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The Duty of Utmost Good Faith and the London Commercial Insurance Market Practice

by

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ABSTRACT

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THE DUTY OF UTMOST GOOD FAITH AND THE LONDON COMMERCIAL INSURANCE MARKET PRACTICE

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This thesis explores the application of the duty of utmost good faith to current London commercial insurance market practices with the assumption that commercial market practices do not make it simple for the duty of utmost good faith to apply. The scope of the duty of utmost good faith in this thesis is the pre-contractual duty as the study of the corpus of the duty of utmost good faith illustrates that the post-contractual duty of utmost good faith introduced by recent common cases is of limited significance.

The thesis examines how this pre-contractual duty accommodates the London commercial insurance market and how the common law judges solve the problems arising from the way the market practices, in particular, where the slip is used at the placing process; where declaration policies e.g. open cover, treaty, binding authority or line slip are used to facilitate insurance business; where there is more than one agent involved in effecting an insurance contract; where the duty of utmost good faith has been waived and; where the insurance contract is effected through electronic insurance. It can be obviously seen from this research that the solutions suggested by the common law judges are merely immediate solutions and cannot solve the situation where the slip is used at the placing process. They do not provide a long term solution to the overall problems. The result of this research is that market self-regulation, the London Market Principles 2001, which overhaul the market infrastructure and introduce the concept of 'clarity and certainty' of contract from the outset, can provide a long term solution to the problems.

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Chapter 1

Introduction

The duty of utmost good faith was first recognised by Lord Mansfield in *Carter v Boehm*[1] under the principle of good faith. He intended to introduce to the common law the principle of good faith which includes the duty not to misrepresent and the duty of disclosure. According to him, inducing a person to enter into a contract, either by making false representations or by withholding information which may be relevant to that person in deciding whether to entertain the bargain, would be an obvious breach of the principle of good faith. However, only the duty not to misrepresent has survived in the common law of contracts. The duty of disclosure has been limited to certain contracts, namely, the contract of utmost good faith, *uberrimae fidei* an example of which is every class of insurance contracts.[2] *Carter v Boehm* itself dealt with a marine insurance contract. It is said that Lord Mansfield's rationale behind the introduction of the duty of disclosure was a response to the conditions prevailing in the marine insurance market of his day whereby the assured had more information in relation to the risks than the insurers.[3] In other words, the case can be regarded as the basis of the application of the duty of utmost good faith, in particular the duty of disclosure, to present insurance law.[4]

This position of law was codified in the Marine Insurance Act (MIA) 1906 that was intended to codify the existing law, drafted by Sir Mackenzie Chalmers. The sections

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[1] (1766) 3 Burr 1905.

[2] Other contracts are contract of surety or guarantee, partnership agreements, contract between spouses and settlements between family members, salvage contracts, contracts for the purchase of shares publicly offered and contract with fiduciary relationship e.g. a duty of disclosure is owed by a solicitor to his client and a trustee to be a beneficiary. It should however be noted that the duty of disclosure under insurance contract is an absolute duty whereby even innocent non-disclosure amounts to breach of the duty.

[3] Nicholas Legh-Jones, John Birds J, David C. Owen, eds., *Macgillivray & Parkington on insurance law*, 10th ed. (London: Sweet and Maxwell, 2002), 453 para. 17-98 (hereinafter in this thesis referred to as "MacGillivray"); John Lowry and Philip Rawlings, *Insurance Law Doctrines and Principles,* (Oxford and Portland, Oregon: Hart Publishing, 2005), 78 (hereinafter in this thesis referred to as "Lowry and Rawlings").

[4] It should be noted that the scope of the duty of disclosure in *Carter v Boehm* seemed to be narrower than the present one. The material facts needed to be disclosed was limited to facts or circumstances which are within the exclusive knowledge of either party. Therefore, it was said that if the insurer might be informed of the material facts no matter how, it could not be said that those facts are the exclusive knowledge of the assured. See generally, R. Hasson, "The Doctrine of Uberrimae Fides in Insurance Law: A critical evaluation," *Modern Law Review* 32 (1969): 615; Lowry and Rawlings, 79.

of the MIA 1906 which concern the duty of good faith are ss. 17-20. It is now clearly held by the House of Lords that the duty applies to all forms of insurance.[5]

Nearly two hundred and fifty years have already passed since the principle of the duty of utmost good faith was introduced. The corpus of the duty of utmost good faith and the market, where the duty is applied, have evolved dramatically.

