this Act extends, then, notwithstanding that provision, the proper law of the contract is the law of that State or Territory.

¹⁰¹ Above n92, 20-21.

¹⁰² *John Kaldor Fabric Maker Pty Ltd v Mitchell Cotts Freight (Aust) Pty Ltd* (1990) 6 ANZ Ins Cas 60-960.

Therefore, section 8 of the ILRA 1977 can be avoided by the use of choice of law clauses, ensuring that arbitration clauses in New Zealand insurance contracts could be effective. The 1977 Act has no equivalent to the Australian provision referred to above. It is submitted that this is a further indication that the section should be repealed. It is inconvenient and contrary to commercial expectations to anticipate that choice of law clauses will be adopted simply because of a legislative error. A provision which encourages this should be repealed.

B Reinsurance

The ILRA 1977 applies generally to all contracts of insurance. Therefore the Act must apply to New Zealand contracts of reinsurance. The author accepts that an international reinsurance contract may be governed by a choice of law clause and thus be subject to another system of law. However, it is in the interests of all New Zealand insurers to have reinsurance disputes resolved in New Zealand. Reinsurance is expanding in New Zealand, and it would be undesirable to allow an industry to develop within restrictive boundaries of dispute resolution.

Arbitration clauses in reinsurance contracts are very common.¹⁰³ An arbitration clause, which is usually part of a large commercial agreement, is the most common source of arbitration.¹⁰⁴ It would be reasonable for a New Zealand insurer to want to specify in an arbitration clause that any dispute arising out of the reinsurance contract would be resolved in New Zealand. However, such a qualification as to the choice of arbitral forum could realistically offer some fundamental problems to an offshore reinsurer. Any agreement for future arbitration would not be binding on a New Zealand insurer as section 8 makes such agreements unenforceable. The one-sided nature of such an arrangement essentially creates an environment where reinsurers would refuse to enter contracts where the arbitration clause specified a New Zealand forum.

¹⁰³ National Report from United Kingdom "Freedom of Contract and Choice of Law in Insurance" (AIDA IXth World Congress, Sydney, Australia, 14-18 August 1994) 339.

¹⁰⁴ O Chukwumerije *Choice of Law in International Commercial Arbitration* (Quorum Books, 88 Post Road West, CT 06881, USA, 1994) 29.

Therefore, a rule which was hailed as protecting consumers almost 20 years ago could potentially have the effect of making New Zealand insurers less competitive in the international reinsurance market. Not only could parties attempt to avoid arbitration in New Zealand, the Australian authority of *John Kaldor*¹⁰⁵ for avoiding choice of law clauses by including a foreign arbitration clause in the contract, may make it far easier for offshore entities to avoid arbitration in New Zealand, thus excluding New Zealand arbitrators from the international market.

V LEGISLATIVE REFORM

A Early Development

Can this restrictive statutory modification of arbitration clauses be justified in the current commercial climate? Recent research into this possible legislative error suggests that it cannot.

Initial commission research in this area¹⁰⁶ was prompted by substantial changes to arbitration in various commonwealth jurisdictions.¹⁰⁷ The commission emphasised the importance of ensuring that dispute resolution processes operate effectively in contemporary social conditions, "a matter close to the heart of the work being done on the structure of the courts."¹⁰⁸

A primary concern of the Commission was whether the question of arbitrability was for the courts¹⁰⁹ or required the attention of comprehensive arbitration legislation.¹¹⁰ Acknowledging that specific New Zealand statutes

¹⁰⁵ Above n102.

¹⁰⁶ New Zealand Law Commission Preliminary Paper No.7 "Arbitration".

¹⁰⁷ Particularly English legislation, on which the New Zealand legislation is modelled, and equivalent legislation in Australia and Canada and elsewhere, as well as the international model produced by the United Nations Commission on International Trade Law (UNCITRAL).

¹⁰⁸ Above n106, vii.

¹⁰⁹ In New Zealand the court's powers to exclude questions of fraud from arbitration are provided for in s16 1938 Amendment Act.

¹¹⁰ The example offered is the Quebec Arbitration Statute of 1968 which provides that "disputes over the status and capacity of persons, family matters or questions of public order cannot be submitted to arbitration."

expressly excluded arbitration, including statutes giving exclusive jurisdiction over aspects of their subject matter to a specialised court or tribunal,¹¹¹ and statutes governing the entire jurisdiction of a tribunal,¹¹² the commission referred specifically to section 8.¹¹³ The public interest justification for having disputes dealt with openly had essentially led to insurance companies being singled out for particular treatment, and had also led to the confusing arrangement that section 8 restrictions were limited to agreements to arbitrate disputes which may arise in the future, not present disputes. The consumer protection issue was recognised as relevant, but there was uncertainty whether specific consumer protection was required, or whether the issues arising could be dealt with under general contract law. There was, however, little confusion over the future of the section:¹¹⁴

"Overall the absolute prohibition does seem to be somewhat anomalous and it may be doubted whether the provision is justified in the context of a modern policy of encouraging arbitration."

A statutory provision for arbitrability was preferred by the commission, as a mechanism to reduce the restrictions on arbitration to a minimum.¹¹⁵ The reduction of other legislative obstacles to arbitration was also considered. Section 8 of the Insurance Law Reform Act 1977 was declared in need of repeal, but the restrictions on arbitration in the Disputes Tribunals Act 1988 and statutes establishing specialised courts and tribunals were considered less problematic as some of the advantages of arbitration are retained in those fora.¹¹⁶

¹¹¹ For instance, Labour Relations Act 1987; Family Proceedings Act 1980.

¹¹² For instance, Disputes Tribunals Act 1988.

¹¹³ Paragraph 58.

¹¹⁴ Above n113.

¹¹⁵ Paragraph 192.

¹¹⁶ Above n115.

This signifies the first formal recognition that an overly restrictive provision may have been mistakenly entrenched in statute, and is the initial step to alteration in the context of general arbitration reform.

