CASE NOTE

INSURANCE—COVER NOTE—AVOIDANCE BY INSURER FOR NON-DISCLOSURE BY PROPONENT: WHAT IS THE TEST OF MATERIALITY?

It is said to be a fundamental principle of insurance law that each party must observe the utmost good faith in making disclosure of all material facts relating to the policy he proposes to effect. The definition of the test of materiality is still a matter for litigation. For example, in *Babatsikos* v. *Car Owners Mutual Insurance Co. Ltd.* [1970] V.R. 297 at 309 the duty was put in two forms:

(i) the test of the prudent insurer:
the test is whether a prudent insurer would have been influenced in his acceptance of the risk or in his assessment of the premium had the question been answered correctly, or

(ii) the test of the reasonable insured:
the test is whether a reasonable proponent would, having regard to all the circumstances, consider the matter material.

Despite judicial approval of the former test: see *Babatsikos* above; *Mutual Life Insurance Co. of New York* v. *Ontario Metal Products Co. Ltd.* [1925] A.C. 344 at 351 and cases given in Ivamy, *General Principles of Insurance Law* (1975) 113; Joske and Brooking, *Insurance Law* (1975) 89; Latimer, *Cases and Text on Insurance Law* (1977) 52 et seq., the matter was recently again subject to definition by the Privy Council on appeal from the Supreme Court of New South Wales.

In *Marene Knitting Mills Pty. Ltd.* v. *Greater Pacific General Insurance Ltd.* (1976) 11 A.L.R. 167 (P.C.) the question concerned the test of materiality. The proponent in taking out a fire policy in 1973 had not disclosed previous fires in 1958, 1960, 1961 and 1965. The cover note was issued on 14 August 1973; fire occurred the following day causing damage agreed at approximately $130,000.

The insurer denied liability under the cover note "upon the ground that neither the plaintiff nor anybody on its behalf disclosed to the said defendant either at or prior to the issue of the cover note that the business had previously had four very serious and substantial fires".

The meaning of "the business" was one point in issue, for if the appellant company could show the fires had occurred to a different business, its duty of disclosure would therefore have been discharged. The appellant company was incorporated in 1937 and was put into liquidation in 1965. The last of the four undisclosed fires occurred during this month on premises owned by a Mr and Mrs Herszberg. In the premises burned

in 1965 were located two partnerships, consisting of Mr and Mrs Herszberg (both partnerships carrying on the business of manufacturers of knitted goods) and a limited liability company, James Knitwear Pty. Ltd. (James), a retailer selling goods made mainly by the two firms. The Herszbergs and their four children held all the share capital of James.

The premises were substantially destroyed following the September 1965 fire and were unable to be rebuilt because of town planning restrictions. In the following month, James bought the stock and plant from the liquidator of the appellant company and Marene Knitting Mills Pty. Ltd. was revived. It was common ground that the same business was carried on by the revived company.

The four fires in question did not affect any property of the appellant company, but the earlier fires did destroy premises owned by Mr and Mrs Herszberg and occupied by their business.

The insurer's contention was that the business suffering the fires was substantially the same as that suffering fire in 1973. Therefore the earlier fires should have been disclosed.

The contention was successful both in the Supreme Court of New South Wales and in the Privy Council. It was found the business carried on by Marene Knitting Mills Pty. Ltd. was basically that which had been carried on previously by the family under other names: the same class of goods were manufactured, the same equipment used, and the same managing director appointed (the senior male member of the family). The four fires in question had affected the same business. (The fact of relocation in Sydney from Melbourne was said not to disquise this fact.)

Could the appellant contend there were sufficient changes in the constitution of the business to make it different? If so, the previous fires not disclosed in the cover note would not be relevant to the appellant.

Adverting to the two tests of materiality, their Lordships quoted Samuels J. in *Mayne Nickless Ltd* v. *Pegler* [1974] 1 N.S.W.L.R. 228 at 239, where his Honour supported the test of the prudent insurer.

Counsel for the appellant criticized the reasoning of his Honour and contended inconsistency with the Privy Council decision in *Mutual Life Insurance Co. of New York* v. *Ontario Metal Products Co.* [1925] A.C. 344 at 351-2. In *Marene Knitting Mills*, their Lordships stated that although the test in the *Ontario* case was expressed in terms different from those of Samuels J., the "somewhat different words" may have been due to the *Ontario* case being governed by the Ontario Insurance Act (R.S. Ont. 1914 C183 s. 156).

Their Lordships found it unnecessary to pursue the matter, as the test adopted by the Supreme Court of New South Wales (as stated by Samuels J. in *Pegler*) had been applied in many other cases.

Is the *Ontario* test the same? At [1925] A.C. at 350-1, their Lordships disapproved the statement of Mignault J. in the Supreme Court of Canada: that the test is what any reasonable man would have considered material to tell the insurer by way of answer to the insurers' questions. Their Lordships countered this by noting the insurer must have attached

relevance to the answer merely by virtue of the fact that the question had been asked: " Now if this were the test to be applied, there would be no appreciable difference between a policy of insurance subject to s. 156 of the Ontario Insurance Act, and one in the form hitherto usual in the United Kingdom".

It is suggested their Lordship's statement in the present case is unnecessarily inconclusive. Is the test in fact stated differently? If so, is it a result of the operation of the Ontario Insurance Act?

That Act, in s. 156(4) says "No contract shall be avoided by reason of the inaccuracy of any such statement (i.e. in an application for a policy) unless it is material to the contract". In the *Ontario* case, s. 156 is stated to mean that no policy shall be avoided for any misrepresentation or inaccuracy in a statement made by the insured on a proposal form whatever the terms of the policy might otherwise import. Therefore any misrepresentation which may give grounds for avoidance of the policy must be material to the contract.

A similar position applies in New South Wales as a consequence of the new sections added to the *Insurance Act* 1902 by s. 6 of the *Commercial Transactions (Miscellaneous Provisions) Act* 1974. Section 18(1) gives the court power in relation to insurance contracts to excuse a failure by the insured to observe a term or condition if the insurer is not prejudiced by the failure. Section 18(2) then states that the rights and liabilities of all persons shall be determined as if the failure had not occurred.

In Victoria, s. 25 of the *Instruments Act* 1958 provides a contract of insurance shall not be avoided by reason of any incorrect statement on the faith of which the contract was made unless the statement was fraudulently untrue or material to the risk. The tests in the New South Wales and the Victorian sections do raise again the tests of materiality that this article posed at the beginning. If an "incorrect statement made by the proponent" (Victoria) or "a failure by the insured to observe or perform a term or condition" (N.S.W.) is to be excused if the insurer is not prejudiced, on whom does the duty lie in determining how much is to be disclosed before there can be said to be failure to perform the condition of disclosure?

In other words, do the common law tests of the duty of the insured to disclose apply in these statutory statements of the law? It is suggested that although these sections appear to "update" the common law in this area, the test is in fact the same. The insurer could therefore argue, if s. 18 were put forward by the insured in the *Marene Knitting Mills* case, that the failure by the insured to disclose four earlier fires to the same business (although operating under different names) ought not to be excused. The insurer's determination whether to accept the risk or not was obviously prejudiced by the failure of the insured to disclose what a reasonable insurer would have considered material. A prudent insurer would have wanted to know of the four previous fires, and because of the non-disclosure, its judgment had been prejudiced. The insurer formulates the rules and poses the questions; the decision whether the insurer

is prejudiced rests with the insurer. Only if no prejudice is shown can the failure to perform the duty of disclosure be excused by the court. The court's subjective power of excusing non performance, it is suggested, must be read in the light of the traditionally formulated test of the prudent insurer.

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