This thesis explores the application of the duty of utmost good faith to current London commercial insurance market practices with the assumption that the commercial market practice does not make it straightforward for the duty to apply. English law takes a positive approach to situations which do not easily fit established rules of law.[6] The duty of utmost good faith cannot be applied to certain circumstances in the market. This creates uncertainties and unclear issues in practice resulting in disputes between the parties involved in insurance contracts. The study of the thesis is based on both insurance and reinsurance market together without separate studies as the markets are closely linked and the arising problems concerning this aspect are similar and are made through case studies. The results of the study provide a long term solution to the problems that might be useful both to the London commercial insurance markets and the markets worldwide, especially those markets that are influenced by the English common law system where similar problems may arise. The thesis is composed of seven chapters and these chapters are divided as follows.

Chapter 2: The concept of the duty of utmost good faith

This chapter focuses on the corpus of the duty of utmost good faith itself, trying to entail the scope of the corpus of duty of utmost good faith. The chapter contemplates the scope of the pre and post contractual duty of utmost good faith and problems arising from the corpus of the duty. The study of this chapter results in the suggestion that the post-contractual duty of utmost good faith should be eliminated. Therefore, the study of the thesis regarding the problems of the duty of utmost good faith, as a

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[5] *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep 427.

[6] Malcolm Clarke, *The Law of Insurance Contracts,* 4th ed. (London: LLP, 2002), 348 para. 11-3A (hereinafter in this thesis referred to as "Clarke"); English law "will not frustrate them on account of some difficulty analysis" per Hobhouse J. in *General Accident Fire and Life Assurance Corporation v Tanter (The Zephyr)* [1984] 1 Lloyd's Rep 58, 72.

result of the commercial insurance market practices considered, focuses on the pre-contractual duty of utmost good faith.

Chapter 3: The use of slip at the placing process and the duty of utmost good faith

When the slip is used in effecting insurance, all material facts are usually disclosed or presented to the leading underwriter, and the following underwriters merely rely upon the judgments made by the leading underwriter in signing the slip. Problems arise when non-disclosure or misrepresentation is made to the leading underwriter and not the following underwriters. Can the following underwriters avoid the contract alleging non-disclosure or misrepresentation made to the leading underwriter? Is there a rule such as the "deemed communication" rule? What is the common law solution to this problem? How does market practice solve this problem?

Chapter 4: Declaration policies in insurance and reinsurance contracts

The nature of declaration policies brings about difficulties in applying the duty of utmost good faith. How does the duty of utmost good faith apply to obligatory or facultative obligatory or non-obligatory declaration policies?

Chapter 5: Agency and the duty of utmost good faith

This chapter focuses on s.19 of the MIA 1906 and whether it encompasses all the problems arising from the practice. In particular, the corpus of s.19 is contemplated. This entails the understandings of the current scope of the agent's duty of utmost good faith. The role of the agent in the commercial insurance market practice is scrutinised. The application of the current duty of utmost good faith to the agent in insurance is examined, namely, the non-disclosure of the agent who is not agent to know or agent to insure. Can the current law accommodate non-disclosure or misrepresentation of every type of agent involved?

Chapter 6: Waiver and the duty of utmost good faith

The corpus of the duty of utmost good faith regarding waiver has been affected by the recent minority judgment of Rix L.J. in *Wise Underwriting Agency Ltd v Grupo Nacional Prvovincial SA.*[7] He has introduced the notion of fairness into the process of consideration whether there should be a breach of the pre-contractual duty of utmost good faith. Should the common law judges adopt this view? What is the tendency of subsequent judgments?

In addition, there are certain types of businesses in the commercial insurance market that the agent of the assured has all the information related to the risk. The assured therefore does not possess information more than the insurers or is not in a better position than the insurers to access information related to the risk. These types of insurance contracts often contain contractual terms waiving the duty of utmost good faith. The scope of these contractual terms is examined. Should the exclusion of the duty of utmost good faith under these clauses subsume fraudulent conduct of the broker?

