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Week 9: Insurance

INSURANCE: Insurance Contracts Act 1984 (Cth)

- essential basis of insurance is you have an insurer and someone who is insured
- the insurer will indemnify the insured for loss of goods, in return for the premiums
- you are only compensated for the loss of goods; life insurance is an example of insurance that is not based on loss of goods

What is an insurance contract?

- a contract of insurance is a contract by which one party, called the insurer, in consideration of a sum of money called the premium, undertakes to pay another person called the insured, a sum of money or its equivalent, on the happening of a specified event.
- Such an event must involve an element of uncertainty – either whether the event will happen, or when it will happen.

Formation of a contract of insurance

Generally, the normal rules of contract law such as capacity, offer and acceptance apply to insurance contracts.

Additional rules with regard to form:

- **The proposal form** – contains a series of questions intended to provide sufficient information to enable the insurer to assess the nature of the risk
- **The policy** – the document containing the formal agreement – names the parties, details the risks and circumstances in which compensation will be paid, identifies subject matter, describes the things which the insured must do or refrain from doing to maintain the contract
- **Cover notes** – interim contract providing immediate temporary protection to the person proposing to insure until completion and acceptance of the proposal (duty of disclosure applies since it is still a contract of insurance)

Basic concepts of insurance law

- **The Insurance Contracts Act** does NOT apply to contracts of reinsurance, health insurance, marine insurance, workers compensation, or compulsory third party: **s 9 ICA**
- An insurer cannot contract out of the Act to the prejudice of an insured and any provision purporting to exclude, restrict or modify the operation of the Act is void: **s 52 ICA**

Basic principles of insurance law:

- insurance interest
- duty of good faith
- duty to disclose
- misrepresentation

Insurable interest

- need to have an equitable or legal interest (Common Law)

16 Insurable interest not required A contract of general insurance is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject-matter of the contract.

17 Legal or equitable interest not required at time of loss

Where the insured under a contract of general insurance has suffered a pecuniary or economic loss by reason that property the subject-matter of the contract has been damaged or destroyed, the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the insured did not have an interest at law or in equity in the property.

18 insurable interest no required

A contract of life insurance or a contract that provides payment of money on the death of someone by sickness or accident is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject-matter of the contract.

Duty of Good faith

- s13 requires that duty of “utmost good faith” applies to both insurer and insured
- utmost good faith depends upon context it is used
- failure constitutes a breach of the requirements of the Act: **s 13(2)**
- utmost good faith requires full disclosure on the part of the insured and compliance with the obligation to act on the part of the insurer, each paying regard to the legitimate interests of the other
- a prompt admission of liability

CGU Insurance Ltd v AMP Financial Planning Pty Ltd

- not limited to circumstances involving dishonesty
- may require an insurer to act with due regard to the legitimate interests of an insured, as well as to its own interests.

13 The duty of the utmost good faith

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

Duty to disclose

21 The insured's duty of disclosure

(1) Subject to this Act, an insured has a duty to disclose to the insurer, before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that:

- a) the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms; or
- b) a reasonable person in the circumstances could be expected to know to be a matter so relevant, having regard to factors including, but not limited to:
 - i. the nature and extent of the insurance cover to be provided under the relevant contract of insurance; and
 - ii. the class of persons who would ordinarily be expected to apply for insurance cover of that kind.

(2) The duty of disclosure does not require the disclosure of a matter:

- (a) that diminishes the risk;
- (b) that is of common knowledge;
- (c) that the insurer knows or in the ordinary course of the insurer's business as an insurer ought to know; or
- (d) as to which compliance with the duty of disclosure is waived by the insurer.

(3) Where a person:

- (a) failed to answer; or
- (b) gave an obviously incomplete or irrelevant answer to a question included in a proposal form about a matter, the insurer shall be deemed to have waived compliance with the duty of disclosure in relation to the matter.

s21: two form test

- section 21(1) requires the insured to disclose matters known to the insured which:
 - (a) insurer knows to be relevant to the insurer;
 - (b) a *reasonable person* could be expected to know to be relevant.
 - 1. what you have to disclose: policy document: an insured person has to disclose every relevant matter that's relevant to the decision making whether to take on the risk or not (**actual knowledge**)

- 2. reasonable persons test: must disclose info that a reasonable person would have known would be a relevant matter (**constructive knowledge**)

