

TERMS IN INSURANCE POLICIES REQUIRING INSURED TO TAKE REASONABLE CARE

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'Reasonable care' policy terms

Most fire and general insurance policies contain a term obliging the insured to take reasonable care in relation to the subject matter of the policy, whether they are policies on property insurance (e.g. house and contents) or liability insurance (e.g. public liability).

These are three examples of terms included in the conditions or exclusions sections of policies in the New Zealand market:

Care of insured property

You must take all reasonable steps to prevent loss or damage and maintain the insured property in good repair.

[Condition in a house and contents policy.]

Care of your vehicle

Reasonable care must be taken to protect your Vehicle and to prevent loss or damage.

[Condition in a motor vehicle policy.]

For all events you are not insured for:

Loss damage, liability or bodily injury... caused by your Vessel being in an unsafe or unseaworthy condition where you were aware of your vessel being in such a condition.

[Exclusion in a private pleasure craft policy.]

Whether written as a condition or exclusion, these terms are intended by insurers to exclude indemnity if the insured fails to take reasonable steps to protect his or her property. As these examples show, insurers use different language to achieve this, but generally speaking the essential part of these terms is that the insured has to act in a reasonable way in protecting the insured property.

The purpose of this discussion is to find out what "reasonable" means in this context.

The following is a fact situation taken from a decided High Court case (*Turanga v State Insurance* (1991) 7 ANZ Insurance Cases 77,525).

Mr T lived in Kaingaroa. He bought a van for about \$30,000 on hire purchase and insured it with State Insurance.

Mr T kept the van in a carport a few metres from his house which was about 30 metres from the road. During the day he kept the keys in the ignition of the van or in the glovebox or under the floor mat so that other family members could use it. He locked the van at night. He had a Doberman pup which the judge later accepted barked at anyone who came up to the house.

Early one evening the insured parked the van in the carport as usual and left the keys in the ignition. He and his family later fell asleep in the lounge. During the night his daughter woke him saying that she had heard the fire station siren. They happened to be members of the volunteer fire brigade so they rushed out of the house to get in the van.

The van had vanished. Later the same night Mr T found it burned out with the keys in the ignition.

State Insurance denied liability relying on a condition in the policy reading:

The insured shall take all reasonable steps to safeguard from loss or damage and maintain in efficient condition, any vehicle described in the Schedule hereto...

The High Court held that it had not been proven that the insured breached this condition.

So what does “reasonable steps” or “reasonable care” mean?

If, instead of this being an insurance case, the van was owned by Mrs X and she lent it to Mr T for the night, he left the keys in it and it was stolen, Mrs X could have sued Mr T alleging that he had been negligent.

To decide whether he was negligent, the legal issue for the court would be whether Mr T took reasonable care of the van. Almost certainly, his conduct would be held to have fallen below that standard and he would be liable to pay damages to Mrs X.

Faced with a condition in an insurance policy also requiring the insured to take reasonable care, surely the courts would take the same approach and hold that if the insured acted negligently, he would not be entitled to cover.

As we will see, the legal position is quite different.

The Courts' approaches

Fire and general policies provide an indemnity against accidental damage to property (this paper does not specifically consider liability policies, but the principles are essentially the same). The indemnity may also cover damage to property which is deliberately or maliciously caused, but not if the insured was responsible for it.

So the essential requirement for indemnity is that the damage was not deliberately caused by the insured. That leaves a wide range of covered causes of damage from so-called acts of God through to malicious damage. In the middle of that range is damage caused by negligence, including the insured's own negligence.

The courts have held that if “reasonable care” conditions were to be interpreted to exclude the insurer’s liability if the damage was caused by mere negligence or carelessness on the insured’s part, that would remove such a large part of the benefit of the policy that this would be inconsistent with the purpose of the policy.

As a result the courts interpret “reasonable” to mean reasonable in the context of an insurance policy that provides cover for accidental damage, including damage caused by the insured’s own carelessness or negligence.

In Mr T’s case above, because his conduct in leaving the keys in the ignition was merely careless or negligent, the High Court held that the insurer was liable under the policy.

What do ‘reasonable care’ conditions exclude, if not negligence?

The courts of different countries have reached different conclusions on this. In England it has been suggested that insurers must prove that the insured knowingly “courted danger” meaning that the insured acted in a particular way knowing of the dangers, but not caring about the consequences.

Similar indications have been given by the Australian courts. This subjective approach requires an insurer to prove that the insured knew of a particular danger and went ahead anyway. This is difficult to prove because it requires an assessment of the subjective, or mental, attitude of the insured.

The alternative approach is to apply an objective standard and ask, on the basis of how reasonable people would act or think, was the insured’s conduct grossly negligent? If it was, indemnity is excluded.

