COVER NOTES : REVIEW OF MAYNE NICKLESS v. PEGLER

Mayne Nickless v. *Pegler* [1] provides authority on two issues. One has universal application to cover notes written by Australian insurers, and the other, although not applicable to all cover notes, may have far-reaching consequences in those cases to which it does apply. The case has since been approved by the Privy Council [2] on the first issue, and it remains the only statement of the law on the second. It has been roundly criticized, both in Australia and in the United Kingdom.[3] The whole of the law of insurance is under review in Australia. In those circumstances, a further review of *Mayne Nickless* v. *Pegler* seems warranted.

The relevant facts in the case were simple enough. One, Koklas, purchased a new car. The vendor, a car dealer, telephoned an insurance company and arranged to insure the vehicle. A cover note was issued in these terms:

> "You are hereby covered from 2 p.m. 3/6/1968 to midnight 3/7/1968 (unless notice of cancellation be given in the meantime) for an amount of $900.00 on your motor vehicle."

The cover note was expressed to be,

> "Subject to the conditions of this Company's comprehensive motor car/vehicle insurance policy and a satisfactory proposal for your insurance."

The insurance company was not told before it issued the cover note that Koklas had four months earlier been involved in a car accident, and had unsuccessfully claimed upon his previous comprehensive insurer. Two days after the issue of the cover note, Koklas's new car, with him at the wheel, collided with a Mayne Nickless truck. The car was damaged and Koklas died of the injuries which he suffered in the accident. As he had not completed a proposal form, his widow completed one after his death. In her answer to a specific question in the proposal form Mrs. Koklas failed to disclose that her husband had been involved in the earlier accident, or that he had made the claim on his previous insurer.

The proceedings appear to have ricocheted to every corner of the Supreme Court of New South Wales, but the question which came to be answered by Samuels J. was whether, at the time of the accident, Koklas was insured by the cover note. The insurer had rejected a claim based on the cover note and argued that it was entitled to do so on two grounds: first, that the deceased's own failure to disclose his earlier accident had made the cover note voidable at the insurer's option; and secondly, that, as the cover note contract was subject to a "satisfactory" proposal being made, the widow's "unsatisfactory" proposal also gave the insurer the right to avoid the cover note. In either event, the company claimed that it was entitled to avoid the cover note *ab initio*, with

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1. [1974] 1 N.S.W.L.R. 228.
2. In *Marene Knitting Mills Pty. Ltd.* v. *Greater Pacific General Insurance Ltd.* (1976) 11 A.L.R. 167, 171-172.
3. See: Birds, "What is a Cover Note Worth?", (1977) 40 *M. L.R.* 79; Thomas, *Australian & New Zealand Insurance Reporter* (C.C.H.), Vol. 1, paras. 5-530, 5-540, 5-560; Thomas, *Guidebook to Insurance Law in Australia & New Zealand* (C.C.H., 1981), paras. 604, 605, 608.

the result that there had been no insurance in force at the time of the fatal accident.[4]

The judge agreed with both arguments. He found that the duty of disclosure applicable to insurance contracts applies to cover notes, and made that finding the basis of his decision.[5] He then proceeded to give his views on the effect of the provision in the cover note making it subject to the completion of a satisfactory proposal.[6]

Cover notes and the duty of disclosure

Samuels J. was unable to rely on any direct authority clearly affirming that the duty of disclosure applies in the cover note situation. The judge pointed out that cover notes are contracts of insurance and that there is no reason " in principle or good commercial sense" [7] why they should not be subject to the duty of disclosure. What authority there was supported that conclusion, at least in the sense that it assumed the existence of the duty in the cover note situation. The judge had been urged to find that even if a duty of disclosure existed, it was a different (and less onerous) duty in cover note cases. He was unconvinced:

> "I may say at once that, granted the existence of a duty to disclose, I can see no ground for diluting that duty when a cover note rather than a policy is in question. It is in each case a duty to disclose all facts material to the risk to be covered." [8]

That left the question: what is the proper test of materiality? After a careful review of the conflicting authorities, the judge decided in favour of the so-called "prudent insurer" test.[9] This necessitated the decision in favour of the insurer.