Moreover, there is an increase in the amount of online insurance. How does the duty of utmost good faith apply to this type of insurance? If there is no space provided for the assured to disclose information material to the risks, should this amount to waiver of the duty of utmost good faith by the insurers?

Chapter 7: The London Market Principles 2001: The long-term solution

This chapter sums up all the problems arising from the commercial market practices in relation to the duty of utmost good faith as examined in chapter three to six and points out which problem can be solved by the current common law system and which one still has defects. The London Market Principles 2001 are closely examined. How do the London Market Principles 2001 provide a long- term solution to the problems?

[7] [2004] Lloyd's Rep IR 764.

Chapter 2

The concept of the duty of utmost good faith

1 Introduction

This chapter considers the corpus of the duty of utmost good faith with the intention to capture the present status of the duty of utmost good faith; whether the duty of utmost good faith is necessary to insurance contracts; and what are its deficiencies.

The chapter is divided into two parts as follows:

The first part deals with the pre-contractual duty of utmost good faith. The explanation of the pre-contractual duty is done by considering the relevant sections in the Marine Insurance Act (MIA) 1906, namely sections17-20 and relevant decisions. The insurer's pre-contractual duty of utmost good faith falls under s. 17. Sections 18-20 deal with the assured's pre-contractual duty of utmost good faith. In practice, at the pre-contractual stage, the application of the duty of utmost good faith falls upon the assured. It is submitted that the assured's pre-contractual duty has defects. There are some suggestions of reform in relation to the assured's pre-contractual duty of utmost good faith, in particular the assured's duty of disclosure and is now regulated under the Financial Services and Market Act (FSMA) 2000. The questions to be answered are therefore: whether the current pre-contractual duty of utmost good faith, including the self- regulation by the insurers, which is now regulated by the FSMA can solve or mitigate the defects; and whether the pre-contractual duty of utmost good faith can operate in the commercial market without obstacles?

The second part deals with the post-contractual duty. The post-contractual duty of utmost good faith has evolved dramatically, especially in the last two decades. Many new situations are considered by the courts as attracting the post-contractual duty of utmost good faith. It is dubious whether the rationale behind the existence of the duty of utmost good faith is still good when applied to the post-contractual duty of utmost

good faith and whether the scope of the post-contractual duty has been expanded too far. This culminates in the question: what should be the real scope of the duty of utmost good faith? The explanation of the post-contractual duty is based on the consideration of s.17 of the MIA and recent cases.

2 The pre-contractual duty of utmost good faith

The MIA 1906 does not mention directly about the duty of utmost good faith as such. There is merely a heading "Disclosure and Misrepresentations" and s.17 providing that a marine insurance contract is a contract based upon utmost good faith. While ss. 18-20 are specified in detail regarding the assured and the broker's pre-contractual duty of utmost good faith, s. 17 is very broadly stated. From the cases, the judges resort to this section for the insurer's duty of utmost good faith and the post-contractual duty of utmost good faith.[8] Section 18 concerns the assured's duty of disclosure; s. 19 deals with the agent's duty of disclosure; and s. 20 with the assured's duty not to misrepresent material facts. The codification of the Act was based upon the existing principles deriving from the existing authorities. Since cases before the promulgation of the act concerned mostly the assured's duty of disclosure during the negotiation of the contract, it is not unusual for the Act to have separate sections concerning the pre-contractual duty of utmost good faith.

This chapter closely considers the assured's duty of disclosure under s.18. Section 19, concerning "Disclosure by agent effecting insurance", is considered in chapter five of this thesis. Section 20, regarding misrepresentation of the assured, is not scrutinised separately because the width of the duty of disclosure often subsumes the question of misrepresentation. The line between the two may be barely discernible.[9] There is a fine line between the two and they are frequently treated as one and the same thing by the judges.[10]Indeed, cases have frequently failed to distinguish between the two and it

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[8] *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1988] Lloyd's Rep 513; *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1990] 2 All ER 947; *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd and Others (The Star Sea)*[2001] 1 Lloyd's Rep 389; *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep 563.
[9] Clarke, 693 para. 23-1.
[10] Lowry and Rawlings, 77.

