

# Commercial Final Exam Notes

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# INSURANCE

## Definition of 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 event must involve some element of *uncertainty*, that is there must be some uncertainty as to whether the event will happen at all, or if the event is one which is bound to happen, as in the case of life insurance payable on death, there must be uncertainty as to the time it will happen.

## Formation of a Contract of Insurance

The normal rules of law of contract such as *capacity, offer and acceptance* apply to insurance contracts. Offer and acceptance tend to be more formalised in relation to insurance contracts.

## The proposal form

- The person intending to take out insurance (*proposer or proponent*) is required to fill out a form called a *proposal form* which contains a series of questions intended to provide sufficient information to enable the insurer to assess the nature of the risk. The completed proposal form constitutes the offer by the proposer to enter into a contract of insurance. The contract of insurance is formed when the insurer accepts the offer, though the terms of the contract may provide that the contract is not to be regarded as complete until payment of the premium or the issue of the formal policy.

## The policy

- The *policy* is the document which embodies the *terms of the contract* as agreed upon by the insured and the insurer. It contains the *formal agreement* by the insurer to compensate the insured for losses arising from the risks insured against.

## Cover notes

- A *cover note* is an *interim contract* of insurance, which generally provides immediate temporary protection to the person proposing to insure until completion and acceptance of the proposal. Since a cover note is a contract of insurance, the ordinary

incidents which apply to the formation of such contracts, including the duty of the insured to disclose all material facts to the insurer, apply to the cover note.

### **Basic Concepts of Insurance Law**

- Except to the extent that the *Insurance Contracts Act 1984* either expressly or by implication limits the operation of certain aspects of insurance law, the existing principles of common-law and equity, as well as State and Commonwealth legislation, continue to apply to insurance contracts: **s 7 of the ICA.**
- The Act **does not apply** to contracts of:
  - Reinsurance
  - Health insurance
  - Marine insurance
  - Workers' compensation
  - Compulsory third-party motor vehicle insurance
- 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.**

### **Basic Principles of Insurance Law**

- The basic principles of insurance law are:

#### **Insurable interest**

- For a contract of insurance to be valid at common law, the insurers had to have what was called an insurable interest (legal or equitable interest in the subject matter of the insurance).
- A contract of general insurance is not void by reason only that the insured did not have an interest in the subject matter of the contract at the time the contract was entered into **s 16.**
- Where an insured does not have a legal or equitable interest in the subject matter of the contract at the time of the loss, but has suffered a pecuniary or economic loss as a result of the damage to or destruction of the subject matter, the insurer is not relieved of

liability because of the insured's lack of an insurable interest: **s 17**.

### **Life insurance**

- The Act provides that a contract of life insurance, or a contract that provides for the payment of money on the death of a person by sickness or accident, is not void by reason only that the insured did not have an interest in the subject matter of the contract at the time the contract was entered into: **s 18(1)**.

### **Duty of Good Faith**

- The Act recognises the basic common law principle that an insurance contract is a contract of the utmost good faith.
- It provides that in every insurance contract there is an implied term requiring each party to act with the utmost good faith towards the other in respect of any matter arising under or in relation to contract **s 13(1)**.
- The concept of 'utmost good faith' is not limited to circumstances involving dishonesty:
  - **CGU Insurance v AMP Financial Planning (2007) 235 CLR 1**
    - *'Utmost good faith may require an insurer to act with due regard to the legitimate interests of an insured, as well as to its own interests. There is a requirement for full disclosure to an insurer, that is to say, a requirement to pay regard to the legitimate interests of the insurer'*.
    - *'Conversely, an insurer's statutory obligation to act with utmost good faith may require an insurer to act consistently with commercial standards of decency and fairness, with due regard to the interests of the insured'*.
- Prompt admission of liability to meet a sound claim for indemnity and prompt payment is required of an insurer by virtue of this obligation to act with the utmost good faith towards the insured. Breach of such an obligation will entitle the insured to damages for the loss suffered, **Moss v Sun Alliance Australia**.
- Where reliance on a provision of the contract would be to fail to act with the utmost good faith, such provision may not be relied on; **s 14(1)**.
- ASIC may exercise its power under the **Corporations Act 2001 (Cth)** if an insurer fails to

comply with the duty of the utmost good faith in the handling or settlement of a claim under the insurance contract: **s 14A.**

