Uberrima Fides in Marine Insurance Contract; Fairness, Commercial Suitability and Possible Reforms

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Introduction

Parties in insurance contracts are under a duty to act in utmost good faith – *Uberrima fides*. However, there is no clear definition on *utmost* good faith. Strain defined Uberrima fides as "firm adherence to promises made to another including disclosure of all relevant facts and complete trust in the fidelity of the other."[1] There has been controversy as to the duties said to flow from the duty of utmost good faith. The author suggests that the pre-contractual duties that are often categorised as flowing from the good faith principle are in fact minimum functionality rules necessary to contracts of speculation. Utmost good faith does not and should not have anything to do with the imposition of duties and there is no need to refer to a duty of utmost good faith as a guiding principle. As to the post-contractual context of duties between insurers and assureds, there is a growing understanding that utmost good faith is irrelevant. In addition to the above, the utmost good faith concept should be abandoned as a guiding principle or a general duty due to its uncertainty that negatively impacts commerce and unduly prejudices the assureds. Until the legislature takes a step towards this direction, the courts could equate the utmost good faith duty in s.17 of the Marine Insurance Act 1906 with the duties of disclosure and non-misrepresentation. Finally, it can be strongly argued that the remedy for breach of the duties of the assured is too harsh and disproportionate.

[1] Robert W Strain *'Reinsurance'*

The first part of the article will analyse the emergence of the duty of good faith. The second part will discuss the duty's codification in statute and the duties said to be flowing from it, as found in statute. The third part will discuss the breach of duties and the final part will comment on proposals for reform. The aim of this article is to offer fresh perspectives on the understanding and application of the duty of utmost good faith and to contribute to the existing area of study.

<u>The Duty of Uberrima Fides</u>

A.1 Historical Background and Rationale

Insurance contracts are contracts of speculation[2]. A contract of speculation is one where the insurer calculates the risk of an event occurring and guarantees to pay the assured a certain amount of money if that event occurs in return of a premium. In order to calculate the risk, an insurer must be aware of all material facts that would affect the odds of an event occurring or not. The common law places a certain duty of disclosure and honesty on the assured known as utmost good faith-*uberrimae fidei,* since knowledge of the relevant circumstances lies with the assured.[3] Lord Mansfield gave the classic statement describing the good faith principle in *Carter v Boehm*[4] and suggested it is a doctrine that governs *all* dealings:

"Insurance is a contract of speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the assured only; the underwriter trusts to his representation and proceeds upon confidence that he does not keep back any circumstance in his knowledge to mislead the underwriter into a belief that the circumstance does not exist. The keeping back such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent

[2] *Carter v Boehm* (1766) 3 Burr 1905
[3] *Greenhill v Federal Insurance Co Ltd* [1927] 1 KB 65, 76-7
[4] (1766) 3 Burr. 1907

intention, yet still the underwriter is deceived and the policy is void; because the risqué run is really different form the risqué understood and intended to be run at the time of agreement… the policy would be equally void against the underwriter if he concealed… good faith forbids either party, by concealing what he privately knows to draw the other into a bargain form his ignorance of the fact, and his believing the contrary."

In subsequent insurance cases Lord Mansfield expressed the same rationale and the wording of good faith, not "utmost" good faith.[5] In the case of *Bates v Hewitt*[6] the shift in emphasis of the duty was evident despite the court not using the wording utmost good faith. Shee J acknowledged that the insurer had constructive knowledge of the material facts relevant in the case but found that the insurer was under no onus to make enquiries. This contrasted Lord Mansfield's decisions. Lord President Inglis in *Life Association of Scotland v Foster* adopted the term *Uberrima fides* - utmost good faith.[7] The term was later incorporated into the Marine Insurance Act 1906. Lord Scrutton in *Rozanes v Bowen*[8] after referring to the same rationale as Lord Mansfield, once again referred explicitly to the insurance contract being of <u>utmost</u> good faith. Focusing on the imbalance of information, his Lordship said the assured is required to disclose all material facts the assured knows, irrespective of whether he was asked. Lord Scrutton said:

"It has been for centuries in England the law in connection with insurance of all sorts, marine, fire, life, guarantee and every kind of policy that, as the underwriter knows nothing and the man who comes to him to ask him to insure knows everything, it is the duty of the assured, the man who desires to have a policy, to make full disclosure to the underwriters without being asked of all the material circumstances, because the underwriter knows

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[5] *Noble v Kennoway* (1780) 99 Eng Rep 326; *Mayne v Walter* (1782) 99 Eng Rep 548; *Frier v Woodhouse* (1817) 171 Eng Rep 345
[6] *Bates v Hewitt* (1867) 2 LRQB 595
[7] *Life Association of Scotland v Foster* (1873) 11 M. 351
[8] (1928) 32 L.I.L.R. 98

nothing and the assured knows everything. That is expressed by saying that it is a contract of the utmost good faith – Uberrima fides." [9]

Three issues arise out of Lord Mansfield's statement in *Carter* and the subsequent case law. The first is what is the meaning of good faith and what do we mean by utmost good faith? The second issue is whether it indeed applies in all dealings as Lord Mansfield said and the third issue is whether the law has evolved on mistaken foundations and the possible ramifications of such a circumstance.

While after the decision in *Carter* English law developed the idea that contracts of insurance are contracts of utmost good faith, there has been some confusion in relation to the meaning of utmost good faith. It is clear from case law that the duty includes the duty of the assured to make disclosure of material facts and avoid the misrepresentation of material facts to the insurer. According to *Carter*, it will also include a duty on the insurer to be pro-active and ask questions to inform himself of the material facts. However, the duty on the insurer is low.