seems to be standard practice of the insurer where possible to plead both defences.[11] Even though there is a difference between an innocent misrepresentation where the proposer does not know the truth and an innocent non-disclosure, where the proposer knows the truth but does not appreciate that he should disclose the fact in question. This distinction does not seem to matter.[12] In addition, most of the legal questions that arise in the context of misrepresentation are concerned with materiality, in which case the same rules are applied as in the case of non-disclosure of material facts.[13]Both duties are absolute, meaning that the state of the assured's mind is irrelevant. If the requirements for there to be a non-disclosure or misrepresentation have been met, no matter whether the assured has acted fraudulently, negligently or innocently, the assured would be in breach of the duty of utmost good faith as in each case the insurers will not have received the information appropriate to the assessment of the risk.[14] This entitles the innocent party to avoid the contract.[15] If the innocent party decides to avoid the contract the contract is avoid *ab initio,* meaning the parties are back to the position they stood before the contract was entered into.[16] Any premium paid is returnable to the assured except in cases of fraud.[17]

2.1 The insurer's pre-contractual duty of utmost good faith

The law has been settled that the duty of utmost good faith is reciprocal in nature and therefore applies to the assured as well as the insurer. The only section in the MIA

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[11] John Birds and Norman J. Hird, *Modern Insurance Law*, 6th ed. (London: Sweet & Maxwell, 2004), 101 (hereinafter in this thesis referred to as "Birds and Hird").
[12] Birds and Hird, 102.
[13] Ibid.
[14] It is submitted that if there is a fraudulent non-disclosure or misrepresentation, there is no need to establish the materiality of the fact misrepresented or non-disclosed to constitute a breach of the duty of utmost good faith *Sibbald v Hill* (1814) 3 ER 859; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep 427, 441-442 , 452 per Lord Mustill; However, there are some doubts as to the correctness this submission. Materiality is still relevant at least to the extent that the insurer was induced to enter into the contract by virtue of the misrepresentation or non-disclosure; the question of inducement will involve the issue of the materiality to the particular underwriter, as opposed to prudent underwriter. See details in Peter Macdonald Eggers and Patrick Foss, *Good faith and Insurance Contracts* (London: LLP, 1998), 118-119 paras. 7.11-7.14 (hereinafter in this thesis referred to as "Eggers and Foss").
[15] Breach of the duty by negligent gives rise to damages under the Misrepresentation Act 1967 s.2 (1). Innocent misrepresentation gives the court discretion to award damages in lieu of rescission or avoidance under the Misrepresentation Act 1967 s.2 (2) . It is, however, submitted that this discretion would never be used in respect of commercial contracts of insurance *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep 109.
[16] *Abram v Westville* [1923] AC 773.
[17] *Chapman v Fraser* BR Trin 33 Geo III.

1906 that could support the existence of the insurer's duty of utmost good faith is s.17. Because of the broad wording of s. 17, the scope of insurer's duty of utmost good faith is rather unclear.

With respect to the pre-contractual duty of utmost good faith, it can be said, in short, that the insurer owes a duty of disclosure to the assured and must disclose facts which are material to the risk or to the recoverability of a claim.[18] The only remedy for the insurer's breach of the duty of utmost good faith is avoidance *ab initio*.[19] This would not give any benefit to the assured since the insurer's breach of the duty mostly comes to light when the loss has already occurred. The assured would prefer to be covered by the insurance rather than avoid the policy and have the premium returned to him.

In practice, there are few circumstances whereby the insurer would be in breach of the pre-contractual duty of utmost good faith, since under an insurance contract, the assured is normally the one who bears the duty of disclosure. The assured is regarded as having the information relating to the insured risk which should be disclosed to the insurer in order to create a fair dealing. Hence, the insurer's pre-contractual duty of utmost good faith is less important.

In contrast, the assured's pre-contractual duty of utmost good faith plays an important role in insurance contracts, which merits a closer consideration.