#### **Duty of Disclosure**

- **Section 21(1)** states that 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:
  - 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
  - In ***Permanent Trustee Australia Ltd v FAI General Insurance Co Ltd (in liq) (2003)*** it was held that the word 'knows' means considerably more than 'believes' or 'suspects' or even 'strongly suspects'
- Duty of disclosure extends to the "moral hazard", that is to disclosure matters of criminal or dishonest conduct known to the insured: ***Naomi Marble and Granite Pty Ltd v FAI General Insurance Co Ltd [1999]***; ***Twenty-first Maylux Pty Ltd v Mercantile Mutual Insurance (Australia) Ltd [1990]***
- There is also a duty to disclose any change in circumstances that increases the risk insured against:  
***Alexander Stenhouse Ltd v Austcan Investments Pty Ltd (1993)***
- A reasonable person in the circumstances could be expected to know to be a matter so relevant.
- Duty of disclosure does not extend to any matter unknown to the insured: ***Midaz Pty Ltd v Peters McCarthy Insurance Brokers Pty Ltd (1999)***
- For contracts entered into or renewed after 28 Dec 2015, in determining **Section 21(1)(b)**, 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; and the class of persons who would ordinarily be expected to apply for insurance cover of that kind.

#### **Permanent Trustee Australia v FAI General Insurance**

**Facts:** The appellant, Permanent, had entered into a multi-layered professional indemnity insurance cover with a number of insurers. The insurance was to provide indemnity in respect of possible claims for professional negligence. One of the insurers was FAI. During an extension period (of one month as Permanent wanted to sack FAI), permanent was sued and notified FAI. FAI refused to provide indemnity, stating that had they known Permanent was not going to renew the contract they would not of provided the extension.

**Held:** The HCA held that the provisional decision of FAI for renewal of cover 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)** since it was not a matter relevant to the *risk*, that is, the particular insurance hazard involved.

- Permanent was not bound to disclose the matter to FAI when negotiating the extension of insurance.
- Further the *knowledge* referred to in **s 21(1)** “*is the knowledge of the insured, and not of any insurance intermediary. The reference to the insured is intended to be a reference to the insured personally and not to its agent*”
- **Midaz Pty Ltd v Peters McCarthy Insurance Brokers Pty Ltd [1999]**
- **Facts:** Appellant owned a block of buildings and agreed to provide interim insurance for the building. Unknown to the insured, the tenants in one of the units stored inflammable materials. A fire occurred and insurer refused to pay arguing the fact that the unit contained inflammable materials should have been disclosed.
- **Queensland Court of Appeal held:** Duty of disclosure under **s 21** does not extend to any matter unknown to the insured. The language of this section did not suggest an intention to extend to matters which should have been known by the insured but were not in fact known.

**Amendments to the Disclosure provision in s 21(1)(b) by the *Insurance Contracts Amendment Act 2013 (Cth)***

- Contracts of insurance entered into or renewed after 28 December 2015, a new **s 21(1)(b)** of the ***Insurance Contracts Act 1984 (Cth)*** will apply, so that 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; and
  - the class of persons who would ordinarily be expected to apply for insurance cover of that kind.

**Disclosure of prior criminal record or dishonest conduct**

- The duty of disclosure under **s 21** of the **ICA** 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 [1999]***.

- While it is still probable that, for example, prior criminal convictions will still be regarded relevant to the insurer's assessment of the risk in determining whether to enter into an insurance contract the case of ***Permanent v FAI*** has cast an element of doubt.

#### **Matters not required to be disclosed.**

- The insured is not required to disclose matter that:
  - Diminishes the risk.
  - It is common knowledge.
  - The insurer knows, 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.
- The insurer will be deemed to have waived compliance if, in response to a question in the proposal form, the insured failed to answer the question or gave an obviously incomplete or irrelevant answer to it **s21(2), (3)**.