The commission has also indicated some disfavour with the restrictiveness of section 8 in research independent of the arbitration study.¹¹⁷

The most authoritative statement on the future of section 8 has arisen in the report of the New Zealand Law Commission,¹¹⁸ which recommends a draft Arbitration Act to replace the present arbitration legislation.¹¹⁹ The framework of the new scheme is largely based on the Model Law on International Commercial Arbitration adopted in June 1985 by the United Nations Commission on International Trade Law (UNCITRAL) and endorsed in December 1985 by a resolution of the General Assembly of the United Nations. The proposed law involves some modifications to the Model Law and some additional provisions applicable to domestic arbitrations.

The proposed Act is very short, with the bulk of the new provisions detailed in schedules. Schedule 1 is essentially the Model law. Domestic arbitrations will generally be governed by schedule 1 as supplemented and modified by schedule 2, which can be opted out of. Parties to international arbitration agreements may opt into the additional provisions of schedule 2. Therefore, the provisions of schedule 2 will apply, unless otherwise agreed, to domestic arbitrations and only if agreed, to international arbitrations.

In its report, the commission acknowledged their previous examination and made a more definitive statement on the future of section 8:¹²⁰

¹¹⁷ New Zealand Law Commission Preliminary Paper no. 11, "Unfair" Contracts. Many of the recommendations of this report formed the foundation for the developments giving rise to the Consumer Guarantees Act 1993.

¹¹⁸ New Zealand Law Commission Report No.20, "Arbitration."

¹¹⁹ The draft Act from the report is now the Arbitration Bill, 117-1, and has been referred to the Justice and Law Reform Committee; Parliamentary Bulletin, 95.18, 25 September 1995. The major changes in the bill relate to the ordering of sections 1-5, an omission of table of contents for the schedule, and the Sea Carriage of Goods Act 1940 and Penal Institutions Act 1954 are not included in the Fourth Schedule as have been amended. Clause 9 remains unaffected. Information received in correspondence with Vanessa Inskip, Law Commission, 23-11-95.

¹²⁰ Above n118, para 238.

"As noted in our discussion paper we found this provision somewhat anomalous given its limited scope. Although our consultation suggested that this provision has not substantially affected practices in the insurance industry, there is some irritation within the industry at being singled out, and there was a general endorsement of the proposition that the consumer protection issue should be addressed more broadly and directly."

This provides the reader with an indication of the potential developments in the arbitration arena. The express emphasis of the Commission in insurance arbitration is on consumer protection. It is necessary to address the relevant recommendation to objectively assess whether the treatment of this issue is adequate, or even desirable.

*B Recommendation*¹²¹

9 Consumer arbitration agreements

(1) Where

- (a) a contract contains an arbitration agreement, and
 - (b) a person enters into that contract as a consumer,
- the arbitration agreement is enforceable against the consumer only if the consumer, by separate written agreement, certifies that, having read and understood the arbitration agreement, the consumer agrees to be bound by it.

(2) For the purposes of this section, a person enters into a contract as a consumer if

- (a) that person enters into the contract otherwise than in trade, and
- (b) the other party to the contract enters into the contract in trade ...

This provision emphasises that the voluntariness with which parties enter a contract can be quite different, depending on whether the parties are business entities or consumers. Significant considerations in this distinction are the

¹²¹ Above n118, 139.

notions of inequality of bargaining power, contracts of adhesion, and the concept of true consent. The Commission acknowledged legislative developments in Australia and the United Kingdom, where the governing provisions in this area highlight quite different concerns.

The Consumer Arbitration Agreements Act 1988 (UK)¹²² defines a consumer by interpreting the context of the contract and the nature of the goods transferred. A potential problem with this type of definition is that distinctions on the nature and use of particular goods may become blurred. This has already occurred, as the scope of the Act has been extended to business buyers of consumer goods.¹²³

The Australian Trade Practices Act 1952¹²⁴ focusses on the nature and the purpose of the goods purchased, but also adds a further dimension of a \$40,000 monetary limit.

Clause 9, by relying on the 'in trade' distinction, includes an element of both of these established models. The author supports the ignorance of a monetary limit, which could result in the creation of some artificial distinctions between purchases. "The formula recommended is designed to maintain a reasonable degree of commercial certainty, to ensure a reasonable degree of informed consent to arbitration, and to provide a broad approach (as compared to s8 of the Insurance Law Reform Act 1977) to protect genuine and informed consumers."¹²⁵

The reference to a contract that "contains an arbitration agreement" retains an emphasis similar to that existing under section 8. It recognises that an arbitration clause may have separate status, and limits the scope of the section to pre-dispute arbitration agreements.

An arbitration clause will only be enforced where the consumer signs a separate agreement certifying an acceptance and understanding of the

¹²² Section 3.

¹²³ *R & B Customs Brokers Co Ltd v United Dominion Trust Ltd* [1988] 1 WLR 321, CA.

¹²⁴ Section 4B.

¹²⁵ Above n118, para 245.

arbitration agreement. Unlike the UK provision, the clause does not state that the certification by the consumer is to occur after the dispute has arisen. The implication is that the consumer can agree to be bound by the arbitration agreement at the time on entry into the contract, but the clause does not preclude certification after a dispute has arisen.¹²⁶

1 Potential implications

Section 8 will be replaced by clause 9 of the bill, if enacted. The potential advantage of this clause is that it will offer an insurer and an insured an opportunity to clearly enunciate their position in relation to dispute resolution. Arguably, much of the uncertainty arising from section 8 will disappear.

The discussion of arbitration agreements above has emphasised that *Scott v Avery* clauses operated in favour of a pro-arbitration party by ensuring that parties would be judicially encouraged into arbitration. Although section 8 attempted to address the operation of these clauses, that provision extended the ban to all arbitration clauses. Clause 9 makes no distinction between forms of arbitration agreements. The clear emphasis in the modern clause is that parties will not be forced into arbitration in any circumstances. Therefore, this provides certainty that parties will not be judicially encouraged to proceed to arbitration because a contract to which they are a party contains a clause specifying that arbitration is a condition precedent to liability.