2.2 The assured's duty of disclosure

It has been said that the MIA 1906 has been considered as less successful in encapsulating the relevant law. With respect to s.18, the assured duty of disclosure,

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[18] *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1988] 2 Lloyd's Rep 513, 545. The Court of Appeal mentioned the scope of the insurer's duty of utmost good faith that: "...the duty falling on the insurer must at least extend to disclosing all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer." This approach was later applied in *Aldrich v Norwich Union Life Insurance Co Ltd* [2000] Lloyd's Rep IR 1. In this case, followed the approach, it was held that the non-disclosed facts were not relevant to the risk sought to be covered.

[19] *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1988] 2 Lloyd's Rep 513; *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1989] 2 All ER 952 (CA); [1990] 2 All ER 947 (HL).

subsequent cases tried to interpret the meaning of "material facts" provided in the section. These subsequent cases must also be considered in order to capture elements of the assured's duty of disclosure.

2.2.1 Elements of the assured's duty of disclosure

S.18 (1) of the MIA 1906 provides that:

"Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is know 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..."

From this section, elements of the assured's duty of disclosure can be extracted as follows:

1) The assured has to disclose material facts relating to the underwriting of the risk before the contract is concluded

The assured here can be a natural person or a corporate assured. The natural assured's knowledge is simply a question of fact. He knows what he knows[20] and therefore cannot disclose something he does not know.[21] The knowledge of the corporate assured is more complex and depends upon the identification of those persons whose actual knowledge is to be counted as the knowledge of the company for the purpose of the disclosure rule imposed upon all proposers for insurance in order to enable insurers to make an informed assessment of the risks presented to them.[22] It is submitted that the knowledge of those who present the directing mind and will of the company, and who control what it does, is to be identified as the company's

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[20] *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241, 253 per Staughton L.J.
[21] *Joel v Law Union and Crown Insurance* [1908] 2 KB 863, 884; *Economides v Commercial Union Assurance Co plc* [1998] QB 587, 601, 607; *London General Insurance Co Ltd v General Marine Underwriters Association Ltd* [1921] 1 KB 104; *Wise Underwriting Agency Ltd v Grupo Nacional Provincial SA* [2004] Lloyd's Rep IR 764.
[22] MacGillivray, 413 para. 17-10.

knowledge, whether or not these persons are responsible for arranging the insurance cover in question.[23]

2) The assured's knowledge of material facts extends to those facts that are deemed known by the assured in the ordinary course of business

This rule of law applies to both natural and corporate assured. Hence, the assured himself might not be aware of the fact. The agent's or employee's knowledge might be considered as something the assured is deemed to know especially in the case of a corporate assured. The courts have interpreted deemed knowledge restrictively, and not all knowledge of the agent or employee is attributed to the assured.[24]

3) Material facts

Facts which have to be disclosed must be material. The meaning of material facts is mentioned in s.18 (2) of the MIA 1906 that:

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

The issue of materiality has now been settled by the majority of the House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd (Pan Atlantic).*[25] The required test is the "mere influence" test whereby a prudent insurer would have wanted to know the information in question and would not necessarily have acted any differently as regards the premium or the risk.[26]

There are two traditional types of material facts:

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[23] MacGillivray., 413-414 para. 17-11.
[24] Ibid., 414 paras. 17-13, 415 para. 17-14.
[25] [1994] 2 Lloyd's Rep 427. It was 3:2 majority. Lords Goff, Mustill and Slynn formed the majority; Lords Templeman and Lloyd formed the minority.
[26] This judgment overruled the "decisive influence" test, under which a prudent insurer would have rejected the insurance or increased the premium, had he known the undisclosed facts introduced by Lloyd J. in *Container Transport International Ltd (CTI) v Oceanus Mutual Underwriting Association,* [1982] 2 Lloyd's Rep 178, 187-189. This notion, however, was rejected by the Court of Appeal [1984] 1Lloyd's Rep 476 of the same case and the "mere influence" test, under which a prudent insurer would have wanted to know the information in question and would not necessarily have acted any difference as regards the premium or the risk introduced by Steyn L.J.

(1) Facts related to physical hazard

Facts may be material because they render the subject-matter insured exceptionally liable to destruction by the peril insured against[27] e.g. type of cargo or vessel insured in the case of marine insurance, construction or the use of premises in the case of fire insurance, or age or state of health of the life assured in the case of life insurance.