Some have expressed the opinion that the English utmost good faith principle includes something more than those pre-contractual duties,[10] a post contractual ambit, and there has been a tendency to use it as a guiding principle of qualitative behaviour.[11] However as to its post-contractual dimension, there was incoherence as to the explanation of the duties as flowing from good faith that resulted in the rejection by the authorities. As to being used as a guiding principle of qualitative behaviour this has not been consistent, its use has been confusing and it has been at times self-contradictory.

Turning to whether the concept of good faith is of a general application to all contracts, as Lord Mansfield in *Carter* suggested, this has not proved to be the case. English law as

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[9] ibid p. 102
[10] see below
[11] for example Lord Mustill in *Pan Atlantic v Pine Top* [1995] 1 AC 501

developed rejected Lord Mansfield's suggestion[12] since it would be a move away from the adversarial system of contract[13] and the rule of *caveat emptor,* buyer beware.[14] This therefore raises the question why such a concept should exist in marine insurance specifically and/or insurance law generally. The answer lies in the different meaning it was given in English law rather than the Civilian concept or as to the meaning adopted in Australia, Canada and New Zealand. Utmost good faith in insurance law relates to pre-contractual obligations of honesty whereas good faith as a doctrine or principle of contract law in the other jurisdictions is taken as a qualitative measure of performance of duties and rights in a contract implied by law.[15] According to Lord Hobhouse in the *Star Sea*[16], the phrase "utmost" good faith was coined to distinguish those transactions to which the principle still applied. However, the different meaning of utmost good faith and good faith leads to the inference that it may not be what Lord Mansfield had in mind when his Lordship referred to 'good faith'.

Looking at the third issue, whether the law has evolved on mistaken foundations, as Johan Botes illustrates[17] Lord Mansfield seemed to be influenced by the Civilian concept of good faith. But the concept was changed in the subsequent decisions that were mentioned above. Lord Mansfield intended to use the duty of good faith in its role as setting minimum standards of qualitative behaviour and as Botes suggests thus favoured a narrow duty of disclosure. This duty focused on information the insurer did not possess. But knowingly or not the duty changed to a broader duty of disclosure, described as 'utmost good faith' astonishingly with expressions of similar rationale to Lord Mansfield's. Jervis points out the substantial difference between *good faith* and *utmost good faith.* In relation to the former "no information need to be volunteered; the statements need not be absolutely 100% accurate just

[12] for detail see Mason "*Contract, good faith and equitable standards in fair dealing*" LQR 2000
[13] ibid
[14] Lord Atkin in *Bell v Lever Bros Ltd* [1932] AC 161,227
[15] see Gummow J's judgment in the Australian decision *Berg Bennett & Associates Pty. Ltd* (1993) 117 A.L.R 393
[16] [1997] 1 Lloyd's Rep 360
[17] Johan Botes "*From Good Faith to Utmost Good Faith in Marine Insurance*" (Peter Lang, 2005) p.98-99

substantially true"[18] whereas the latter requires the disclosure of "all facts that might affect the judgment of a prudent insurer."[19] It is submitted that when utmost good faith is defined as relating only to the pre-contractual duties of the assured or the insurer, it is not problematic irrespective of how it evolved. But as a guiding principle and the reason for having those duties it is.

A.2 Marine Insurance Act 1906 (MIA 1906)

The MIA 1906 "embodies a partial codification of the common law"[20] in sections 17-20. S.17 places a general duty of utmost good faith on both parties, whereas ss.18 and 19 refer to disclosure by the assured and the insurer respectively. S.20 relates back to the disclosure.

<u>Section 17 – Insurance is *uberrimae fidei*</u>

Section 17, often described as a reciprocal duty, states that:

"*A contract of marine insurance is a contract based upon the utmost good faith, and if the utmost good faith be not observed by either party, the contract may be avoided by the other party.*"

The fallacy of using a general concept of utmost good faith has crept into statute. As Lowry illustrates,[21] s.17 codified the prevailing common law rather than Lord Mansfield's judgments and does not mirror Lord Mansfield's intentions. Further, section 17 does not define utmost good faith. It has been argued by Hendrick Botes that "good faith, as the contractual principle from which utmost good faith mutated is known in the civilian legal tradition, is a principle that does not allow of a definition, it being by its very nature a flexible,

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[18] Barrie Jervis *"Reeds marine insurance"* (Adlard Coles Nautical 2005) p. 18
[19] ibid
[20] per Lord Mustill in *Pan Atlantic Insurance Ltd v Pine Top Ltd* (1994) 1 AC
[21] Lowry "*Whither the duty of good faith in UK insurance contracts*" CILJ

imprecise and evolving concept."[22] It is the author's view that such concepts do not have a place in commercial law. Firstly, it is a given that commercial law requires certainty and secondly there is no need in either insurance or general contract law for a general concept of good faith to define culpability. Even if one were to define culpability by notions of good faith, one would have to define good faith. One could say that good faith is the opposite of fraud but if it is the opposite of fraud why not ban fraud, which is a well-known concept? 'Utmost good faith' as it is used is wider than the opposite of fraud. A policy will be voidable for innocent misrepresentation of material facts or material non-disclosure. Therefore either the utmost good faith principle punishes non-culpable actions and as such it is conceptually self-contradicting or the utmost good faith principle does not apply in all circumstances. In either case, the obvious question is why have it? It furthers certainty to have easily explainable concepts such as duties not to misrepresent or to disclose information to the insurer without a reference to utmost good faith.