This development signifies a responsible approach to consumer protection which was not evident in earlier legislation. The consumer focus of the 1975 committee resulted in a perceived power imbalance favouring insurers to such an extent that it was recommended that non-traditional dispute resolution be avoided. It is clear that this wisdom is now being revised, with an emphasis on arbitration as a preferred method of resolving disputes. Therefore, it is interesting that in less than two decades arguments for a

¹²⁶ Above n118, para 240 summarises the approach in the Consumer Arbitration Agreements Act 1988 (UK) which provides that, where a person enters into a contract as a 'consumer' an arbitration cannot be enforced against that consumer except (a) where the consumer has given written consent after the dispute has arisen, or (b) where the consumer has submitted to arbitration under the clause (whether in respect of the present or another dispute), or (c) where the court makes an order that it is not detrimental to the interests of the consumer for the dispute to be referred to arbitration having regard to, in particular, the availability of legal aid and the expense which may be involved in arbitration.

particular form of protection have resulted in quite diverse recommendations. A previous ban on arbitration is now being replaced by an encouragement of the practice with specific protective mechanisms.

This is consistent with a modern desire for speedy and cost-effective dispute resolution. The 'first wave' of alternative dispute resolution which was emphatically accepted in the 1970s has been replaced by an inquisitive and critical approach to the package of resolution processes available. This has resulted in greater awareness of the pitfalls of arbitration, mediation and associated methods of resolution, and a revised perspective of the benefits of these schemes. The reform of arbitration law is ideally suited to such informed times. It will provide tangible encouragement to the development of all forms of ADR, and a defined mechanism for promoting the use of arbitration.

The repeal of section 8 and the replacement by clause 9 will offer consumers protection in the arbitration market. Commercial parties, including commercial insured's, have not been offered equivalent protection. This may be a recognition that although some specific protection must be offered to certain parties, the wide restrictions of section 8 are inappropriate. The implication is that parties operating in a commercial environment do not require explicit protection, and are assumed to be capable of looking after themselves.

The author suggests that it is overly simplistic to suggest that parties with commercial experience should be restricted to traditional forms of dispute resolution without choice, which was the result after 1977. The recent bill identifies consumers as 'special' parties. Business entities are therefore provided with a mandate to regulate their own arbitration agreements, and decide individually whether they are bound by them, independent of protective provisions like clause 9.

It is submitted that the focus of consumer arbitration provisions is on ensuring the parties do not have to go to arbitration, while the lack of detail regarding commercial parties is intentional to ensure the parties have the option to do so.

2 Criticism

A specific purpose of legislative reform is to consider the repeal of dated or onerous provisions which cannot be sustained in the contemporary environment. However, reform will always incite criticism from parties who accept the established rule of law. This has occurred in the context of arbitration reform.¹²⁷ The author presents this as a useful point of entry into an examination of the consumer arbitration provision.

This criticism identifies arbitration clauses as oppressive, creating a barrier between the citizen and justice.¹²⁸ The common objections identified relate to costs (legal aid is not available), and privacy. Proponents of this view favour the retention of provisions like section 8 which recognise explicitly the "injustices resulting from arbitration clauses,"¹²⁹ and reject the current movement of encouraging arbitration.

The criticism of the proposal on consumer arbitration agreements is summarised in three points:¹³⁰

1 "It is based on the rather naive premise that if a consumer signs a document saying he has read and understood something he has in fact done so... It is surprising to see the Commission recommended the revival of this outmoded and ineffectual consumer protection technique. The proposal should be replaced by something less feeble, preferably a simple provision along the lines of the various statutes... making arbitration clauses void or unenforceable.

2 "A more meticulous draftsman would have realised the need to except from the operation of the new provision those arbitration clauses which provide machinery to determine issues (such as contested rent reviews) not otherwise justiciable.

¹²⁷ D Dugdale "Arbitration as oppression" (1992) NZLJ 135.

¹²⁸ Above n127, 135.

¹²⁹ Above n127, 135.

¹³⁰ Above n127, 136. The author has emphasised the word 'not' in point 3. From a reading of the criticism of Dugdale, it must be suggested that the word 'not' has been mistakenly included in the text of (1992) NZLJ 136.

3 "The proposal is unsatisfactory because it removes from an insured any protection along the lines of section 8 in cases where the insurance contract is not entered into by the insured "in trade". The reasons for the present protections in the insurance law of Australia and New Zealand apply as much to the position of an insured in relation to his business as to that of an insured who is a private consumer... The statement that section 8 did not substantially affect practices in the insurance industry is true only of some insurers who before the enactment of section 8 were prepared to waive arbitration other than in relation to quantum and is certainly not true of all insurers. The fact that a statutory protection irritates insurers is not, one would have thought, a particularly cogent argument in favour of removing it."

The author interprets the above criticism as stating three simple points. First, consumers are not well-informed parties and are vulnerable to exploitation. Second, a distinction can be made between arbitration arising in various industries. Finally, commercial and consumer insureds deserve similar protection. These three points will be addressed separately, but for consistency of argument the third criticism will be raised prior to the second.

VI ANALYSIS OF CRITICISM

A Consumers Well Informed?

Arguably, an ability to listen to the consumer is the most important issue today facing industry, generally, and the insurance industry, in particular."¹³¹ The desire to respond to the challenge of consumer demands arises in the context of self-regulation. A warning is issued, by referring to the Australian banking and life insurance industries, to accept this challenge. It is suggested that "...during the eighties these industries in many cases failed to listen to what their customers (and their representative bodies) were saying. As a consequence they have had many solutions thrust upon them through legislation."¹³²

¹³¹ Peter Corrigan "Consumer Responsiveness and the Strategies of the General Insurance Industry" (1994) 19 *The Insurance Record of Australia and New Zealand*, 22.

¹³² Above n131, 23.

There must be a desire in the general insurance industry to resolve consumer problems long before the need arises for external interference. In New Zealand, some 'interference' has already been formalised. This may provide some insight into how consumers are perceived in specific areas of insurance.