The essence of the criticisms which have been made of this aspect of the decision is that it renders illusory the protection offered to the insured by the cover note procedure. Birds appears to have no quarrel with the decision as a statement of the existing law.[10] He nonetheless argues

> "... that the circumstances of the issue of cover-notes do not lend themselves to more than a duty to disclose 'those matters which would create a situation where no reasonable person would believe that an insurer knowing those facts would grant cover' — the argument put forward for Pegler." [11]

This is, in effect, an argument for a different test of materiality in relation to cover notes. Thomas, on the other hand, strongly criticizes the decision on legal grounds.[12] He argues that the informality of the circumstances in which a cover note is usually issued raises an estoppel preventing the insurer from

4. [1974] 1 N.S.W.L.R. 228, 232.
5. *Id.*, 234.
6. *Id.*, 240-243.
7. *Id.*, 234.
8. *Id.*, 234-235.
9. *Id.*, 239.
10. *Loc. cit.* (*supra*, n.3), 80, n.7.
11. *Id.*, 81.
12. *Op. cit.* (*supra*, n.3).

relying on the insured's duty of disclosure.[13] He cites several authorities in support of this proposition.[14]

With one exception, the authorities cited by Thomas are not cover note cases, and provide no direct authority for what occurs in the cover note situation. The exception is *Johnson* v. *Guardian Assurance Co. Ltd.*,[15] a decision of the Full Court of the Supreme Court of New South Wales. In the course of purchasing a property at Hay, Johnson arranged through his agent for the issue of a cover note for fire insurance on the property. The cover note was issued for the usual period of one month and was later extended for a further month. During the period of the extension the premises were damaged by fire. Johnson was Greek by birth and had been the victim of previous fires. Neither of those facts had been disclosed to the insurer, which sought to rely on the non-disclosures to deny liability for Johnson's most recent misfortune. Johnson's claim against the insurer was tried by jury. The jury found for Johnson. The insurer appealed to the Full Court of the Supreme Court of New South Wales.

It appears from the report of the decision that the issue at the trial was the materiality of the facts which were not disclosed. Expert evidence had been led by the insurer with a view to establishing that the facts were material. The jury found, as a matter of fact, that the non-disclosure was immaterial. It was against this finding of fact that the insurer appealed.[16] The only question for determination by the Full Court was whether or not it was open to the jury, on the evidence, to make such a finding. Whether the duty of disclosure applies to the cover note situation was not in issue. Halse Rogers J. delivered the only judgment, Jordan C.J. and Harvey C.J. in Equity concurring. The following critical passage sets out the basis of the judgment of Halse Rogers J.:

> "It is open to an insurance company to obtain a properly filled in proposal before issuing any cover, but if it does not adopt this course and issues cover without asking any questions, it is really making a contract different from the usual contract.
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> [The insurer] argued that so far as concerns the omissions now under consideration, the absence of a proposal and the failure of the company to ask questions are immaterial, because this particular contract, like every other insurance contract, is *uberrimae fidei,* and there was a duty on the plaintiff, apart from any express condition, to disclose to the company all matters which might influence a reasonable person on the question of whether the risk should be accepted or rejected.