Permanent Trustee Australia Ltd v FAI General Insurance Co Ltd (in liq) (2003) 214 CLR 514

FACTS – Permanent multi-layered professional indemnity insurance cover with a number of insurers – leading insurer wanted to obtain certain further information before deciding whether to renew with Permanent which was likely to cause delay – asked FAI to extend cover for a month – FAI agreed in the belief that it would be invited to quote for participation in the renewal of Permanent’s insurance – Permanent sought indemnity during the extension period and FAI refused on the grounds that had it known it would be invited to participate in the renewal it would not have provided a one month extension

HELD – High Court – since it was not a matter relevant to the risk, that is the particular hazard involved, it was not a matter relevant to the decision of FAI in agreeing to an extension of the existing cover within the meaning of s 21(1).

Midaz P/L v Peteres McCarthy Insurance Brokers P/L [1991] Qd R 279 – nail polish case

FACTS – Unknown to the insured, the tenants in one of the units stored inflammable materials that were used to make up nail polish and similar substances. The day after the interim insurance was provided, a fire occurred in the unit which gutted that unit and damaged adjoining parts of the building.

ISSUE – Insurer refused to pay the insured claim for the loss, arguing that the fact the unit contained inflammable materials should have been disclosed to it.

HELD – Qld CA dismissed insurer’s appeal – the duty of disclosure in s 21(1) did not extend to any matter unknown to the insured (further, the language suggests that it does not extend to matters that should have been known but were not in fact known). Therefore, no duty to disclose the presence of the inflammable liquids because unaware.

Amendments to the disclosure of provisions in s21(1)(b) *Insurance Contracts Amendment Act 2013*

- in determining whether a reasonable person in the circumstances could be expected to disclose a matter that is relevant to the contract of insurance which is to be entered into, regard is to be had to factors including but not limited to:
 - the nature and extent of the insurance cover to be provided under the contract of insurance;
 - the class of persons who would ordinarily be expected to apply for insurance cover of that kind.

Disclosure of prior criminal or dishonest conduct

- disclosure under s 21 extends to the moral hazard, that is to matters concerning the honesty and integrity of the insured including disclosure of criminal or dishonest conduct known to the insured even though there has been no conviction or charge made in respect of such conduct.
- ***Naomi Marble and Granite v FAI General Insurance Co Ltd***

Matters not to be disclosed

The insurer is not required to disclose matter that:

- diminishes the risk;
- is of common knowledge;

- the insurer known, or in the ordinary course of its business as an insurer ought to know; or
- as to which compliance with the duty of disclosure is waived by the insurer.

An insurer is deemed to have waived the compliance in the proposal form, the insured failed to answer the question, or gave an obviously incomplete or irrelevant answer: **s 21(3) ICA**

22 Insurer to inform of duty of disclosure

(5) An insurer who has not complied with ss (1) and (if applicable) ss (2) may not exercise a right in respect of a failure to comply with the duty of disclosure, unless the failure was fraudulent

- the insured is under a duty to disclose any change in circumstances that increases the risk insured against prior to each renewal of the insurance contract: **s 21 ICA**

Eligible contract of Insurance

- section 21A ICA modifies the insured's obligation of disclosure in respect of certain types of insurance contract, referred to as "eligible contracts of insurance", that provide cover commonly sought by individual consumers.
- The insurance contracts regulations 1985 specifies that the following insurance contracts are "eligible contracts of insurance": motor vehicle insurance; home buildings insurance; home contents insurance; sickness and accident insurance consumer credit insurance and travel insurance.
- Designed to improve the capacity of an insured to comply with the duty of disclosure by requiring an insurer to ask specific questions regarding the information which the insurer needs to assess the risk in respect of a proposed contract of insurance, in default of which the insurer is deemed to have waived the duty of disclosure.