Johan Botes suggested that the principle of Uberrima fides requires the assured to respond honestly to questions put to him by the insurer. This gives rise to the conceptual issue of whether it is actually the principle of utmost good faith that requires an honest response. There has been a tendency in the judiciary to suggest that disclosure of material facts and non-misrepresentation as being required by good faith, something that implies culpability.[23] Culpability may have a subjective standard such as when the conscience of the assured is affected or an objective standard such as that stated by Lord Steyn in *First Energy (UK) Ltd v Hungarian International Bank Ltd*[24] that it is based on the 'reasonable expectations of honest men'.

[22]above n. 17 p. 117
[23] Lord Mustill in *Pan Atlantic*, the Litsion Pride
[24] [1993] 2 Lloyd's Rep. 194 in Mason above. 12

However on a closer reading of Lord Mansfield's decisions and later case law, it seems that culpability standards are not required. In fact considering culpability was often self-contradicting. The author suggests that the pre-contractual duties of the assured are required in order for a contract of speculation to be workable, without notions of culpability. Since the law is focused on the effect of the misrepresentation or non-disclosure it seems there is no actual assessment of culpability or a need to do so. The primary aim in all decisions was to address the imbalance of information. Lord Mansfield's decisions referred to above, support the proposition that lack of good faith was a complementary or parallel characterisation that is not necessary in every situation. In *Carter,* his Lordship was clear that even in the absence of fraud or lack of good faith an insurer will also be able to set aside an insurance policy for material non-disclosure or misrepresentation because the "risqué run [is] different than the risqué understood."[25] Thus inadequate knowledge of all the information by the insurer is the underlying reason why such contracts of speculation are to be avoided. Thus material non-disclosure and misrepresentation are punished because positive disclosure and honesty are minimum functionality rules. This was further supported in the landmark case of the *Star Sea* where Lord Hobhouse said, "[the reason for avoidance] thus was not actual fraud as known in common law but a form of mistake of which the other party was not allowed to take advantage."[26] Finally, the remedy of avoidance instead of damages also points to the effect that culpability is not considered. It is submitted that the explanation of the duties being minimum functionality rules should be preferred and notions of utmost good faith abandoned.

Further, s.17 illustrates a shift from the common law position stated by Lord Mansfield in *Carter* that the contract is void, to a position that the contract is *voidable*. The final point on s.17 is the use of the words *either party,* which makes it clear that the duty of utmost good

[25] Lord Mansfield in *Carter v Boehm*
[26] above n.16

faith operates on a reciprocal basis. Slade LJ observed the mutuality of obligation in the case of *Banque Keyser Ullmann v Skandia*[27]:

"The obligation to disclose material facts is a mutual one imposing reciprocal duties on insurer and insured. In the case of marine insurance contracts, section 17 in effect so provides."[28]

While s.17 refers to duties being reciprocal, it is hard to envisage any actual duties that the insurer is under that flow from the utmost good faith principle. If the insurer commits fraud then, it is the fraud itself as defined in common law that would be the reason for avoidance and there is no need for a concept of good faith. Perhaps, culpable behaviour on behalf of the insurer, such as being aware of information and not disclosing that or making vague questions, should be a bar towards arguing a breach of s.17 or the following sections by the insurer, but s.17 does not provide so. S.17 only provides for the remedy of avoidance and this is inadequate for the assured.

Conceptually the duty of utmost good faith of the insurer is also irrelevant when considering the duty of the insurer to ask questions of facts he is presumed to know under s.18(3) of the MIA 1906.[29] The court in *Cohen*[30] held that the insurer had waived disclosure by failing to ask such questions. Waiver and utmost good faith do not have a similar rationale. Waiver is a neutral act of affirmation, which, if proven, is conclusive evidence of intention recognised in the law. Finally, actual or presumed knowledge of the insurer addresses the imbalance of information and as such there is no need for disclosure by the assured.

<u>Section 18 – Disclosure by assured and Section 19 – Disclosure by agent affecting insurance</u>

[27] [1987] 1 Lloyd's Rep 69
[28] ibid p.93
[29] *Cohen v Standard Marine Insurance Co* (1925) Comm.Cas.139
[30] ibid

Sections 18 and 19 operate together to impose an obligation of disclosure on the assured and its agents. In this part of the article references to the assured and the agent will be treated interchangeably since they have a common interest. Section 19 of the MIA 1906 requires disclosure by an agent to the insurer of every material circumstance, which he is deemed to know and every material circumstance, which the assured is bound to disclose.[31]

Under section 18 "*the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract."*

The duty of the assured to disclose material facts is a 'positive' rather than a 'negative' duty requiring the assured to disclose even without being asked.[32] Section 18(2) provides the test for materiality:

"*Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk."*

Authority for the prudent insurer test derived from *Ionides v Pender*[33]. Various cases have considered the actual threshold of materiality and as Bennett[34] points out the standard is not high. In *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd*[35], the CA decided that the phrase 'influence the judgment of a prudent underwriter' did not require a significant influence on the prudent underwriter's decision but an impact on his calculation of the risk. This means that even if a prudent underwriter would have accepted on the same terms a different i.e. higher risk, the actual underwriter would be

[31] see E R Hardy Ivamy *'Chalmers' Marine Insurance Act 1906'* (Tottel Publishing 10th ed. 2007) p. 32
[32] ibid p. 27
[33] (1874) LR 9 QB 531 at 538
[34] Bennett "*The Law of Marine insurance"* (OUP 2010)
[35] [1984] 1 Lloyd's Rep 476

able to avoid the policy.[36] As argued by the CA, materiality flows from relevance and not weight.