The New Zealand courts have not finally determined whether they prefer the objective or subjective test, but strong indications have been given in cases before both the High Court and Court of Appeal that an objective test is to be preferred.

Under this test, a standard of “gross negligence” would be applied, determined by how a hypothetical *reasonable* insured (not the insured) would act if he or she was in the shoes of the actual insured (this is sometimes described as a mixed objective/subjective test but it is fundamentally an objective test).

“Gross negligence” does not have a particularly well defined meaning, however it is intended to mean a high degree of careless conduct where the consequences could be foreseen, but falling short of deliberate damage.

The objective test is in my view the preferred test and is likely to be adopted by the New Zealand courts when the issue arises for determination. It is illogical to apply a subjective test of recklessness because if property is damaged by the insured’s recklessness, it would not usually be covered anyway because it would fall outside the requirement for damage to be accidental from the standpoint of the insured.

Whichever test is applied, the insurer has the burden of proving that the condition applies.

In considering whether in a particular case an insured’s conduct has fallen below the required standard, the insurer must:

- First, examine the policy condition (and the whole policy) carefully. They vary, and the wording of the individual condition may provide the complete test. For example, the Pleasure Craft policy exclusion above suggests that a subjective test is required regardless of our courts’ preference for an objective test.

- Second, the facts of each case are always different. It is dangerous to apply previously decided cases to individual claims. The differences might seem subtle, but they are crucial. All of the circumstances of a claim, including the location, the type of risk, the circumstances of the insured and the occasion of the loss have to be investigated and examined carefully before an informed decision can be made.

With that warning, a couple of examples may help in an appreciation of when the courts will decide one way or the other.

Insurer succeeds

MMI Insurance (NZ) Ltd v P D Davies Ltd (1998) 6 NZBLC 102,605

The facts

The insured operated business premises on Taradale Road, Napier which were separated from the main road by a service road. A few months after buying it new, the insured's Holden Calais car was stolen from the carpark in front of the insured's building.

The insured's managing director (who used the car) had parked the car at about 2.35pm and left the keys in the ignition intending it be cleaned by a part time employee when she arrived at about 3.30pm. He forgot to ask her to clean the car and the car was stolen at about 3.15pm.

The carpark was in full view of the building and customers and tradesmen came and went in the carpark throughout the day.

The decision

The judge hearing the case held that the insured's managing director had miscalculated the risk of theft and that he was clearly negligent in leaving the keys in the ignition.

However his actions were not grossly irresponsible or grossly negligent and so the reasonable care condition had not been breached.

Insured succeeds

Kelly v National Insurance Co of NZ Ltd [1995] 1 NZLR 641

The facts

The insured operated an engine reconditioning business. He decided to relocate the business within the same street. To move a 3½ tonne piece of machinery, he hired a forklift which lifted the machinery and carried it down the street. Under the insured's direction and control, the forklift driver put the plant on to some lengths of timber and then drove around the other side to lift it up again and put it into its final position. The machinery toppled off the forklift and was damaged.

The insured held a material damage policy which included a condition requiring the insured to take "all due care and diligence to prevent loss [or] damage...".

The decision

The court held that the insured thought that the 3½ tonne machine could be kept in the right position by people holding on to it while it was being moved, and he also directed that two men sit on the rear of the forklift to try to push the rear down in order to get enough forward traction to steer the forklift.

The insured also agreed in evidence that the plant had a high centre of gravity, which made it more likely that it would topple. He also concluded that the insured refused to listen to the advice of the other men involved in the manoeuvres.

The judge decided the case against the insured, concluding that even if the more stringent subjective test of recklessness applied, that test was satisfied. The insured appealed to the Court of Appeal which did not interfere with that finding.

I suggest that the second example is at the outer reaches of where an insurer can rely on a reasonable care condition. On paper, the facts look more like negligence than gross negligence let alone recklessness, but the case demonstrates how important the facts of individual case are to the judges who have to decide these issues.

Section 11

It should be remembered that section 11 of the Insurance Law Reform Act 1977 will usually apply to reasonable care terms, regardless of whether they are drafted as exclusions or conditions.

If the insured can prove that its unreasonable conduct did not cause or contribute to the loss, indemnity will still be available.

Conclusions

When considering claims that appear to have been caused by the carelessness of the insured, if the policy includes a reasonable care clause insurers have the burden of proving that the insured's conduct amounted to at least gross negligence.

Claims that appear to have been caused or contributed to by the carelessness of the insured need to be scrutinised and investigated with a careful eye to detail before decisions are made to deny liability on the basis of reasonable care conditions.