13. This is the view which he expresses in his *Guidebook,* (*supra,* n.3), para. 605. In his earlier work (*Australian & New Zealand Insurance Reporter*) he argues that there is a waiver by the insurer (para. 5-560, p.10,742), although later in the same paragraph he refers to the possibility of an estoppel (p.10,744). It is assumed that estoppel is the basis of the argument, as it seems to place more emphasis upon what the insured is led to believe than on what the insurer intended him to believe. This is made apparent by Thomas's statement that the insurer "... will be *deemed* to have waived the duty of disclosure..." [Emphasis added] (p.10,744). (For a discussion of the difference between estoppel and waiver in insurance contracts see Sutton, *Insurance Law in Australia & New Zealand* (1980), ch.11, 424 *et seq.*).
14. The authorities are: *Johnson* v. *Guardian Assurance Co. Ltd.* (1931) 31 S.R. (N.S.W.) 386; *Western Australian Insurance Co. Ltd.* v. *Dayton* (1924) 35 C.L.R. 355; *Maye* v. *C.M.L.* (1924) 35 C.L.R. 14; *Lickiss* v. *Milestone Motor Policies at Lloyds* [1966] 2 All E.R. 972.
15. (1931) 31 S.R. (N.S.W.) 386.
16. *Id.,* 390.

> It being conceded that there was such a duty on the plaintiff to disclose all material matters, and it being also conceded that it was for the jury to decide as to whether any information omitted was material, the question for our determination is whether the evidence as to materiality was all one way, or whether there was evidence which entitled the jury to refuse to accept what was referred to as the unchallenged evidence of the insurance managers.
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> On the question of materiality the plaintiff claimed that the conduct of the company in this very case could be regarded by the jury as evidence to be put in the scale against the oral testimony of the managers. In my opinion that contention is sound. The outstanding facts were the form of contract, and the actions of the company in that they did accept the risk without asking any questions and without bringing under plaintiff's notice the form of proposal or policy, and that they held the insured covered for a month still without any questions, and then in the same state of ignorance extended the cover for another month. In my view, it was open to the jury to find on that evidence that in making contracts of this kind the insurers did not take into consideration matters similar to those considered when determining whether or not a policy should be issued, but were willing, without any consideration of the history or nationality of the proponent, to take whatever risk might arise up to the time of the receipt of a proposal duly completed; and that the company did so as a matter of business and with a view to securing as many clients as possible." [17]

Thomas regards this passage as a statement of the proposition that the circumstances in which cover notes are most usually issued raise an estoppel preventing the insurer from relying on the duty of disclosure.[18] It is difficult to see how the passage cited could be so interpreted. Certainly it makes reference to the insurer's conduct as a relevant factor, but the context is not that of an estoppel by conduct. It is no part of this decision that the insurer is estopped from relying on the duty. The issue was materiality. If the insurer had been estopped from relying on the non-disclosure of a particular fact, the materiality of that fact would never have become relevant. Although *Johnson's* case is not, therefore, authority for Thomas's argument based on estoppel, that is not to say that there is no merit in the argument. There may certainly be circumstances in which an insurer is estopped by reason of his conduct from relying on the non-disclosure of a particular fact or facts. But there is no authority to the effect that a mere failure to ask questions of a proponent can amount to an estoppel against the insurer.[19]

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17. *Ibid.*
18. *Supra,* n.13; particularly the later work where, however, he omits the second and third paragraphs from his citation of the passage.
19. See *MacGillivray and Parkington on Insurance Law* (6th ed., 1975), p. 333, para. 799: "Quite apart from any statements made by the assured which ground the waiver the assured can *assume that the insurers are waiving disclosure* of matters concerning which they appear to be indifferent or disinterested. The mere fact that a *prima facie* material matter is not made the subject of a question in the proposal form is not, however, a ground for inferring such a lack of concern." [Emphasis added]. The words "the assured can assume", it is submitted, are a reference, not to waiver, but to circumstances raising an estoppel. See *supra,* n.13. The distinction is unimportant in the context in which the passage appears.