The CA in *CTI v Oceanus* also decided that inducement of the actual underwriter in entering the insurance was irrelevant. In *Pan Atlantic* case the HL affirmed the objective test in *Oceanus* in respect of having an effect on understanding the risk but changed it in respect to inducement. Lord Mustill expressed the opinion of the majority and gave two reasons for rejecting the decisive influence test. The first was on a reading of the MIA 1906, the absence of adverbs qualifying the phrase 'influence the judgment of a prudent insurer' such as decisively, or significantly, was taken to mean that this what was Parliament intended. Lord Lloyd in his dissenting judgment analysed the words by their meaning in the Oxford English Dictionary and illustrated that the opposite result could have been meant. The second reason given by Lord Mustill was that establishing the action of a prudent insurer was an impossible task. Lord Lloyd on the other hand observed that where a prudent insurer would perceive an increased risk he would actually increase the premium. With all due respect to his lordship, the prudent insurer would have taken into account the subjective commercial factors the actual insurer would face. Lord Templeman, who was of the same view as Lord Lloyd, suggested that if a prudent insurer said "I would like to know but it would not have made any difference"[37] then there would be "no objective or rational grounds upon which this statement of belief"[38] could be tested. While the result in the case is tenable it would have been too harsh on the assured without some form of reliance on the part of the insurer.

The HL in *Pan Atlantic* on a 3:2 majority suggested inducement was an implied term into the MIA 1906 and thus required to be proved. As such, proving inducement of the insurer to

[36] The CA in *St Paul Fire & Marine Insurance Co (UK) Ltd v McDonnell Dowell Constructors Ltd* [1995] 2 Lloyd's Rep 116 said the risk should be affected not increased but there is no reason if the risk is decreased why the insurer should be allowed to avoid the policy. Bennett suggests that to this extent the decision is not good law.

[37] *Pan Atlantic v Pine Top* [1995] 1 AC 501

[38] ibid

enter into the contract mitigates the effect of having a very low threshold for materiality.[39] In the words of the HL in *Pan Atlantic* "if the misrepresentation or non-disclosure of a material fact did not in fact induce the contract, the underwriter is not entitled to rely on it as a ground for avoiding the contract."[40] The requirement for inducement makes the discussion around the decisive effect test on materiality superfluous. It could be seen as a disguised decisive effect test. In *Asicurazioni Generali SpA v Arab Insurance Group (BSC)*[41] the majority endorsed Clarke LJ's opinion on what constitutes inducement. Clarke LJ said that the insurer "must show that the non-disclosure or misrepresentation was an effective cause of entering into the contract on the terms that he did. He must therefore show at least that, but for the relevant non-disclosure or misrepresentation he would not have entered into the contract on those terms."[42] This is strikingly similar to the decisive effect test on materiality. Mance LJ affirmed the test in *Brotherton v Aseguradora Colseguros SA (No2).*[43]

An important point in relation to s.18 is the requirement for the material fact to be known by the assured. Knowledge of the assured relates to knowledge of circumstances alone and not their materiality.[44] Opinions also do not qualify as material facts. [45] The form of knowledge recognised most certainly includes actual knowledge.[46] Companies have been held to have imputed knowledge of information known by their "directing mind and will"[47] and this seems to apply whether that person is an actual or a shadow director as defined in the Companies Act 2006.[48] Not any director would satisfy the test.[49]

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[39] Something mentioned by Lord Goff in *Pan* Atlantic and by Bennett
[40] above n.37
[41] [2002] EWCA Civ 1642
[42] ibid
[43] [2003] EWCA Civ 705
[44] *London Assurance v Mansel* (1879) 11 ChD 363
[45] above n.31
[46] *Joel v Law Union and Crown Insurance Company* [1908] 2 KB 863; *Economides v Commercial Union Assurance Co Plc* [1998] QB 587
[47] *Lennard's Carrying Co v Asiatic Petroleum Co Ltd* [1915] AC 705
[48] s.251 Companies Act 2006
[49] *Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1997] 1 Lloyds Rep 360

In the absence of fraud an agent's knowledge will also be imputed to the assured if the agent ought to have communicated the information to the assured.[50] Section 18(1) also considers the assured to have constructive knowledge by deeming the assured 'to know what ought to be known by him'. What the assured is deemed to know depends on what "an honest and competent agent would have communicated to the assured in the ordinary course of business."[51] In plain words and quoting Struckhoff "the insured is held to an objective standard of disclosure and will be in breach of this standard even if, subjectively, the undisclosed material circumstance was not known to him."[52]

The duty of disclosure under section 18 and 19 does not have to be equated with the duty of utmost good faith if one takes into account that the duties in ss.18-19 are pre-contractual and the duty in s.17 is not limited by time. Hoffman LJ in *Societe Anonyme d'Intermediaries Luxembourgeois v Farex Gie*[53] argued that "the obligations in section 18 and 19, although derived from the basic principle in section 17, go a deal further"[54] as sections 18 and 19 allow an insurer to repudiate for non-disclosure of imputed knowledge which he considered it to be "far from any ordinary understanding of lack of good faith."[55] It is the opinion of the author that it is the purpose of the rules that defines them not their characterisation. They are minimum functionality rules in relation to a contract of speculation and not rules that observe the good faith of parties. Preventing fraud and encouraging good faith is a collateral benefit. With all due respect the duties in s.18 and s.19 have not derived in any actuality from s.17 or good faith in common law. Sections 18 and 19 do not go further than utmost good faith; they just illustrate that good faith was an unfortunate characterisation that crept into statute.