#### **Insurer to inform insured of duty of disclosure.**

- The insurer is required to clearly inform the insured in writing of the general nature and effect of their duty of disclosure before they enter into the insurance contract.
- Where an insurer fails to comply with this information requirement, the insurer may not exercise any right it would have had for the insured's breach of the duty of disclosure, unless such breach was fraudulent; **s 22**.

#### **Amendments to the insurer's duty to inform the insured of the duty of disclosure under s 22 by the ICA**

- The **ICA** has substituted a new **s 22** which will apply to contracts entered into or renewed after **28 December 2015**.

- Under this section, the insurer must, before a contract of insurance is entered into, clearly inform the insured in writing of the general nature and effect of the duty of disclosure and that the duty of disclosure applies until the proposed contract is entered into.
- If the insurer complied with this requirement and proposes to enter into a contract of insurance more than two months after the insured person's most recent disclosure, then the insurer must give the insured a reminder notice stating the duty of disclosure applies until the proposed contract is entered into.
- An insurer who has not complied with these requirements may not exercise a right in respect of a failure to comply with the disclosure, unless the failure was fraudulent.

**Duty of disclosure extends to change in circumstances prior to renewal of contract.**

- The insured is under a duty to disclose any change in circumstances that increases the risk insured against prior to renewal of the insurance contract **ss21(1) and 11(9)**.

**Alexander Stenhouse v Austcan Investments**

**Facts:** During the initial contract of insurance, the use of business premises changed from the retail selling of water beds to including their manufacture, which increased the storage of flammable materials on the premises. This alteration was not disclosed to the insurer prior to renewal of the insurance contract by the insured. The premises were damaged by fire and a claim made under the insurance contract.

**Held –** The HCA held that there had been a non-disclosure by the insured to which allowed the insurer to reject to indemnify the insured.

**Statutory limitations on an insured's duty of disclosure in respect of an "eligible contract of insurance"**

- "Eligible contracts of insurance" are motor vehicle insurance; home buildings insurance; home contents insurance; sickness and accident insurance; consumer credit insurance and travel insurance: **Reg 2B of the *Insurance Contracts Regulations 1985 (Cth)***
- **Section 21A (2) of the *Insurance Contracts Act 1984*** provides that the insurer is

taken to have waived compliance with the duty of disclosure in relation to the contract unless the insurer complies with **21A**.

**(3)** and **21A (4)**.

- **21A (3)** Before the contract is entered into, the insurer requests the insured to answer one or more specific questions that are relevant to the decision of the insurer whether to accept the risk and, if so, on what terms
- **21A(4)** Before the contract is entered into, the insurer expressly requests the insured to disclose each “exceptional circumstance” that is known to the insured; and the insured knows, or a reasonable person in the circumstances could be expected to know, is a matter relevant to the decision of the insurer whether to accept the risk and on what terms.
  - a. The onus of proving that a matter is an "exceptional circumstance" lies on the insurer:

#### **Section 21A (8)**

- **21A(5)** If an insurer complies with either (3) or (4) set out above, but also requests the insured to disclose any other matters that would be covered by the duty of disclosure in relation to the contract, then the insurer is taken to have waived the duty of disclosure in relation to those matters

### **Amendments to the “eligible contract” provisions by the Insurance Contracts**

#### **Amendment Act 2013 (Cth)**

- The Insurance **Contracts Amendment Act 2013 (Cth)** repeals and replaces **s21A** of the previous Act in respect of an ‘eligible contract of insurance’ originally entered into after 28 December 2015.
- The principal difference from the former **s21A** is that an insurer is not permitted to ask ‘exceptional circumstances’ questions under the substituted **21A**.
- The new **s 21A** provides that the insurer may ask one or more specific questions that are relevant to the decision whether to accept the risk and, If so, on what terms.
  - If the insurer does not ask one or more questions, the insurer is taken to have waived compliance with the duty of disclosure: **s 21(1)-(3)**.
  - Further, if an insurer makes a request in relation to a matter outside the