1 Insurance regulation

Laws regulating and supervising those engaged in the business of insurance are generally enacted in the interests of certainty, to ensure that funds created by contributions are held, managed and disbursed in a prudent and proper manner. Protection against insolvency is usually the main objective of insurance regulation.¹³³

However, solvency may not be the sole objective of regulation. Other reasons may be equity, for example ensuring reasonableness of premiums and equitable treatment of policyholders; fairness to policyholders; and social goals. Social goals may be political, for example about democracy, liberty and protectionism; economic, for example about socialisation of risk, freedom of enterprise, and capital accumulation; or moral, for example about reduction of gambling, risk control, loss prevention, and avoidance of corruption.¹³⁴

Major legislative alterations in the area of company regulation and financial reporting standards have impacted on the insurance industry, either directly or indirectly. In addition, 1994 saw the passage of two new insurance-specific statutes.¹³⁵ This area has traditionally been subject to the regime operated by the Insurance Companies Deposits Act 1953, which aims to provide security for policyholders who may have claims against an insurer, and to protect the insured from insurer insolvency.¹³⁶

¹³³ J R McDermott "A Legal Audit of the Insurance Companies Deposits Act 1953", LLM Research Paper, VUW 1994, 21.

¹³⁴ Above n133, 21; refers to Professor S L Kimball "The Purpose of Insurance Regulation" (1960-61) 45 *Minnesota Law Review*, 471.

¹³⁵ Insurance Intermediaries Act 1994, Insurance companies (Ratings and Inspections) Act 1994.

¹³⁶ Above n133, 1.

A government review of the regulatory regime in New Zealand, including the ICDA 1953,¹³⁷ recommended that the requirement of deposits with the Public Trustee be discontinued in favour of a rating system. A rating system would provide information to the public on the ability of an insurer to meet its liabilities.¹³⁸ The Insurance Companies (Ratings & Inspections) Act 1994 is a direct attempt to give effect to the Brash report's recommendations.

a Brash McLean report

An examination of the specific references and allusions to consumer concerns in the review indicates the general attitude towards insurance consumers and regulation.

The stated objective of a prudential regime is policyholder protection. The nature of a prudential regime depends on the business activity in which institutions are engaged. Strict regimes have classically bound the operation of banks in New Zealand. In comparing banks and insurance companies the latter were found to be notably different as "they are not primarily dependent on very short-term deposits for their funding, and so are vulnerable to rumour in a less sudden and catastrophic way; they are not central to the payments system; and the failure of one insurance company does not usually impact directly on others."¹³⁹ Therefore, the unique nature of the insurance industry provided justification for a specialised prudential regime.

Risk is the fundamental concept on which insurance exists. Although the assets of all financiers contain some element of risk, the liability faced by insurers is far more unforeseeable. Standard company reporting requirements do not cover significant contingent assets and liabilities, and therefore do not provide an adequate assessment of the claims-paying ability of an insurance company.

The type of insurance information made publicly available is often incomprehensible to all but the skilled professional. "For a consumer who purchases relatively small quantities of insurance, the cost of obtaining an

¹³⁷ D Brash, I Mclean "A Prudential regime for Insurance Companies" (Wellington, New Zealand, 1993).

¹³⁸ Above n133, 1.

¹³⁹ Above n137, 4.

accurate assessment of an insurance company's ability to meet possible claims is prohibitive."¹⁴⁰

Fire and earthquake insurance usually operates on a 12 month cycle, with payment generally securing a service in advance of necessity. For this reason "it is too late to return a faulty insurance product to an insurer after the disaster has struck."¹⁴¹

The report acknowledges the attraction of fraudulent parties to the insurance industry. "Entry costs are low, and by the use of a glamorous name and glossy promotional material, silver tongued salesfolk can persuade otherwise sensible citizens to part with premiums."¹⁴²

The suggestion offered is that if the Companies Act provisions are not adequate, and it is for all practical purposes impossible for the ordinary policyholder to protect his or her own interest, then arguments for a specific prudential regime may be justified.¹⁴³

The report sounds a caution against an acceptance of overseas experience, where prudential regimes provide a formal guarantee of the payment of claims. "The danger is that the existence of a prudential regime will lead the public to believe that the government is guaranteeing their claims."¹⁴⁴ The implication is that policyholders will have little incentive to analyse and invest with sound companies, and avoid marginal firms with low premiums, if it is perceived that an ultimate guarantee exists.

A rating is considered necessary as the "public should be able to rely on the fact that a licence is current as indicating that the company has met all criteria, and any risk of failure is minimal"¹⁴⁵

¹⁴⁰ Above n137, 4.

¹⁴¹ Above n137, 4.

¹⁴² Above n137, 5.

¹⁴³ Above n137, 5.

¹⁴⁴ Above n137, 6.

¹⁴⁵ Above n137 8.

When dealing with overseas examples and evidence, the report questions why the various supervisory agencies overseas do not provide better information to consumers, to facilitate the making of informed decisions when purchasing insurance.¹⁴⁶

Undigested reports provided to the supervisory authorities in the UK and Australia are available to the public, but the consumer does not have the expert analytical skills to adduce information from them. "Therefore, the absence of such public judgement by the supervisory authorities arises because it is inappropriate for governments to rate products in any market according to quality. In other words, the lack of consumer information is not accidental but inherent in the system."¹⁴⁷

The report assesses the relative advantages and disadvantages of public and private sector rating. The latter is accepted as significantly reducing the moral commitment on the government to compensate the policyholders of failed insurers.¹⁴⁸ The reasoning is that well-informed customers cannot expect to be compensated for bad decisions.¹⁴⁹

Private sector agencies may facilitate the decision-making process by providing an opportunity to avoid those companies whose claims paying ability is weak or suspect. The report emphasises the need to make the "ratings comprehensible to the lay person."¹⁵⁰ A simple rating would "be quite intelligible to the commercial property owner and indeed to the residential property owner. If a property owner wanted to insure with a company of lower claims paying ability, perhaps because of a lower premium, he or she could do so, but would be aware of the greater risk of default in the event of a major catastrophe."¹⁵¹

¹⁴⁶ Above n137, 9.

¹⁴⁷ Above n137, 9.

¹⁴⁸ Above n137, 9.

¹⁴⁹ Above n137, 10.

¹⁵⁰ Above n137, 11; The report refers to Standard & Poors example of rating on a 5 grade system, from 'very secure, secure, satisfactory, may be adequate, and vulnerable'.

¹⁵¹ Above n137, 22.