Pervaded as it is by the assumption that the duty of disclosure applies to all forms of insurance contracts, including cover notes, *Johnson's* case was clearly given its proper effect by Samuels J. in *Mayne Nickless* v. *Pegler.*

As Birds appears to concede, and the above analysis confirms, *Pegler's* case is correct in law. *Johnson's* case does, however, suggest a way in which the application of the duty of disclosure to cover notes might be ameliorated. It might well be thought unjust to require the applicant for insurance to disclose, at cover note stage, all the facts which he is required to disclose at proposal stage. It might also be thought that the law should take some account of the essential informality of the cover note procedure. The applicant is certainly under a duty, at both cover note and proposal stages, to disclose all material facts. But the test of what is material may be sufficiently flexible within itself to take account of the differences between the two stages.

At the centre of the duty of disclosure is the insurer's need to be able to assess its risk. It is entitled to insist only on disclosure of those facts which are relevant[20] to the risk it is being asked to accept. At cover note stage, the risk which the insurer accepts is different from that which it accepts at proposal stage. At the former stage, the insurer is concerned only to determine whether or not to accept the risk *at all.* Having decided to do so, it accepts the short term risk and then investigates the applicant (usually by means of a proposal form) to determine whether or not to accept the long term risk, and if it does so decide, upon what terms as to premium and otherwise. Because the risk is to be brief in duration, the insurer is prepared to be told less. The acceptance of a higher risk over a shorter term is what cover notes are all about. A flexible application of the materiality test would take this into account. There may be no need for a different test to allow for the more informal approach to the issue of cover notes. What is material for full term insurance may not be material for interim cover.

Johnson's case itself provides an illustration of the way in which the one materiality test can reach a different result according to the stage which the insurance transaction has reached. It will be remembered that the facts not disclosed in *Johnson's* case were the nationality of origin and the previous fire experience of the plaintiff. The jury found that those facts were not material in the circumstances (that is, at the cover note stage). There is authority to suggest that, at the proposal stage, those facts would have been material.[21] Halse Rogers J. said that the jury was entitled to take into account the informal nature of the cover note situation in deciding what was material.[22] He appears to have had in mind a test which would not now be considered the correct test of materiality. Had he been thinking of the "prudent insurer" test, his Honour would presumably have said that the jury was entitled to take into account the practice of the insurance industry in regard to cover notes, rather than the conduct of the particular insurer. None of this alters the fact that the case is authority for the following propositions:

20. That is, to a *prudent* insurer: see *Marene's* case (1976) 11 A.L.R. 167. See, also, the interesting recent decision of the Full Court of the Supreme Court of Queensland in *Visscher Enterprises Pty. Ltd.* v. *Southern Pacific Insurance Co. Ltd.* [1980]Australian & New Zealand Insurance Reports 77,116.
21. See cases cited in Sutton, *op.cit.* (*supra,* n.13), 112, n.74 (previous fire) and 113, n.78 (foreign birth). The latter would now be far less likely to be considered as being material at any stage.
22. (1931) 31 S.R. (N.S.W.) 386, 391.

(a) that the duty of disclosure applies at cover note stage;

(b) that the duty is, at that stage, no less than it is at any later stage, a duty to disclose all material facts; and

(c) that the test of materiality is sufficiently flexible to reflect the difference between the risks which insurers accept at each stage.

The finding on the facts in *Pegler's* case is quite consistent with the foregoing.[23] Non-disclosure of a previous recent accident and refusal of claims would, it is submitted, always be relevant at both cover note and policy stages.[24]

It must be admitted that once one has ventured beyond the fact situation in *Johnson's* case, the distinction which that case suggests between facts which are material at cover note stage and those which are material at policy stage, is very difficult to pin down. It is tempting to express the distinction in terms of facts going to the moral hazard, and facts going to the statistical hazard; to say, in other words, that the former must always be disclosed to the insurer, while the latter need not necessarily be disclosed at cover note stage. While it can clearly do no more, it is submitted that this notional distinction may provide a starting point for the application of the materiality test in cover note cases.[25]

Of course, the suggestion that there may be some (albeit ill-defined) distinction between facts which are material at cover note and policy stages does not meet all the criticisms which may be made of imposing a duty of disclosure at cover note stage. Nonetheless, it would allow more flexibility in the case-to-case application of that duty, and would provide a means of avoiding unjust consequences in hard cases.