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[50] *Simmer v New India Assurance Co Ltd* [1995] LRLR 240
[51] *PCW Syndicates v PCW Reinsurers* (1996) 1 WLR 1136
[52] Jeffery B. Struckhoff *"The irony of uberrima fidei: bad faith practices in marine insurance"* (Tulane Martime Law Journal) [Vol. 29 2005] p:292
[53] [1995] L.R.L.R. 116
[54] ibid
[55] ibid p. 149

Section 20 – Representations pending negotiation of contract

Section 20 of the MIA 1906 "*provides that the contract of marine insurance will be voidable for misrepresentation.*"[56] It has been argued that the line between sections 18 to 20 is "often imperceptible."[57] Although both misrepresentation and non-disclosure have some basic similarities a line must be drawn between the two concepts. The difference between the two concepts is that "non-disclosure means that you have failed to disclose something which was not the subject of a question but which was known to you and which you ought to have considered for yourself would be material, whereas a representation is something directly said in answer to a specific question."[58] The significance of this distinction "is that misrepresentation of a material fact will afford grounds for avoidance of the policy whether or not the proposer was aware that it was incorrect, whereas avoidance for non-disclosure will be restricted to facts of which the proposer was aware and which they ought to have realized the insurer would regard as material."[59]

Section 20(1) states that "*every material representation made by the assured…must be true. If it be untrue the insurer may avoid the contract*."[60] Accordingly, there are two limbs under s. 20(1) that need to be analysed. Firstly, we must consider the test for materiality of the representation and secondly we must determine whether the representation is true. As analysed above, the test for materiality under section 20 (2) is the same with the test for non-disclosure. Accordingly, after establishing materiality, the next step is to determine whether the representation is in fact true. Under s. 20(4) "*a representation as to a matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and*

[56] above n.17 p. 141
[57] above n.37 p. 452
[58] Law Commission "Insurance Contract Law, Issues Paper 1, Misrepresentation and Non-disclosure" September 2006, p. 7
[59] ibid p. 8
[60] above n.31 p. 33

what is actually correct would not be considered material by a prudent insurer."[61] Accordingly, the test for materiality applies both for determining whether a representation has been material and whether a representation is true.

A.3 Adequacy of Remedies

It is clear from ss.17-20 MIA 1906 that the insurer may avoid the contract *ab initio* for non-disclosure or misrepresentation of material facts. This means that the parties are placed in the same position as they would have been if the contract was not made. As a result, "the insurer is viewed as if it had never come on risk with the result that no future liability may be incurred, any outstanding liabilities are discharged, and any loss moneys already paid are recoverable."[62]

In the words of Lord Nicholls V-C in *Pan Atlantic v Pine Top*[63]:

"*Justice and fairness would suggest that when the inadvertent non-disclosure came to light what was required was an adjustment in the premium or, perhaps, in the amount of the cover. Those are not options available under English law. The remedy is all or nothing. The contract of insurance is avoided altogether, or it stands at its entirety. This is not the only field in which English law seems to adopt a fairly crude, all-or-nothing approach, when what is needed is a more sophisticated remedy more appropriate, and in that sense more proportionate, to the wrong suffered.*"

The remedy of avoiding the contract *ab initio* is described as "draconian"[64] since it does not consider the seriousness of the breach even if the breach was an innocent mistake. The

[61] above n.31 p. 34
[62] above n.34 p. 160
[63] above n.37
[64] above n.34 p: 161

harshness of the all-or-nothing approach has been recognised amongst others by Lord Lloyd[65] and by Nichols V-C,[66] who suggested that this approach is not proportionate to the seriousness of the breach and more remedies should be available. This is evident where there is a slight change of risk but the prudent insurer would still insure on the same terms. Furthermore, damages as opposed to avoidance may be a better option especially when the breach is due to carelessness.

Nevertheless, the argument for damages as a possible remedy was rejected in the case of *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd.*[67] Slade LJ argued that "it would not be right for this court by way of judicial legislation to create a new tort, effectively of absolute liability, which would expose either party to an insurance contract to a claim for substantial damages in the absence of any blameworthy conduct."[68] With all due respect, it is submitted that such an approach is too harsh and unjust due to it being disproportionate. The peculiarity of an insurance contract should warrant the award of damages without culpability. Why should an insurer be able to avoid the payment of an insurance where there is a material non-disclosure or misrepresentation of a certain fact that if disclosed would only result in the change of the premium paid. Non-fraudulent omissions will also deem voidable an insurance policy and the result is not satisfactory. The article is in line with the authors that suggest that the current available remedy for breach of the duty of utmost good faith is outdated, does not respond to the current commercial issues, and is unjust on the assured. Statutory reform will certainly benefit the English market, as it will attract perspective assureds.

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[65] *Pan Atlantic* in the HL
[66] ibid
[67] [1990] 1 QB 665
[68] ibid

The right to avoid the contract may be waived. Bennett[69] suggests, this may occur either by affirmation or by equitable or promissory estoppel. In relation to affirmation, "the insurer must know of the misrepresentation or non-disclosure, he must know that, consequently, it has the right in law to avoid the contract and he must unequivocally represent to the assured that it is exercising its right of election so as to forsake its right to avoid and instead affirm the contract."[70] While on a first reading the standard may appear very high, this is not the case. An unequivocal representation that the insurer forsakes its right to avoid the contract may be by conduct. The conduct may be for example acceptance of the premium.[71] Passive conduct could also suffice, for example when the insurer becomes aware of the material non-disclosure or misrepresentation and a reasonable time has passed by which to bring an action but the insurer fails to take such action.[72]

The article respectfully disagrees with Bennett's suggestion of an equitable estoppel barring the insurer from bringing a claim. This is not a possibility under English law since not only is it limited to land[73] but the test seems very hard to satisfy, for example in the absence of any reliance by the assured. Not only that but the HL has shown its aversion towards using notions of equitable estoppel in commercial law.[74] There is also a problem with promissory estoppel in that it requires a clear and unequivocal representation by the insurer that will lead to reliance by the assured.[75] This will be almost impossible to satisfy since it would require an insurer saying for example 'I know you lied to me or have not told me all the material facts but I will insure you on these terms irrespective of your lie/non-disclosure.' Further, it is very hard to prove reliance in either equitable or promissory estoppel without resorting to fictions. Estoppel in any sense cannot apply either at the stage where the insurer is aware of