The report noted that overseas regimes are reliant almost entirely on government action rather than the response of well informed customers. The nature of a New Zealand rating system would ensure government awareness of an unsatisfactorily rated company, but would "leave it to current and prospective policyholders to seek better cover.."¹⁵²

The recommendations focus on the removal of any perceived government obligation to guarantee the safety of investments made by private citizens, and rather insist that investors are well informed.¹⁵³ In conclusion it is stated that the recommendations are designed to greatly enhance the ability of consumers to choose wisely when purchasing earthquake or fire insurance, and at the same time reduce the implicit guarantee of the Government.

b Insurance Companies (Ratings and Inspections) Act 1994

Part I of the Act requires that insurance companies must have a current rating from an approved rating agency of their ability to pay claims. Part II provides for a system of inspection that gives power to the registrar of companies to inspect documents for the purpose of determining whether an insurance company is unable to pay its debts.¹⁵⁴ The application of the Act extends to all insurers carrying on insurance business in New Zealand, but some exceptions apply.¹⁵⁵

A rating is a formal indication of an insurer's ability to pay present and future claims. A rating is to be expressed as a symbol, with explanatory comments.¹⁵⁶ Every insurer to which the Act applies is required to have a current rating from an approved agency by December 1995. Failure to comply with the section is an offence under the Act carrying the possibility of a fine

¹⁵² Above n137, 18.

¹⁵³ Above n137, 21.

¹⁵⁴ Above n133, 1; This is identified in the long title "An Act to provide for-a)The rating of the claims paying ability of insurers in relation to the business of insurance except life insurance;and b)Inspections of insurance companies of doubtful sloveny. "

¹⁵⁵ For instance, insurers who carry on business only with members of a group of companies of which the insurer is a member; the business of life insurance carried on by the insurer (s 4); an insurer who is not involved in disaster or general insurance may elect not to be rated under this act (s 9(1)).

¹⁵⁶ Section 2.

not exceeding \$100,000.¹⁵⁷ The insurer must, within 5 days of issue by an approved agency, deliver to the Registrar a certificate of rating from the agency, as well as a copy and explanation of the rating scale used.¹⁵⁸ An inspection of this information is open to the public for a prescribed fee.¹⁵⁹

Before entering into or renewing a contract of insurance an insurer (or intermediary) must disclose to the insured in writing the current approved rating,¹⁶⁰ the scale of rating, and any 'credit watch warning'.¹⁶¹ Disclosure must occur where the rating given to an insurer is lower in value than the immediately preceding rating given to the insurer, and in this case public notice pursuant to the requirements of section 3 is also mandatory.¹⁶²

Insurers not required to be rated must also, before entering into or renewing a contract of insurance, disclose to the insured their non-rated status.¹⁶³

If the disclosure requirements of section 10 have not been complied with the insured may cancel the contract within 20 days of the contract being entered into.¹⁶⁴ Provision is made for the default of premiums if cancellation is made.

The primary emphasis of the Act and the initial report has been outlined above. The motives surrounding this form of regulation are positive, but it is possible that the mechanism imposed is unrealistic. Although insureds are encouraged to become informed participants in insurance transactions, an immediate transformation is unlikely. What does this regime suggest about insurance consumers?

The report constantly refers to the 'consumer', 'sensible citizen' and 'policyholder', and refers to a desire to protect and inform such parties, and

¹⁵⁷ Section 5.

¹⁵⁸ Section 6.

¹⁵⁹ Section 7.

¹⁶⁰ Section 10.

¹⁶¹ This is a new concept, and refers to any indicator used by a rating agency considering a downgrading of an insurer.

¹⁶² Section 8.

¹⁶³ Section 12.

¹⁶⁴ Section 11.

allow for objective decision-making when confronted by unscrupulous entities and confusing information. The necessary implication from the report is that a ratings scheme will provide a mechanism by which consumers will be able to guard against fraudulent parties, and will be able to assess and compare the respective features of highly and lowly rated, and unrated companies.

The report clearly anticipates that the position of consumers will be significantly altered by a ratings regime. The suggestion made is that well-informed customers will not make bad decisions. The purpose of such a scheme is to encourage consumers to base decisions on the claim-paying ability of an organisation. Is this a sustainable proposition?

Will the majority of consumers understand the conceptual reality of a rating, and further, act on such information? Although the insured is bound to receive rating information, it will be interesting to monitor whether parties take significant notice of, and allow decisions to be affected by, this material.

The report suggests that as informed participants in the insurance relationship consumers will, through the availability of rating information, be in a position to affect the market perception of an insurer. This is particularly clear when reference is made to insureds leaving an insurer, risking loss of premiums, and causing a flight of custom by other insureds.¹⁶⁵ Again, careful monitoring is required to ascertain whether this eventuates.

Clearly, a major assumption is made of the understanding of consumer insureds, and the abundance of informed consumers, in the insurance market. The fact that an inspection of section 6 ratings is made possible by section 7 of the Act may provide little comfort to consumer advocates attempting to create an accessible insurance industry. Similar criticism can be aimed at the duty to disclose current rating, scale of rating and credit watch warning details under section 10. The problems associated with a duty to disclose are among the most obvious and controversial in insurance relationships, and to enforce the disclosure of further technical information places an identifiable conceptual burden on consumers. It is not unreasonable to expect that consumers will simply accept this with the mass of other general information they receive in

¹⁶⁵ Above n137, 18.

an unqualified manner. If an insurer is downgraded by an approved agency, this information is to be publicly notified in newspapers and the Gazette (section 3). Further, the consumer insured is expected to make an informed decision between rated and non-rated insurers, as both types of status require disclosure at the time of contract formation. If a rated insurer is accepted without disclosure, the consumer is then offered the opportunity to cancel the contract. The author's concern is whether the majority of consumers would even entertain the notion of termination on such grounds.

Despite these apprehensions, the Ratings legislation and preceding research operates on an 'informed consumer' basis, anticipating a party with the capacity and acumen to locate and assess technical information relating to the claim-paying ability of an insurer, and terminate an insurance relationship for non-disclosure. This is a healthy picture which the law of insurance must be seen to encourage. The grounds on which the Act is founded are positive. It may be too early to predict whether consumers will follow the lead of the legislation.

