Life insurers often reserve to themselves the right to reduce amounts payable under Income Protection policies by offsetting certain payments of an Income character.

The purpose of an offset clause is to ensure that a disabled insured does not receive more in “replacement income” than would be the case if he or she was not disabled. The reasons for an insurer doing so should be reasonably clear – by ensuring income from all sources received by an insured person do not exceed pre-disability income, insured persons retain a motivation to return to work. The right to offset must be embodied in the contract; the right does not arise at common law.

Any interpretation of the insurance contract must give effect to the policy’s commercial purpose. When he was President of the NSW Court of Appeal, Justice Kirby commented that;

“Insurance Policies will be construed in their commercial and social setting and having regard to their purposes. If one construction strikes fundamentally at the purpose of the policy, which is to spread the risk insured against, whilst another construction that is reasonably available would affect that purpose the latter will be preferred”

Similar comments were made by His Honour from the High Court in a matter of McCann. His Honour went on to say in McCann;

“The meaning to be given to an insurance policy must take into account the commercial and social purposes for which it was written. Under the guise of giving the language of a policy its ordinary and fair meaning, a court is not entitled to make a new contract for the parties at odds with that upon which they have agreed. . . .

And;

“…Courts now generally regard the contra proferentem rule (as it is called) as one of last resort because it is widely accepted that it is preferable that judges should struggle with the words actually used as applied to the unique circumstances of the case and reach their own conclusions by reference to the logic of the matter, rather than by using mechanical formulae.”

As may be apparent an offset clause will generally stand or fall on the strength of its drafting.

Practical problems often arise in the case of life insurers seeking to offset social security payments and lump sum Workers Compensation payments.

In a recent NSW Court of Appeal decision of Berzins, the Court grappled with an offset clause in a General Insurer’s Group Personal Accident Policy where the benefit payable was;

“…the amount shown in the compensation table in this section of the Policy, or the amount of the insured person’s pre-disability earnings which they have actually lost, whichever is less, and will be reduced by weekly benefits paid or payable from any... statutory workers compensation scheme.” (highlighted text most relevant)

In awarding payments under the Group Income protection policy to the claimant, the trial judge had deducted a sum of $26,000 representing an estimation by the judge of the proportion of a lump sum settlement related to weekly compensation benefits. No evidence had been adduced supporting that approach.

The claimant under the policy contended that approach was wrong because, amongst other reasons, the policy did not permit deduction of lump sum settlements. The Court of Appeal with Sackville AJA delivering the leading judgement, agreed with the claimant’s contentions. The offset clause permitted offset of weekly benefits, not lump sum damages payments. There was no evidence as to what component of the settlement represented weekly workers compensation benefits. The insurer could not offset that amount.

Potential problems with respect to social security payments are also illustrated in the case of Phillips. In that case, the insurer sought to offset social security payments received by the claimant on the basis it represented “similar State or Federal legislation” within the context of the provision set out below,

“...(b) Workers Compensation, Workcare, Accident Compensation or any other similar State or Federal Legislation…”
The Court, while stating that “the question of construction” was “a close one”, ultimately determined that social security payments were not sufficiently “similar” to Workers Compensation benefit schemes to fall within the offset clause.

Einstein J said;

“It is necessary to focus upon the meaning of the word ‘similar’ appearing in clause D19.0. To my mind in the instant context the social security payments do not qualify as relevantly ‘similar’ within the subject definition. In order to so qualify any relevant benefits would have to arise by reason of accident compensation schemes or statutory accident compensation schemes or the like.”

Offset clauses play an important role in ensuring claimants are properly, but not overly, compensated at times of disability. A well designed offset clause will, in company with other assistance such as rehabilitation (where available), provide an incentive for a disabled person to return to work, which will generally be in the long term interests of a claimant. However, care needs to be taken in drafting such clauses.

While Courts will construe the provisions to give effect to their clear commercial purpose, if there is ambiguity, the clause may not successfully operate. Particular problems might arise in seeking to offset social security payments and lump sum settlements as discussed in this article.

1 Legal & General Insurance Australia Limited v Esther (1986) 6 NSWLR 390
2 McCann v Switzerland Insurance (2000) HCA 65; 203 CLR 579; 176 ALR 711; 75 ALJR 325 (14 December 2000)
4 Carolyn Philips (nee Durrand) v Tower Australia Ltd (2008) NSWSC 1047
5 Carolyn Philips (nee Durrand) v Tower Australia Ltd (2008) NSWSC 1047