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May 2011

Can a broker's knowledge be imputed to an insured?

This newsletter examines the circumstances in which a broker's knowledge can be imputed to an insured for the purposes of an insurer establishing material non-disclosure.

Section 21 Insurance Contracts Act 1984 (Cth) ("ICA") imposes upon insured parties, an obligation to disclose relevant information to their insurer. That section provides as follows:

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.

Often an insured's broker arranges insurance on its behalf, filling out the necessary paperwork and liaising directly with the insurer to effect appropriate coverage. The question sometimes arises, what happens when a broker has information on matters relevant the insurer's decision to insure (but unknown to the insured itself) which the broker fails to disclose to the insurer? Is the insured deemed to have breached its duty of disclosure in such circumstances?

In certain cases it has been found that a broker's knowledge may be imputed to an insured for the purposes of finding a breach of the insured's duty of disclosure.

The basis for imputing knowledge to an insured is found in the law of agency. In this regard, *Con-stan Industries of Australia Pty Ltd v Norwich Wintarthur Insurance (Australia) Ltd* (1986) 64 ALR 481 determined that "*under the general principles of the law of agency, a broker is the agent of the assured, not the insurer …there will be rare circumstances in which a broker may also be an agent of the insurer, but the courts will not readily infer such a relationship because a broker so placed faces a clear conflict of interest…*".

Accordingly, it is often the case that the broker is the agent of the insured, and there will be a prima facie basis for imputation of relevant knowledge between the parties.

Case law has also confirmed that s 21 of the ICA contemplates not just actual knowledge of the insured, but also constructive knowledge such as by imputation from an agent.

In *Lindsay & Ors v CIC Insurance Limited* (1989) 5 ANZ Insurance Cases 60-193 ("*Lindsay*"), His Honour Rogers CJ of the NSW Supreme Court held that "*…the matter required to be disclosed is what is "known" either to the proponent personally or to a relevant agent of the proponent…I am satisfied that the section cannot be confined to the actual knowledge of the proponent alone. Nor, in my opinion is the knowledge confined to that of the agent charged with effecting insurance.*"

In that case, the knowledge of a managing agent was able to be imputed to the owner of a property, as the managing agent was a "relevant agent" and "*His knowledge of matters relating to the property which impact on the insurance risk ought to be imputed to the owners. In other words, by delegating the management of the*

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property to an agent, the owners cannot avoid having knowledge of matters which might result in a proposal being refused or a higher premium being imposed."

Similarly in the case of *Ayoub v Lombard Insurance Co (Aust) Pty Ltd* (1989) 5 ANZ Insurance Cases 60-933, the plaintiffs instructed their broker to obtain insurance for their property. The broker first attempted to arrange insurance through National and General Insurance Ltd, who after surveying the property, refused to insure the risk. The plaintiffs were not informed of the refusal to provide cover by National and General Insurance Ltd. The broker then sought cover through the defendant, but did not disclose the previous refusal of cover by National and General Insurance Ltd.

The court held that, "*In the particular circumstances, there can be no doubt that the knowledge of [the broker] was the knowledge of the plaintiffs for the purpose of determining what was required to be disclosed. The plaintiffs had confided to [the broker] the task of effecting insurance. Accordingly the first requirement of s 21 of the* Insurance Contracts Act 1984 *(Cth)…that the relevant matter, if known to the insured, must be disclosed, is satisfied.*"

The above cases therefore tend to suggest that courts will readily infer a broker's knowledge may be imputed to an insured for the purposes of establishing a breach of s21. However the most recent case authority, *Permanent Trustee Aust Ltd v FAI General Insurance Co Ltd* [2003] HCA 25 ("Permanent Trustee") appears to qualify the circumstances in which an imputation of knowledge may arise.

Permanent Trustee held professional indemnity cover with FAI which was due for renewal. Based on adverse reports of FAI's financial status, Permanent Trustee asked its broker to seek quotes from various other insurers rather than renew their insurance with FAI.

Permanent Trustee was still negotiating new cover with another insurer when its FAI policies were about to expire. It therefore arranged a 30 day extension of the FAI cover. Neither Permanent Trustee nor its broker informed FAI of Permanent Trustee's intention not to renew the FAI policies at this time.