The author accepts that the modern insurance climate, highlighted by the ratings scheme, clearly expresses the desire of parliament for consumers to be independent, informed, and aware of their individual relationship with an insurer. This may be considerably distinct from the common perception of consumers as powerless and exploitable. It is unrealistic to expect an instant transformation of consumer attitudes. However, the law should be cast to encourage this transformation to occur as quickly as possible. Clause 9 of the arbitration bill, which offers the consumer an opportunity to reject an arbitration agreement, is a useful example of this required encouragement.

B Commercial and Consumer Insureds

The author submits that the fundamental assumptions evident in the Ratings scheme are created by the treatment of consumer and commercial insureds as like entities. The Act makes no express distinction between commercial and consumer insureds, and in fact seems to expect that all insureds exist on an equal level. In practice it cannot be expected that such parties will operate identically in the market. The necessary conclusion is that they are worthy of special protection due to their status in the insurance market.

It is submitted that consumer and commercial insureds operate in the insurance market at different levels and with different emphasis. Protections adequate for one party may be inappropriate for another. This has been recognised in some recent developments in New Zealand, particularly the establishment of the office of the Insurance and Savings Ombudsman. A further development has been the potential encroachment of the Consumer Guarantees Act on the law of insurance.

1 The New Zealand Insurance and Savings Ombudsman

The development of this scheme is directly attributable to the failure of the insurance market to provide any realistically effective dispute resolution procedures for consumers.¹⁶⁶ The recognised limits of the Disputes Tribunal,¹⁶⁷ both in terms of disputed sums¹⁶⁸ and the ability to offer expert resolutions for consumers with any form of consistency, has been a significant factor in searching for insurance-specific resolution systems with a wider jurisdiction than the in-house complaints procedures offered by insurance companies.

Influenced by the Insurance Ombudsman Bureau (UK) and the Australian Insurance Industry Complaints Council, the New Zealand scheme offers a free and independent dispute resolution service for non-commercial insureds. The scheme is supervised by representatives from the Ministry of Consumer Affairs and an insurance industry board.

The operation of the Ombudsman is governed by the Terms of Reference. These provide definitional guidance, details of complaints procedure, and the powers and limits of the Ombudsman.

Any complaint must relate to personal or domestic insurance in New Zealand. The Ombudsman has no authority to act where the participating

¹⁶⁶ Consumers Institute "Insurance Against the Insurers" (1992) 309 Consumer 3.

¹⁶⁷ Ministry of Consumer Affairs "Review of the Disputes Tribunals From a Consumer Perspective" (Wellington 1994).

¹⁶⁸ Maximum of \$5000.

insurer complained against is not registered as a member of the scheme. Some time constraints are imposed on the complaints process.¹⁶⁹

Further fundamental limitations are imposed to restrict abuse of the scheme. The amount claimed cannot exceed \$100,000.¹⁷⁰ A complaint cannot relate to an insurer's assessment of risk, the setting of premiums, investment strategies, policy renewal and cancellation, and conditional approaches to cover.¹⁷¹

The Ombudsman retains considerable discretion of procedure adopted for assessing complaints, although some general guidelines are offered.¹⁷² It is necessary for a complainant to endorse the requirements for privilege, confidentiality and return of documents.¹⁷³

A unique opportunity exists for an insurer to avoid the jurisdiction of the Ombudsman and pursue the complaint in a court. This can occur where the contentious issue has important consequences for the insurer's business, or involves a significant point of law.¹⁷⁴

As at 30 June 1995 the ISO office database recorded 515 consumer contacts, falling into the respective areas of health (8%), savings (2%), life (32%) and Fire and General (58%) insurance.¹⁷⁵ The adoption of the ISO in New Zealand has created the potential for a very significant gap to be filled in the insurance industry. As expected, some preliminary hurdles will need to be addressed. Of particular concern are the restrictions in the Terms of Reference¹⁷⁶ which place in doubt the fundamental fairness of the scheme. These relate specifically to the questionable independence of the ISO from industry organisations, the inability of complainants to decide when the ISO should be

¹⁶⁹ The insurer must initially have attempted to resolve the complaint internally, (para 3.1d). The complainant then has two months to approach the Ombudsman, (para 3.1e).

¹⁷⁰ Para 3.1a; However, some flexibility exists to increase this sum.

¹⁷¹ Para 3.2; 3.3.

¹⁷² Para 4.1.

¹⁷³ Para 8.1; 8.2.

¹⁷⁴ Para 6.1.

¹⁷⁵ Unreported statistics received prior to release in cooperation with the ISO.

¹⁷⁶ S Rogers "Industry Lapdog or Consumer Champion? A Review of the Insurance and Savings Ombudsman Scheme" LLB(Hons) Research Paper VUW 1995.

approached, the coverage of additional complainant costs, the lack of national accessibility, and the ultimate requirement of public accountability.

2 Consumer Guarantees Act 1993

The formal acceptance of the Consumer Guarantees Act 1993 into New Zealand Law on 1 April 1994 identified a significant coup for advocates of consumer protection schemes, and was proclaimed as 'great news for consumers' by the Consumers Institute.¹⁷⁷ However, the impact of the legislation is yet to be felt, as various areas of goods and services provision become encapsulated within the scope of the Act's guarantees.

Insurance is such an area. The extension of the Act to include services broadens parameters for protection considerably. However, a warning is sounded against expectations that the CGA will command a primary role in insurance contracts. The nature of the protection is untested, and it is possible that the Act may have an insubstantial effect on insurance law.¹⁷⁸ Regardless of this danger, it is arguable that complementary actions in contract, tort, statute and an underlying duty of utmost good faith could provide the necessary 'teeth' for the CGA to impact on insurance. At the very least, the guarantees offer a mechanism for balancing the bargaining power between insurer and insured.¹⁷⁹

The definition of 'service' includes a "contract of insurance, including life assurance and life reinsurance."¹⁸⁰ A 'consumer' is defined as someone who "acquires from a supplier goods or services ordinarily acquired for personal, domestic, or household use or consumption."¹⁸¹

¹⁷⁷ J C Skinnon and L Sligo *Companion to the Consumer Guarantees Act 1993* (Butterworths, Wellington, New Zealand, 1994) v.