[69] above n.34
[70] above n.34 p: 163
[71] *Wing v Harvey* (1854) 5 De GM&G 265
[72] *McCormick v National Motor & Accident Insurance Union Ltd* (1934) 49 L1LRep 361
[73] *Crabb v Arun DC* [1976] CH 179; *Taylor Fashions Ltd v Liverpool Victoria Trustees Co Ltd* [1982] QB 133
[74] *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55
[75] Woodhouse A. C. in *Israel Cocoa Ltd SA v Nigeria Produce Marketing Co Ltd* [1972] 2 All ER 271

the material misrepresentation or non-disclosure or when reasonable time to bring proceedings to deem the contract void has passed. With respect Bennett can only use notions of estoppel in a descriptive way to characterise the effect on the insurer. Equitable estoppel cannot be a legal action, defence or bar in the sense that Bennett uses it. Promissory estoppel could be a bar to the insurer's claim but it is almost impossible to prove without resorting to fictions and distorting its legal requirements.

The Ambit of Section 17

B.1 Post-contractual dimension of section 17

One of the criticisms of *Carter v Boehm* is that it concerned a pre-contractual duty. Lord Mansfield did not consider the post-contractual dimension that the duty can have. Namely, what are the duties of the parties after the contract is made.

Sections 18 and 20 both state that the duty of utmost good faith arises "*before* the contract is concluded." The purpose of the wording in these sections is to ensure that the assured reveals all the necessary information needed to the insurer in order to make a decision. Accordingly, once proper disclosure is made and the insurance contract is signed these sections no longer apply.

However it has been suggested that due to the wording of section 17, the Uberrima fides duty is not limited only to the pre-formation of the contract and as such goes beyond ss.18 and 20.[76] Section 17 imposes a duty of utmost good faith upon both parties as a general principle without referring to this duty as a pre-contractual duty. Accordingly, the question is whether

[76] above n.17 p. 181

the duty of utmost good faith under the Act namely under section 17 has a post-formation application or whether case law has limited its application only to pre-formation.

References to the post-contractual context of the duty of utmost good faith are made in respect of two circumstances. Firstly that the duty applies in prohibiting the presentation of fraudulent claims and secondly that it applies in requiring the assured to disclose a change of circumstances such as for example that a circumstance has become material either during the policy or when there is a variation.

In the case of *The Litsion Pride*[77] the post-contractual dimension of the duty was pointed out in relation to the presentation of claims under the policy. Hirst J said that:

"*So far as claims are concerned, I consider that the general principle requiring utmost good faith must apply also…in contract to the pre-contract situation, the precise ambit of the duty in the claims context has not been developed by the authorities; indeed no case has been cited to me where it was considered outside the fraud context in relation to claims. It must be right, I think….to hold that the duty in claims sphere extends to culpable misrepresentation or non-disclosure.*"[78]

With all due respect, it is submitted that this was not a correct response. Avoidance of a contract in general contract law suggests that its formation was problematic and the law will not recognise it as a valid contract. It is the invalidity at the formation level that attracts the remedy of avoidance and this is evident from Lord Mansfield's famous quote referred above. Since a breach of the utmost good faith principle as referred to in s.17 makes the contract voidable, this must relate to good faith only until the contract is properly formed. Thus, any reference to an utmost good faith duty or principle cannot attach to the presentation of claims.

[77] *Black King Shipping Corp v Massie* [1985] 1 Lloyd's Rep. 437
[78] ibid at 512-13

In *The Star Sea*[79] Lord Hobhouse disapproved the reasoning in *The Litsion Pride* "that divorced the requirement of good faith from the provisions of section 17 and the remedy of avoidance."[80] His Lordship was rightfully sceptical of applying the remedy of avoidance against an assured bringing a fraudulent claim. As Lord Hobhouse mentioned, the result would be effectively penal.[81] Mance LJ in *Agapitos v Agnew (The Aegeon)*[82] reasoned that the common law has its own rule for the presentation of fraudulent claims, which is the forfeiture of benefit under the policy. In *Diggens v Sun Alliance and London Assurance Plc*[83] the 'forfeiture of benefit' was defined as the entire benefit of the insurance contract and not only the part that relates to the fraudulent claim. The legal analysis is based on the avoidance of fraud in the performance of the contract as an express or implied term of the contract.[84] Breach of that implied or express term is a repudiatory breach that discharges the contract. Obviously this has nothing to do with a concept of utmost good faith. However, the effect is that forfeiture of the entire benefit of the insurance comes close to or is a punitive measure. The policy is to discourage fraud but it may be disproportionate in some circumstances to lose the entire benefit of the insurance. The insurer can investigate the truthfulness of the claim and the claim may stop at that. If the claim goes further and proceeds to court then the assured who committed fraud will lose his claim and be liable to pay the costs of the insurer under the general rule of costs in CPR 44.[85] An adverse costs decision as well as the loss of the claim should be enough to discourage fraud.