Remedies for non-disclosure

- General insurance (not life or disability insurance): **s 28(1)**
- Applies where there has been:
 - A failure to comply with the duty of disclosure: **s 21** (pre-contract)
 - A misrepresentation to the insurer (pre-contract)
- Innocent non-disclosure: where the insured's failure to disclose was innocent, the insurer is not entitled (at least directly) to avoid the contract. However the liability of the insurer for a claim in such a case is reduced to the amount that would place the insurer in the same position as it would have been had the non-disclosure not occurred: **s 28(1)**
- Where the insurer can show that it would not have entered into the contract at all had it known of the non-disclosure then its liability under the contract will be reduced to nil under **s 28(3)**, which in effect enables the insurer to indirectly avoid the contract.
- The intention is to put the insurer in the position it would have been in if the relevant disclosure had been made. If the insurer would not have accepted the policy, then the only way in which the insurer can be restored to the position that it would have been in is by reducing the payment required to be made under the policy to nil. That is because the damage to the insurer is the total amount of the claim made against it: **Lindsay v CIC Insurance**
- Fraudulent non-disclosure: **s 28(2)** liability can be avoided altogether. Alternatively, liability can be reduced to the position it would be in had the disclosure occurred: **s 28(3)**. Deliberate withholding of information of the kind required to be disclosed under **s 21(1)** would constitute fraudulent non-disclosure: **Burns v MMI-CMI Insurance Ltd (1994) 8 ANZ Insurance Cases 61-228** (deliberate failure to disclose previous insurance claims and the unusually high number of burglaries on the premises which had not been claimed)
- The court, however, may disregard the avoidance of a contract by an insurer as a result of fraudulent non-disclosure when it would be harsh and unfair not to do so, and allow the insured to

recover the whole or such part as the court thinks just and equitable of the amount that would have been payable if the contract had not been avoided: [s 31](#).

Twenty-first Maylux P/L v Mercantile mutual insurance (Australia) Ltd [1990] – fraudulent

FACTS – directors of plaintiff company were husband and wife who ran gift shop – insurance taken out in name of company – fire on premises but M Ltd rejected the claim because of a non-disclosure that the husband had a criminal record for being knowingly involved in importing and processing a large quantity of cannabis – proposal form did not contain any questions as to prior convictions but husband had previously entered insurance contracts where proposals had contained such questions.

HELD – husband's criminal record was relevant to M Ltd and if it had been disclosed M Ltd would not have accepted the proposal – husband knew it was relevant to insurer within meaning of s 21 and non-disclosure was 'fraudulent' within the meaning of s 28(2) – M Ltd entitled to avoid insurance contract

Liability of co-insureds

- when two or more persons enter into an insurance contract in respect of the same subject matter, the HC has held that the duty of disclosure applies to each of the co-insureds and hence even if only one of the co-insureds has been responsible for a fraudulent non-disclosure the insurer will be able to avoid the contract of insurance under the *ICA, s28(2)*: [Advance Insurance Agencies v Matthews](#)

Life Insurance

Where the non-disclosure does not relate to the age of the life insured, the position is as follows:

1. where the insurer would have entered into the policy even if the insured had made full disclosure, the insurer will have no remedy: *Insurance Contracts Act 1984* (Cth), [s 29\(1\)](#)
2. if the failure to disclose was *fraudulent* the insurer may avoid the policy: [s 29\(2\)](#)
3. in the case of an *innocent non-disclosure*, if the insurer would not have entered into the contract on any basis if the duty of disclosure had been complied with, the insurer may avoid the policy within three years after the policy was entered into: [s 29\(3\)](#)
4. if the insurer has not avoided the contract under [s 29\(2\) or \(3\)](#), the insurer may by notice in writing given to the insured before the expiration of three years after the contract was entered into, vary the sum insured in accordance with a formula prescribed in [s 29\(4\)](#).

Misrepresentation

- statement is not to be treated as a misrep unless the insured knew, or a reasonable person in the circumstances could be expected to have known, that the statement would have been relevant to the insurer's decision whether to accept the risk and, if so, on what terms: [s 26\(2\)](#) – onus on insurer
- statement will not be treated as a misrep even though it is untrue, where it was made on the basis of a belief held by the insured, being a belief which would have been held by a reasonable person in the circumstances: [s 26\(1\)](#) – onus on insured
- a person will not be held to have made a representation simply because they failed to answer a question or gave an obviously incomplete answer to a question in the proposal form: [s 27](#)

Remedies for misrepresentation

- Innocent misrepresentation: same as non-disclosure – liability is reduced to the amount that would place the insurer in the same position as it would have been had the misrepresentation not been made and can be reduced to nil where they would not have entered into the contract at all: [s 28\(1\), \(3\)](#).