

The Illegality Defence – Has your insured been misbehaving?

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Insurers and superannuation fund trustees assessing life and disability claims may have cause to consider an insured's unlawful conduct and whether grounds arise to decline a claim on the basis of the illegality defence. There are a number of aspects to the illegality defence. This paper will review the impact of public policy on claims for indemnity arising out of unlawful conduct on the part of insureds.

Who does this impact?

Insurers and superannuation fund trustees assessing disability insurance claims.

What action should be taken?

Unlawful conduct by an insured may allow an insurer to deny liability for an insurance claim on the grounds that it would be against public policy to allow an insured to receive a benefit under the policy.

As the application of public policy often involves making difficult value judgments, each case will depend upon its own particular circumstances. As such, you may first wish to seek advice as to what action to take having regard to the facts of your particular claim.

Illegality and Public Policy

It is well established that a claim that arises out of a loss caused directly in the commission of a felony or similarly serious criminal offence by an insured can be denied on the ground that to pay the claim would be contrary to public policy.¹ This is based on the principle that no person should benefit from their crime or wrongdoing (*"the public policy principle"*).

The public policy principle was expressed by Sir Samuel Evans as follows:

It is clear law that no person can obtain or enforce any rights resulting to him from his own crime, neither can his representative claiming under him obtain or enforce any such rights. The human mind revolts at the very idea that any other doctrine could be possible in a system of jurisprudence.²

The rationale for the public policy principle is twofold:

1. To prevent an insured from profiting from his or her wrongdoing; and
2. To deter unlawful conduct.

What is the Test to be Applied?

- If there is an intentional, unlawful act which results in intended loss, an insured cannot recover on a policy of insurance as it would be against public policy to recover benefits for the intended consequences of an insured's intentional criminal act.
- If there is an intentional, unlawful act from which unintended consequences ensue, the principle that an insured may not benefit from his or her crime does not automatically apply. Rather, consideration will need to be given to the circumstances of the particular claim and the conduct of the insured. Consideration will need to be given as to whether the act "... is of such an anti-social character that the interests of the public require that the courts should for their protection, decline to enforce the contract".³

The leading Victorian judgment, *Fire and All Risks Insurance Pty Ltd v Powell*⁴ provides a useful guide as to the relevant factors to be considered, noting that a court will look to balance the need to uphold the observance of contracts with the public policy principle that an insured should not benefit from his or her crime. In *Powell*, the court considered the following matters were relevant to performing this balancing exercise:

- the gravity of the offence committed;
- whether the offence is of such an anti-social character as to justify a refusal to enforce the claim in the interests of the public;
- the offender's knowledge of the facts or law making the conduct unlawful;
- the degree of likelihood that if the claim were allowed, encouragement would be given to the commission of similar offences;
- the degree of likelihood that if the claim were allowed, the interests of innocent victims would be promoted; and
- the public interest in the observance of contracts.

The conduct of an insured does not necessarily need to result in him or her being charged or convicted of a criminal offence in order to rely on

the public policy principle, although the grounds may be easier to establish in circumstances where the insured has engaged in unlawful conduct and has been prosecuted or penalised for their conduct.

The public policy principle is unlikely to apply to unlawful conduct which lacks a sufficient degree of seriousness or "moral culpability", such as minor traffic offences.

For example, in *Powell* a carrier of goods drove a truck under a bridge which was too low, causing damage to the goods. The carrier did not hold the necessary permit to carry a load of such height. The owner of the goods brought a claim for damages against the carrier who sought indemnity from his insurer under a carrier's liability policy. The court rejected the insurer's defence that the carrier was precluded from claiming on the policy by reason of an intentional criminal act on the basis that the deliberate act of not obtaining a permit was "not of such a grave character or so anti-social that the court should decline to assist the insured to recover under the contract of indemnity."

By contrast, the Court in *Gray v Barr*⁵, considered the use of a loaded firearm to be such a grave, anti - social act so as to prevent the insured from claiming indemnity on a personal accident policy.

Application to Life Insurance and Disability Claims

The circumstances where the public policy principle might apply to disability claims are wide ranging and include:

- where an insured suffers injury during the course of an illegal act such as burglary or assault;
- where an insured suffers an illness (such as depression or other mental health condition) following an investigation or sanction by a professional body for misconduct.

As definitions of "total disability" generally require that the inability to work or perform work duties be "because of" injury or illness, difficult questions of causation can often arise.

It will often be necessary to consider if the “proximate” or “direct or dominant” cause of the disability is in fact the insured’s illegal acts or misconduct. This will require careful consideration of the claim history and relevant medical and other evidence.

In some cases, disability policies provide that “total disability” must arise “solely” as a result of a sickness, disease or disorder. On its face, the phrase “solely because of” would seem to require a stronger causative link than the phrase “because of”, as the natural and ordinary meaning of the word “solely” indicates a requirement that there be only one cause, exclusive of all other causes. As such, it is arguable that if there are other causes preventing an insured from performing the duties of their occupation, other than illness or injury, the definition of total disability will not be satisfied.