Cover notes expressed to be subject to a satisfactory proposal

It has already been noted that Samuels J. was not bound to consider the second ground of the insurer's defence, which required construction of the provision purporting to make the cover note subject to the completion of a satisfactory proposal. His Honour did, however, express a considered view of the matter. The insurer argued that the provision was a condition precedent and that failure to provide a satisfactory proposal meant that no liability to indemnify ever arose.[26] The insured argued that it was a condition subsequent and that the insurer was at risk at least until it received an unsatisfactory proposal.[27] The judge did not decide whether the condition was a condition precedent or subsequent and pointed out that even if it had been a condition subsequent, its failure would not necessarily have had the effect for which the insured had argued:

> "In my view, the matter is not to be determined by selecting categories ... but by determining as a matter of construction what the indorsement

23. The decision in *Club Development and Finance Corporation Pty. Ltd.* v. *Bankers & Traders Insurance Co. Ltd.* [1971] 2 N.S.W.L.R. 541 is also consistent with the argument, but does not advance the matter because the facts there not disclosed would not have been material at any stage.

24. It can hardly be said that the refusal of the cover based on non-disclosure of those facts did any injustice. Birds, in fact, agrees. See Birds, *loc. cit.* (*supra,* n.3), 82, n.19.

25. No higher claim is possible. To note only one of the obvious difficulties, moral hazard and statistical hazard are overlapping concepts.

26. [1974] 1 N.S.W.L.R. 228, 240.

27. *Id.,* 240-241.

> was intended to effect. In my view, its purpose was to ensure that no binding contract of insurance ever came into effect unless and until a satisfactory proposal... had been furnished by or on behalf of the deceased. Let it be assumed that a proposal was furnished which plainly indicated that the offer was one which no prudent insurer would reasonably accept. It could not be intended that, none the less, the insurer should be unconditionally on risk until the proposal was received. If that were so, and I leave out of account any duty to disclose at common law, a cover note might become a means of deceit."[28]

The judge decided that the insurer was entitled to avoid its contract *ab initio* if it had not received a satisfactory proposal. He then decided that the proposal was not satisfactory because " ... upon any view, a proposal which contains a mis-statement of fact which would amount to a breach of warranty and which conceals ... a fact material to the risk, cannot be satisfactory." [29] While he did not therefore need to define "satisfactory" for the purpose of his decision, Samuels J. did speculate upon what that definition might be:

> "Hence, it seems to me that 'satisfactory' cannot mean formally satisfactory in the way contended for by [counsel for the insured]. Equally it cannot mean that the criterion is to be left solely to the unfettered and possibly capricious judgment of the company itself. If one draws an analogy from the law relating to the materiality of facts, it appears reasonably clear to my mind that 'satisfactory' should be construed as meaning a proposal which would be acceptable to a prudent and reasonable insurer. Or, indeed, it may be that a negative criterion should be applied; that is to say, that a proposal is not satisfactory if it was reasonably open to a prudent insurer so to regard it. And, of course, the insurer in question must have himself come to that conclusion." [30]

If this is what "satisfactory" means, the insured will not get his temporary cover if a prudent insurer would reasonably have refused him full term cover. Quite apart from any other effect which it may have, the effect of a "subject to satisfactory proposal" condition in a cover note is to force the insured to disclose at cover note stage all the facts which he is required to disclose at proposal stage. If the distinction suggested in the previous section of this paper[31] is correct, the effect of the "satisfactory proposal" condition must be to require the insured to disclose more at cover note stage than he would otherwise have had to disclose at that stage. In those circumstances, whether or not he is actually "covered" by the cover note becomes even more uncertain.