¹⁷⁸ J D. McManus "The Consumer Guarantees Act 1993: Issues in Insurance Law" LLH(Hons) Research Paper VUW 1995, 2.

¹⁷⁹ Above n178, 3.

¹⁸⁰ Section 2(1).

¹⁸¹ Section 2(1).

The Act provides that the service will be carried out with care and skill.¹⁸² A further guarantee is that the service is reasonably fit for any purpose, and of such nature and quality that it can reasonably be expected to achieve any particular result that the consumer has made known to the supplier before or at the time of making the contract for the supply of the service.¹⁸³

There is a guarantee that the service will be completed within a reasonable time¹⁸⁴ and that a reasonable price will be charged for the service, unless the price is fixed by the contract.¹⁸⁵

Essentially, the CGA simply creates powers for consumers to pursue statutory rights in the courts. There are no provisions for penalty or sanction. However, the Act does provide boundaries in which industry bodies can operate, and in conjunction with established common law and statutory actions, may emphasise the status of the consumer insured in the marketplace.

These two developments indicate that some distinctions do, and need to continue to, exist between consumer and commercial parties in a market like insurance. However, when making this distinction it is necessary to find for consumers an acceptable balance between protectionism and freedom of contract.

The author submits that the above concern,¹⁸⁶ that a repeal of section 8 will create a distinction between consumer and commercial insureds, is difficult to justify in the context of the modern insurance environment. It is inherent in the insurance industry that such a distinction will exist.

C Insurance Consumers v General Consumers

An issue derived from Dugdale's second criticism is that, in the context of arbitration, there may be some justification for approaching particular

¹⁸² Section 28.

¹⁸³ Section 29.

¹⁸⁴ Section 30.

¹⁸⁵ Section 31.

¹⁸⁶ Expressed by Dugdale above n127, 136.

industries differently.¹⁸⁷ It has been established that it is common for consumer insureds to be offered specific protection due to their non-commercial status. The author proposes to analyse whether consumers in the insurance industry exhibit certain characteristics which may require specific treatment independent of general consumer regulation. This may confirm whether a general arbitration clause for consumers is adequate, or if a more industry-specific provision is required.

The Consumer Guarantees Act 1993 is a useful starting point. (The Act is discussed below) The Act does not make a distinction between consumers in different industries. The implication is that significant difficulties could arise if general protection provisions were varied to accommodate different market contexts. The fact that a recent and widely acclaimed piece of legislation fails to make this distinction may suggest that consumers in arbitration legislation should be treated similarly.

However, it has been suggested that the nature of insurance services makes it difficult for general legislation like the CGA to combat the common problems faced by consumer insureds.

The difficulty with applying the new law to insurance services is related to the intangible and uncertain nature of insurance. Whereas tangible consumer services¹⁸⁸ attempt to achieve a specified result, a breach of an insurance service often involves long-tail liabilities, substantial loss, and formal proceedings for resolution.¹⁸⁹ Prima facie, the appropriateness of the CGA is questionable. "Banks, lawyers and insurance companies tend to require specialised legislation rather than general legislation such as the CGA. Nevertheless the Act is drafted to capture all such services. While it seems clear that consumers need legislative protection in their dealings with the supplier of services that have no physical end product, the post-sale consumer statute seems the wrong place for it. Specialised statutory treatment for insurance services may be the desirable alternative."¹⁹⁰

¹⁸⁷ Dugdale makes the point that contested rent reviews are an example of matters which should automatically be arbitrated, and thus should not be subject to a provision like clause 9.

¹⁸⁸ For instance, automobile repairs, plumbing etc.

¹⁸⁹ Above n178, 4.

¹⁹⁰ Above n178, 5.

Therefore, although the Act expressly acknowledges the incorporation of insurance services, it can be argued that guarantees in relation to those services may not develop in any significant manner. The Act's failure to distinguish between consumers may not be completely authoritative.

The author acknowledges this concern, but suggests that, as above, the legislature has expressly indicated the manner in which consumers should be considered. This Act suggests that the concerns of all consumers in relation to the purchase of goods and services, including insurance, can be addressed by a comprehensive and encompassing scheme. This legislative message, for the sake of consistency, should not be ignored by future reform. The arbitration reform package appears to have considered this trend.

Despite the influence of contemporaneous legislation, it would still be possible to justify an insurance-specific arbitration provision if it could be established that insurance consumers differ substantially from general consumers.

Although it has been suggested that the insurance industry has a unique and independent existence,¹⁹¹ it is necessary to examine the issues facing consumer insureds before it can be asserted that they require particular attention.

1 Standard form

Standard forms for selling insurance is a world-wide phenomenon, due to the economics of selling cover on the basis of standardised risks. The development of standard forms restricts the freedom to contract. Insurers are unwilling to depart from the standard form, particularly in fields of mass-produced insurance. Buyers of those insurance products have to 'take it or leave it.'

2 Necessity

Insurance is a necessary aspect of modern existence. Associated with general concepts of property law and ownership is the notion of security of that ownership. Parties in possession or ownership of goods have always

¹⁹¹ Above n137, 4.

attempted to secure some assurance to compensation in the event of a specified contingency. The social benefit of this assurance cannot be exaggerated. The operation of a stable and progressive modern society depends on these types of guarantees of repayment or replacement.

The risk of misfortune is able to be spread by the entry of parties into insurance relationships. Members of society each pay a certain amount to provide money for the losses of an unfortunate few. It is unreasonable to expect the right to insurance to be waived, and to do so emphasises exceptional risk-taking which arguably should not be encouraged.

3 Non-tangible

The nature of insurance which offers a useful distinction is the inability to recognise any element of the promise as tangible. When insurance is purchased, a customer has nothing to expressly refer to except a policy document. What is purchased is protection for a contingency, and peace of mind that such protection will materialise.