“Other causes” might include the fact that an insured is incarcerated, awaiting trial for criminal offences, has lost a licence to practice, or even suffered public notoriety and disgrace such that he or she could never attract or hold down employment in his or her own and/or any occupation.

As noted above, the particular facts of each case will need to be considered.

Case law

The case law in Australia and England does not include examples of losses (such as depression and resulting disability) indirectly resulting from an unlawful act being treated as contrary to public policy. However, there are a number of cases in the United States that suggest that the public policy principle would extend to resulting disability⁶.

For example, in *Massachusetts Mutual Life Insurance Company v Millstein*⁷, a lawyer claimed that he suffered from attention deficit disorder, conduct disorder and chemical dependency which caused him to suffer a loss of earned income. Despite his extensive history of illegal substance abuse, he was competent to perform legal work. However, after diverting his clients’ trust fund accounts, his licence was suspended.

He was later convicted and sentenced to a term of imprisonment.

In rejecting the insured’s claim for benefits under his disability income insurance policy, the court held that the loss of earned income was not caused by his psychological impairment but by the suspension of his licence to practise law. He was capable of performing his duties absent the legal restriction.

Further, in *Massachusetts Mutual Life Insurance Company v Woodall*⁸, a disability insurer brought action for a declaration that its insured was not entitled to disability benefits for depression which arose from misconduct that led to his disbarment. The court observed that insurance policies were a matter of public concern because rulings in cases involving common policies affected risk and associated insurance rates at a mass level.

The Court in *Woodall* stated:

“...there is something inherently disturbing about a man who commits a grievous wrong, unsurprisingly becomes “depressed” when confronted and punished over it, and then demands that his disability insurer pay him for a disabling “depression” as documented by his own psychiatrists.

One would think that a disability policy would explicitly include a “chutzpah” exclusion of some sort. On the other hand, policy exclusion pages would be longer than policies themselves if courts required insurers to anticipate and expressly exclude every conceivable way that an insured can engage in wrongdoing and benefit from it. Too, insurers can reasonably argue that, since fundamental public policy concerns have long been embedded in mass-policy insurance law, they shouldn’t have to “laundry-list” every conceivable wrongful act upon which a claim should be denied.”

Conclusion

It seems clear from the decision in *Powell* that intentional, unlawful acts which result in intended loss or injury will preclude an insured from

claiming indemnity on a policy of insurance on the grounds of public policy.

However it remains uncertain whether Australian Courts will adopt the same line of reasoning as their United States counterparts in their application of the public policy principle to losses indirectly resulting from unlawful acts.

Whilst claims circumstances will no doubt arise that may justify application of the public policy principle, care must be taken in its application. The courts will not readily set aside an insurer's obligations under a policy of insurance, Lord Escher MR recognising that the "*doctrine of public policy ought not be stretched beyond what is necessary for the protection of the public*"⁹. The relevant factors for consideration as set out above in *Powell's* case will therefore require careful application to the claims circumstances to hand.

Special care should also be taken where a claim is made by an innocent joint policy owner where the relevant criminality is that of the other joint policy owner. In such circumstances, it may well be that a public policy defence is not available.

Factually these cases are often difficult to prove and substantiate before a court or the FOS because there is frequently an overlap between the initial period of criminal behaviour and the onset of the disabling condition which the insured often asserts is the cause of uncharacteristic criminal behaviour.

We have found these issues can only be addressed by a detailed examination of the events in question and assembling a precise chronology which can be compared against the insured's medical history.

For more information,
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¹ See *Troja v Troja* (1994) 33 NSWLR 269; *Helton v Allen* (1940) 63 CLR 691; *Beresford v Royal Insurance Co, Ltd* [1938] AC 586 at 596-599; *Gray v Barr* [1971] 2 QB 554

² *The Estate of Crippen* (1911) p 108 at page 112

³ *Fire and All Risks Insurance Pty Ltd v Powell* [1966] VR 513 per O'Bryan and Pape JJ at p523.

⁴ [1966] VR 513

⁵ [1971] 2 QB 554

⁶ *Massachusetts Mutual Insurance Co v Millstein* 129 F. 3d 688 (2d Cir. 1977); *Massachusetts Mutual Life Insurance Company v Ouellette* 617 A.2d 132 (Vt 1992); *Goomar v Centennial Life Insurance Company* 855 F.Supp 319 (S.D.Cal 1994); *Provident Life and Accident Insurance Company v Fleishoer* 26 F.Supp.2d (C.D.Cal. 1998)

⁷ 129 F.3d 688 (1997)

⁸ 304 F. Supp 2d 1364 (2003)

⁹ *Cleaver v Mutual Reserve Fund Life Assoc* (1892) 1 QB 147 at p 153

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