Birds and Thomas both criticize the second aspect of the decision in *Pegler's* case. Both commentators give several reasons for saying that the judge's decision was incorrect in law. Birds says that the offending condition should be construed *contra proferentem,* and that the result of so construing it would be that it had no more effect than to warn the insured " ... that it will be necessary to complete a proposal form before a proper policy is issued."[32] He

28. *Id.*, 241.
29. *Id.*, 243.
30. *Ibid.*
31. *I.e.*, the distinction between facts material at cover note and policy stages.
32. *Loc. cit.* (*supra,* n.3), 81.

goes on to suggest that the judge might have been able to find " ... that a binding oral contract of insurance was concluded by phone before Koklas received the cover note ..." [33] with the result that the condition in question was never a part of the contract. The first argument is unconvincing. The phrase "Subject to" is hardly ambiguous. It is commonly used by draftsmen to introduce a condition to a contract.[34] Birds' second argument assumes (correctly, no doubt) that Koklas was not told of the condition in the cover note before it was issued. Samuels J. did not make any finding on that point, presumably because he did not regard the state of Koklas's mind to be relevant. The difficulty with Birds' argument on this point is that it seems to assume that an insurer might be prepared to enter into an oral contract of insurance in which the usual terms (including, if it was a usual term, the "subject to satisfactory proposal" condition) of its cover note were not to be implied. That seems most unlikely. An insurer will only offer temporary cover on the terms contained in its cover note.[35] If that is so, there seem to be two alternative ways of viewing the situation. Either the contract of temporary insurance incorporates the usual terms of the insurer's cover note or (which seems most unlikely) the contract is able to be vitiated by reason of mutual mistake.[36] From the insured's point of view, the second alternative would be even worse than the first.

Thomas uses arguments similar to those discussed above in criticizing the second aspect of the *Pegler* decision. He argues that since the "subject to satisfactory proposal" condition is a provision which is unusual in terms of general insurance industry practice, the insurer must, if it intends to rely on the condition, give notice of its inclusion in the cover note before the cover note issues.[37] The argument seems to be based on the view that an oral contract is concluded before the issue of the cover note, which oral contract contains different terms. Reasons have already been given why it is thought that this argument is unlikely to succeed. Thomas also suggests that the condition is severable, presumably upon the ground that it is so unreasonable as to be void. Such an argument gains some, although not strong, support from the line of cases which includes the High Court decision in *Commissioner for Railways (N.S.W.)* v. *Quinn*.[38] Thomas suggests that the inclusion of the "satisfactory proposal" condition in a cover note without specific notice to the insured might constitute misleading or deceptive conduct within the meaning of s.52 of the Trade Practices Act 1974.[39] Whether that was so would depend upon the

33. *Id.*, 82.
34. The phrase "Subject to" has this effect in relation to the "usual terms and conditions" part of the same clause. It is, in that context, more than explanatory because it affects the terms upon which the cover is given (see *MacGillivray & Parkington on Insurance Law, op. cit.* (*supra,* n.19), p.118, paras. 284, 285.) That being so, the one phrase "Subject to" would have two meanings in the same sentence, if Birds' argument were correct.
35. The fact that many, if not all, of the terms of the insurance contract are unknown to the insured is not unique to the cover note stage. Acceptance of the insurer's conditions, unseen and unknown, certainly occurs all the time at policy stage.
36. There is a third alternative; namely, that any uncertainty as to the terms of the contract might be resolved in favour of the insured. That would seem a very remote possibility indeed. See, generally, Cheshire & Fifoot, *The Law of Contract* (3rd Australian ed., Starke & Higgins (eds.)), 249 *et seq.*
37. *Guidebook, op. cit.*(*supra,* n.3), para. 608.
38. (1946) 72 C.L.R. 345.
39. *Guidebook, op. cit.*(*supra,* n.3), para. 608.

facts, and the cause of action might be difficult to establish. Section 55A of the Act might well assist the insured.

Both Birds and Thomas take the view that if *Mayne Nickless* v. *Pegler* is correct in this aspect of its decision, "satisfactory proposal" conditions operate unfairly against the insured in that they give with one hand and take away with the other.[40] With that conclusion one must agree.