A claim was subsequently brought against Permanent Trustee within the 30 day extension, and FAI declined indemnity on the basis that Permanent Trustee's failure to disclose its decision not to renew with FAI was a fraudulent non-disclosure in breach of s 21.

In evidence at trial, the broker said it believed that if the decision not to renew was disclosed to FAI no extension of cover would have been granted, although it did not advise Permanent Trustee to this effect. FAI sought to argue that the knowledge of the broker could be imputed to the insured.

The trial judge and court of appeal held that the failure of the broker to inform FAI of the intended renewal elsewhere was a breach by Permanent Trustee of its duty of disclosure under s 21.

However, the High Court reversed the decision of the New South Wales Court of Appeal holding that:

- The decision not to renew the insurance was not a matter "*relevant to the decision of the insurer whether to accept the risk and if so, on what terms"* within the meaning of ss 21(1)(a) and 26(2) ICA; and
- The finding of fraud by the Court of Appeal was not open to it and should be overruled.

With respect to the issue of imputation, the High Court held that the insurer's reliance on *Lindsay* and *Ayoub* was misplaced and clarified the law as established by those cases as follows:

a) Where an insured does not have *actual knowledge* of:

   i) a matter; and

   ii) the relevance of that matter to the insurer,

but the broker does, s 21(1)(b) must be used to determine whether the duty of disclosure has been breached; and

b) For that purpose, matters known by the broker may only be taken into account if the broker had a duty to inform the insured of those matters.

The High Court judgement stated:

Section 21(1)(a) does not implicitly impose a duty of disclosure on the agent to insure by attributing his knowledge of the insured. Section 21(1)(a) deals with the insured's actual not constructive knowledge. The court of appeal erred in holding that the act incorporated the notations of an agent to insure and an agent to know such that failure by the broker to communicate to the insurer what it knew, whether or not that knowledge was gained in the course of carrying out the agency would amount to a breach by the insured of the duty of disclosure pursuant to s 21(1)(a).

The imputation argument in this case was therefore rejected on the basis that:

1) The ICA does not impose a duty of disclosure on brokers which binds the insured.

2) The ICA does not attribute constructive knowledge to the insured for the purposes of s 21(1)(a); and

3) The broker's knowledge (that Permanent Trustee's decision not to renew with FAI may influence FAI's decision to grant an extension of cover), was knowledge gained outside the performance of the broker's agency with Permanent Trustee.

Conclusion

As a result of the High Court's decision in *Permanent Trustee v FAI*, when an insured does not know of a matter and its relevance to the insurer, but the broker does, the application of s 21(1)(b) determines whether or not the insured has breached its duty of disclosure. For the purpose of this subsection, only knowledge which the broker had a duty to tell the insured may be taken into account.

However, s 21(1)(a) only has regard to the insured's actual knowledge not constructive knowledge. Accordingly knowledge cannot be attributed or imputed to the insured for the purposes of this subsection.

Carter Newell proud to sponsor Insurance Intensive 2011

Carter Newell is proud to once again sponsor the AILA and QLS Intensive 2011 to be held 2-3 June at the Sheraton Noosa Resort and Spa, Noosa Heads.

Designed for insurance lawyers, brokers, re-insurers and insurer representatives, the 2011 Insurance Intensive will equip attendees with the tools to deal with the emergent issues facing the industry.

The intensive, carrying the theme: **"Insurance - opening the flood gates"**, will feature experts from across Australia to provide thought leadership and debate as well as practical examples.

The program explores the implications arising from the spate of recent natural disasters, new areas to watch in claims including, nanotechnology and cybercrime, along with developing trends in liability.

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Carter Newell Special Counsel to present at Employment Law Intensive

Workplace Relations Special Counsel Stephen Hughes is set to present at the Tonkin Employment Law Intensive being held 23 May in Brisbane. The full-day program is tailored to inform and update those within HR, Employment Relations and Workplace Relations with the latest legal developments and implications that have arisen since the commencement of the National Employment Standards and Modern Awards.

For event information visit www.employmentlawintensive.com