Relating back the prohibition of fraud to the concept of utmost good faith, there is no peculiarity in the prohibition of bringing fraudulent claims in insurance law that would justify

[79] above n.49
[80] Jimmy Ng *"Continuous Responsibility and non-disclosure in marine insurance"* p: 2
[81] at p.494
[82] [2002] EWCA Civ 247
[83] [1994] CLC 1146
[84] *Orakpo v Barclays Insurance Service* [1994] C.L.C 373
[85] for an overview of authorities on fraudulent claims see *Danepoint Ltd V Allied Underwriting Insurance* [2005] EWHC 2318

their prohibitions because of a separate concept of utmost good faith. To describe that the prohibition of fraud is because it would be in breach of the 'good faith' of the assured is unfortunate and unnecessary irrespective of whether bringing a fraudulent claim would or could include a material misrepresentation.[86] The common law prohibits the bringing of fraudulent claims by prohibiting fraud something unrelated to the concept of utmost good faith in insurance law. The law in this respect focuses on culpability whereas the pre-contractual context of prohibiting material misrepresentation or non-disclosure focuses on the minimum functionality of a contract of speculation. Until formation, contracts of speculation are unique and rightly deserve a unique approach; that of imposing a higher duty of disclosure. But when the insurance contract is properly formed, they seize to be different than other contracts. At that point general contract law concepts regulating performance must apply.

In relation to the disclosure duty continuing after the contract is entered into, this has been rejected in the case of *Cory v Paton*[87] where Blackburn J argued that:

"*…whether after the negotiation is complete and the contract made in fact and in good faith, and the underwriter is under a moral obligation to execute a formal policy the assured is bound by good faith to give information to the assurer of a matter which would make him aware that his bargain was a bad one, information which ought to have no effect on him, but would expose him to a temptation to break his contract, which, as far as the law is concerned, he may do with impunity, because of fiscal purposes the legislature has forbidden the court, either of law or equity, to enforce the contract.*"

Accordingly "any fresh fact coming to the knowledge of the assured need not be communicated to the underwriters, however material it may be."[88] This is very reasonable.

[86] see Eggers QC in "*Chitty on Contracts*" Chapter 41 p.1205 as to the types of fraud
[87] L.R. 7 Q.B. 304

Once the contract is correctly entered into, the insurer takes the risk of making a bad bargain or improper calculation. The insurer takes the risk of the initial probabilities changing or an unfortunate event occurring. Post-contractual disclosure would not entitle the insurer to change the terms of the insurance contract. Not only that but the specific referral of sections 18 and 20 in the pre-contractual context of disclosure rationally precludes the concept of post-contractual disclosure.[89] Finally, the *Carter v Boehm* reasoning focusing on an imbalance of information and improper calculation of the risk also precludes any later duties of disclosure. The only thing that matters after the contract is properly entered into is whether a claim exists or not.

Botes[90] suggests that a continuing duty could apply in the context of variation of the insurance contract. However, when a contract is varied, this may operate in two ways. Firstly, when the contract expressly requires the assured to disclose the occurrence of certain events and allows the insurer to amend the terms of the insurance contract. Secondly, if the contract does not provide for alteration and the insurer and assured agree to alter their contract.

In the first circumstance, it is not a continuing duty of utmost good faith that requires the disclosure but the contract itself. In the absence of such an express term, a duty of utmost good faith cannot imply alteration in the contract for the aforementioned reasons. As in general contract law, the insurer can protect itself by alteration of risk clauses in the contract. There is no reason why default rules of insurance law should protect the insurer to such an extent. There is no minimum functionality rationale, nor any culpability on behalf of the assured, nor is it reasonable for one to expect that such a duty is to be imposed since the insurer can protect himself in the contract. As Soyer suggests, to use a post-contractual duty

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[88] *Lishman and Another v The Northern Maritime Insurance Company* L.R. 10 C.P. 179 at p. 182
[89] also argued by Botes above n. 17 p. 180; contrast Sir Mackenzie Chalmers in his commentary to the MIA 1906 argued that the sections which follow section 17, namely sections 18 to 20, are not exhaustive but merely illustrative; Ivamy above. 31
[90] above n.17 p.183

of utmost good faith requiring the assured to do so would contradict the principle of freedom of contract.

In contrast to the above arguments, Hirst J. in the *Litsion Pride*[91] arrived at a different result. The dispute was about a term in the insurance policy covering war risks, to inform the insurer once the vessel entered an excluded area, allowing the insurer to charge an additional premium. The policy further provided that despite not informing the insurer, the policy would not be affected. Hirst J held that the duty of utmost good faith applied and found the policy to be void in retrospect. This has been heavily criticised by Bennett[92] because it contradicted the wording of the policy and because the parties themselves had agreed on the consequences of a failure of notification. The flawed reasoning of the case makes it hard to follow. In *Hussain v Brown (No2)*[93] a similar clause required information to be given by the assured to the insurer for any alteration likely to increase the risk. The High Court distinguished the *Litsion Pride* on the ground that the clause in the *Litsion Pride* was specific and in the current case was vague. The H.C found that the duty of utmost good faith did not attach on these circumstances.

The second situation, where the insurer and assured agree to alter the insurance contract, effectively either means that a new contract is created or that a new part of the contract is created.[94] The duty relates only to facts material to the alterations and not facts already agreed upon by the insurer that would in effect allow the insurer to avoid a bad bargain.[95] Thus the duty of material disclosure and honest representation is still in the pre-contractual context irrespective of a prior existing relationship between the parties.