4 Complex

The nature of insurance involves complex concepts and terminology which can result in confusion for the purchaser. The courts offer succinct guidelines to the existence of a legal insurance relationship,¹⁹² but the implications of such judicial pronouncements are negligible to the ordinary insured. It is possible that all but the most aware of customers will be oblivious to the precise contractual arrangement they are endorsing when entering into an insurance relationship.¹⁹³ Arguably, consumer disputes would not arise if consumers received what they understood they were paying for.¹⁹⁴ The proliferation of standard form insurance contracts provides an environment where customers accept terms which they have had little input in creating. This may be exacerbated by intentionally or accidentally withheld information. Non-disclosure in insurance contracts is recognised as a primary

¹⁹²*Medical Defence Union v Department of Trade* [1979] 2 All ER 421; *The Motor Cycle Specialists Ltd v The Attorney General* (1988) 5 ANZ Ins Cas 60-822.

¹⁹³ Manatu Kaihokohoko "Study of Insurance Practices" Ministry of Consumer Affairs (Wellington 1993).

¹⁹⁴ T Weir "Insurance Tomorrow" The Insurance Institute of New Zealand 1995 National Conference, 16.

cause of disputed claims. "Withheld, wrong, incomplete or otherwise misleading information is often the source of dispute. .. Problems involving real or alleged misrepresentation or non-disclosure to a significant degree may be caused by a failure of communication between the parties."¹⁹⁵ The complexity of the insurance relationship is not aided by the traditional notion of insurers,¹⁹⁶ which suggests that much of the information offered to prospective policyholders is clouded in jargon and generic language.

The nature of an insurer's business is to make money. The fundamental tension between insurer's and their clients arises from the 'money-for-promise' arrangement. "All that an insurance company has to sell is its promise to pay. Yet, all other things being equal, the better an insurance company is at avoiding that promise, the more money it makes."¹⁹⁷

Insurance companies tell two different sets of stories about insurance at two distinct points in the insurance relationship. When marketing their services, companies tell expansive 'sales stories', which emphasise protection and appeal to a fear of limitless hidden dangers, suggesting that insurance will provide unlimited security.¹⁹⁸ When handling claims, insurance companies tell 'claims stories' to a policyholder returning for an appraisal of the promise told in the first story. Claims stories "emphasise the limits of the contract and often ask the individual to sacrifice her needs for the benefit of the larger community of policyholders whose interests the insurer holds in public trust."¹⁹⁹

Of significance to this analysis is the fact that within this dichotomy of tales, the insured is not a dominant party. The balance of power may only allow the insured to function as a submissive party, either accepting stories as true, or rejecting them with few grounds for recourse.

¹⁹⁵ C Brown "Unfinished Business: Misrepresentation and Non--Disclosure in Insurance Proposals" 1994 15 NZULR 195.

¹⁹⁶ As alluded to above by Brash, above n137.

¹⁹⁷ T Baker "Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages" (1994) Texas Law Review, 1395, 1401.

¹⁹⁸ D A Stone "Promises and the Public Trust: Rethinking Insurance Law Through Stories" (1994) Texas Law Review, 1435, 1436.

¹⁹⁹ Above n198, 1436.

There is no doubt that insurance consumers are involved in a unique and complex relationship. However, it is difficult to assert that insurance arrangements are sufficiently distinct from those arising in other commercial areas that special treatment is justified. For instance, is an insurance contract sufficiently different from, for instance, a banking contract. The banking consumer encounters standard forms, disguised fees and charges, and often will have only limited understanding of the complexities of an investment.

The author submits that although insurance consumers can refer to some aspects of their relationship with an insurer as particularly unique, there are no sufficient reasons to suggest that such a distinction is so obvious as to justify creating specific treatment for insurance consumers in arbitration legislation.²⁰⁰ To do so could simply continue the practice of 'singling out', which the insurance industry and the Law Commission have regularly referred to as anomalous.

VI CONCLUSION

The author has attempted to show that the legislative reform initiated by the 1975 committee and endorsed in the ILRA 1977 is fundamentally problematic.

The 1977 insurance law reform package has been considered in two ways. The committee was concerned with the common mode in which insureds were forced into arbitration, and attempted to ameliorate this by making arbitration clauses ineffective. Although it has been suggested that their concern was *Scott v Avery* clauses, the committee recommended the rejection of all arbitration clauses. The second enquiry examined why the committee was concerned with insureds being involved in arbitration. The justifications of the committee for rejecting arbitration in insurance disputes have been analysed.

After analysing the 1975 reasoning in this dual manner it is clear that the committee was significantly confused and misinformed.

As a result of the misunderstandings in 1975 section 8 of the Insurance Law Reform Act 1977 was passed. It has been described how the effect of this

²⁰⁰ The author suggests that the existence of separate ombudsman schemes does not indicate that the two areas are distinctly polar, but simply developed out of the regulatory requirements at specific times.

provision in practice has implications far more extensive than simply guarding against *Scott v Avery* clauses.

The New Zealand Law Commission has taken a significant step in repealing section 8, in the context of arbitration reform. Therefore, as a result, there exists a significantly revised stance on insurance dispute resolution. While the 1977 reform included arbitration as simply a matter for consideration in neutralising a perceived imbalance in insurance contracts, modern reform has occurred in a converse manner, with insurance contracts being considered as a factor in the revitalisation of arbitration law.

The developments in the research of the commission have been examined systematically. Of particular interest in relation to section 8 is the recommendation of a consumer arbitration agreement provision. Recent criticism of this proposal has provided the author with an opportunity to carefully examine the grounds on which clause 9 is justified. This has resulted in three general conclusions.

Consumers are being presented, in the insurance context, as informed and capable parties. Although the author has expressed some apprehension over the feasibility of this assumption, it is suggested that this positive direction must be accepted. The Arbitration Bill, by allowing consumers to veto an arbitration agreement, clearly supports this emphasis. It is anticipated that the influence of the practice under the Consumer Arbitration Agreements Act 1988 (UK), which has provided a model for the recommendation, may have a significant effect on the operation clause 9.

A distinction between commercial and consumer parties has been shown to be a necessary feature of the insurance industry. Clause 9 is consistent with this trend.

Although the features of the relationship between an insurer and a consumer insured can be considered unique in some circumstances, it is difficult to identify a sufficient difference between insurance consumers and general consumers to advocate a specific arbitration provision for consumer insureds.

Therefore, as clause 9 is consistent with the general messages being expressed in the law of insurance, the author cannot accept the specific criticisms described above. Clause 9 is an empowering provision which emphasises the

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