An argument which might be used against such provisions is that, since their effect is extraordinary, there is a duty on the insurer to disclose to the insured, prior to the formation of the contract, that it will contain the relevant condition. Authority makes it clear that the duty to act in good faith is not confined to the insured.[41] If that is so, it could possibly be argued that the insurer is estopped from relying upon an undisclosed condition of that type.[42]

It may be useful to add, before leaving the present subject, that it does not follow from the decision of Samuels J. that, where the cover note contains a "satisfactory proposal" condition, cover can never pre-date the proposal form unless the proposal results in the issue of a policy. That is to say, upon the delivery of a satisfactory proposal the insured can obtain cover in respect of a loss which has already occurred, even though by reason of that loss no policy will ever issue.[43]

Conclusion

This commentary has been restricted to an analysis of the law as it stands after *Pegler's* case. That is not to say that the writers are in favour of retaining the duty of disclosure in its present ambit, either in relation to cover notes or to insurance contracts generally. There have been proposals made for the reform of the materiality test.[44] Whatever test is eventually adopted, it is submitted that the same test should apply at both the cover note and proposal stages. The most likely effect of openly adopting a significantly different test of materiality for cover notes would be to make cover notes less attractive, ultimately, to insurers. The consequent reduction in the availability of interim

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40. Neither Birds nor Thomas actually considers whether the inclusion of such a condition takes matters any further than the application of the duty of disclosure. This is presumably because both of them would see the condition as reintroducing a full duty of disclosure into a situation in which either there is, or should be, a lesser duty or no duty at all.
41. See, *e.g.*, the judgment of Murphy J. in *Deaves* v. *C.M.L. Insurance* (1979) 23 A.L.R. 539, 580, and the authorities there cited. Unfortunately, the Courts appear to have been blind to the possibilities inherent in the doctrine of good faith as applied to the insurer rather than the insured.
42. See the remarks of Dixon J. (as he then was) in *Thompson* v. *Palmer* (1933) 49 C.L.R. 507, 547: "The object of estoppel *in pais* is to prevent an unjust departure by one person from an assumption adopted by another as the basis of some act or omission which, unless the assumption be adhered to, would operate to that other's detriment. Whether a departure by a party from the assumption should be considered unjust and inadmissible depends on the part taken by him in occasioning its adoption by the other party. He may be required to abide by the assumption *because it formed the conventional basis upon which the parties entered into contractual or other mutual relations,* such as bailment: or because he has exercised against the other party rights which would exist only if the assumption were correct ..." [Emphasis added].
43. Thomas's remarks on this point (see *Australian & New Zealand Insurance Reporter, op. cit.* (*supra,* n.3), para. 5-530, p.10,701) are not clear. It may be that he argues that no loss which occurs before the acceptance of a satisfactory proposal will be covered by the cover note. If that is his argument, it is respectfully submitted that he is incorrect.
44. Law Reform Commission (Aust.) Discussion Paper No. 7, *Insurance Contracts* (1979), para. 38, pp. 24-25; the Law Commission (U.K.) Working Paper No. 73, *Insurance Law: Non-Disclosure and Breach of Warranty* (1979), para. 97, pp. 56-61.

cover would not be in the public interest. Clauses making cover notes subject to the completion of a satisfactory proposal should, on the other hand, be prohibited. They are unfair to the insured, in that they import into an informal insurance transaction all the features of the formal insurance contract (including, if the foregoing analysis of *Johnson's* case is correct, a duty to disclose facts which might not otherwise have been material at cover note stage). The use of such clauses is not, apparently, so widespread that their proscription will affect the viability of the cover note system. They should simply be rendered ineffective.[45]

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45. See Law Reform Commission (Aust.) Discussion Paper No. 7, *op. cit.* (*supra*, n.44), para. 39, p. 25.

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