[91] [1958] 1Lloyd's Rep. 437
[92] Bennett *"Mapping the Doctrine of Utmost Good Faith in Insurance Law Contract Law*" [1999] LMCLQ 165
[93] (1996) Unreported (Q.B)
[94] for example see *Fraser Shipping Ltd v N.J Colton & Ors [1997] 1Lloyd's Rep 586*
[95] *Lishman v Northern Maritime Insurance Co* (1875) LR 10 CP 179 per Blackburn J

Proposals for Reform

Firstly, the article suggests that there is no need to term, characterise or categorise the duties between insurer and insured as giving rise to a contract in utmost good faith or duties to act in such a way. This may only lead in confusion and surprisingly in injustice against the assured who is the only one who has *actual* and *clear* duties. Avoiding the use of the term 'utmost good faith' will avoid the inconsistency between decisions and enhance the predictive value of the law. The way to do this is to define and equate the duty of utmost good faith in s.17 to its true meaning; that found in ss.18-20. It relates solely to the pre-contractual duties of disclosure of material facts and avoiding the misrepresentation of material facts. The constant references throughout the case law to utmost good faith illustrates that judges sometimes see utmost good faith as a *guiding principle.* Interestingly, the Law Commission suggested keeping good faith solely as "a general interpretative principle that would not, in itself, give rise to any cause of action."[96] It is submitted though that the guiding principle should not be good faith but minimum functionality. For example, the issue on how the assured presents information to the insurer. If utmost good faith is the norm, this implies a high standard on the assured. The assured should disclose everything in the most coherent manner. If minimum functionality becomes the norm, then the assured's duty need not be so high. He should avoid misleading the insurer but the insurer would also be under a duty to discover certain facts or ask further questions to that effect. Anything more than minimum functionality rules in commercial insurance is unnecessary.

Secondly, while both parties are under a duty of utmost good faith, it is unclear what this entails on behalf of the insurer. In effect the insurer is left with the minimum or no duties at all other than a duty to make certain questions. These questions are often vague and it is not

[96] The Law Commission and the Scottish Law Commission "*Insurance contract law: the business insured's duty of disclose and the law of warranties"* p:130

clear to the assured, what he is being asked or what to disclose.[97] Therefore the assured may find himself in a position where he is required to disclose material facts under s.18 of the MIA 1906 but is unaware of what may constitute material facts. 'Utmost good faith' as a guiding principle and the duties in ss.18-20 are clearly one-sided. As a minimum the insurer should be barred from avoiding the contract when it was not clear what he was asking.

A proposed reform would be to impose a duty on the insurer to guide the assured throughout the process of the policy making to reveal all material information and inform him about the consequence of failing to disclose such information. For example, the insurer could also be under a duty to make the appropriate checks on the ship before insuring against sinking. Obviously the principle of minimum functionality and reasonableness would dictate what checks would be proportionate for the insurer to conduct.

The Law Commission proposes reform of the current law of non-disclosure as policyholders find it difficult to understand what might be material to the insurer. It suggests modifying the prudent insurer test to a test of what a reasonable insured would think it is relevant to a prudent insurer.[98] Supporting this proposal the Faculty of Advocates argued: "the current test of the prudent insurer is clearly fraught with difficulty for the insured – who is unlikely to have much insight in the mindset of an insurer – when considering what information requires to be disclosed."[99] Nevertheless, the proposed test may also lead to uncertainty, as a reasonable insured would change in every case. Thus this would lower the predictive value of the law. However, it would be a fairer result.

Thirdly, as to the issue of remedies, the only remedy for the assured is avoidance of the contract under s.17 MIA 1906 and this is inadequate. When the insurer is at fault for an

[97] The Law Commission and The Scottish Law Commission *"Consumer insurance Law: Pre-Contract Disclosure and Misrepresentation"* December 2009 p:15
[98] above n.96 p:46
[99] above n.96 p:47

improper insurance cover by virtue of his non-disclosure or non-guidance of the assured for example, then damages should be a better option. Damages would cover the amount the assured would be paid under a proper insurance as calculated by an objective standard, minus the premiums that would be paid.

As to the insurer's remedy, the Law Commission has suggested "the remedy should focus on the contract that the insurer would have entered into with the policyholder if the policyholder had fully complied with its duty of disclosure. In particular, if the insurer would not have entered into the insurance contract at all, the insurer may avoid the contract. If the insurer would have entered into the contract on different terms, the contract should be treated as if it included those terms. If the insurer would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim or the assured could be required to pay the additional premium (which may be additional to the inclusion of other terms)."[100]

The harshness of the all-or-nothing approach and the attraction of a proportionality element have been evident in *Pan Atlantic* in all the courts that have heard the case.[101] Proportionate remedies are the fairer result. While the harshness of the approach incentivizes assureds not to behave fraudulently or negligently, the benefits of proportionate remedies outweigh this. The main problem with proportionate remedies is the evidential issues as to how much the premium would be raised. But the courts are competent in dealing with this. Other than that, proportionate remedies are in line with the reasoning requiring disclosure and honesty. Lord Mansfield referred to the calculation of the risk. Thus a proportionate remedy would in effect address the improper risk calculation. The author agrees with the Law Commission's proposals on proportionate remedies.

[100] above n.96 p:119

[101] See the judgments of Lord Mustill, Kerr LJ, Nicholls V.C

Conclusion

The article has argued that there is no need to refer to a duty of utmost good faith either as the reason for having specific duties between an assured and an insurer or as a qualitative principle of behaviour. The pre-formation duties on both assureds and insurers are better explained as minimum functionality rules rather than rules flowing from utmost good faith. There is no benefit from referring to utmost good faith or a need to do so. The article has also showed that the post-contractual duties are irrelevant to utmost good faith. Further, the article suggested that minimum functionality should be used as a guiding principle, something clearly explicable that would recognise that beyond the disclosure duties, commercial insurance law is not different than the rest of commercial law. Regarding remedies, the harshness of the all-or-nothing approach of the law has been emphasised and it needs to be addressed by the legislature. If the insurer as a result of the misrepresentation or non-disclosure would have entered into the insurance policy on different terms then the remedy should not be avoidance but damages.