(2) Facts related to moral hazard

Facts may be material because they indicate that the proposer is not a person whose proposal may be accepted as a matter of course without careful consideration[28] e.g. previous losses and claims under other policies

It is clear that both types of facts are relevant to the risk insured. Recent case law seems to introduce a novel type of material facts. In *North Star Shipping and Others v Sphere Drake Insurance plc*[29] it was held that failure to pay premiums under an earlier policy is a material fact which has to be disclosed under s.18(2) of the MIA 1906. If the assured is impecunious it is understandable that it goes to moral hazard as the assured may intentionally create the loss and claim for insurance money. However, a mere failure to pay premiums should not be regarded as a moral hazard as the assured may be financially stable but failed to pay the premium for business reasons. It may be said that in this case the assured was in a poor financial position. Hence, failure to pay the premiums might indicate the assured's impecuniosities. In any event, materiality is a pure question of fact in each case and the decided case therefore gives no more than an indication of what conclusion a court or an arbitrator would reach in any particular case.[30] Hence, the circumstance of the case might be regarded as special and not an authority.

4) Actual insurer inducement

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[27] Robert Merkin, ed., *Colinvaux's Law of Insurance*, 7th ed. (London: Sweet & Maxwell, 1997), 133 para. 5-23 (hereinafter in this thesis referred to as "Merkin, *Colinvaux's Law of Insurance*").
[28] Ibid.
[29] [2005] 2 Lloyd's Rep 76 rejecting the earlier contrary view in *O'Kane v Jones* [2004] 1 Lloyd's Rep 389.
[30] Merkin, *Colinvaux's Law of Insurance*, 133 para. 5-22.

Breach of the duty of disclosure by the assured entitles the insurers to avoid the contract if they can prove that the non-disclosure induced them to enter into the contract. This actual insurer inducement requirement, the subjective test, was added by the House of Lords in *Pan Atlantic*.[31] This element is very important as it has become a means to limit the broad scope of material facts which the assured has to disclose. This is illustrated in the next issue regarding deficiencies and unsettled issues in the corpus of the assured's duty of disclosure.

5) Exceptions to the duty of utmost good faith

S. 18(3) of the MIA provides that:

"In the absence of inquiry the following circumstances need not be disclosed, namely:-

(a) Any circumstance which diminishes the risk;
(b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;
(c) Any circumstance as to which information is waived by the insurer;
(d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty"

These exceptions apply also to the agent of the assured who is under separate duty of utmost good faith. Current common law cases illustrate that the exceptions come to play in limiting the scope of duty disclosure and liability of the insurers. This issue is considered separately in chapter six of the thesis.

2.2.2 Deficiencies and unsettled issues in the corpus of the assured's duty of disclosure and examples of deficiencies as a result of the market practice

[31] They held that the inducement requirement for misrepresentation in general contract law must also be applied to misrepresentation in insurance law. They used s. 91(2) of MIA 1906, which preserves the common law rules unless inconsistent with an express provision of the Act, to support their reasoning.

It was once said that the prudent insurer test of materiality, in particular, the "mere influence of the prudent insurer test" put a burden upon the assured to disclose facts that might not be material from a layman's or a prudent assured's view. For example, in motor insurance the assured has to disclose facts of different offences other than driving offences. Thus, the convictions for garage-breaking, forgery and theft are material facts.[32] Indeed, there have been attempts by the courts to modify this requirement by using the reasonable insured's opinion instead of that of the prudent insurer.[33] In addition, in some types of insurance the assured merely has to answer the question in the proposal forms prepared by the insurers. By doing this, the assured would normally think that he does not need to disclose other facts apart from those asked by the insurers. Moreover, the prudent insurer test favours incompetent insurers by permitting them to escape liability for a loss by reference to the standard of underwriting diligence and prudence of the prudent insurer even though the non-disclosed facts might not affect their willingness to write the risks.[34]

At the beginning, the only thing that has been done was a self-regulation by the insurance industry. In 1977 the insurance industry in the United Kingdom made a voluntary proposal to mitigate some of the severity in the present law of non-disclosure. This was actually made in return for the government exemption of insurance contract from the Unfair Contract Terms Act 1977.[35] The British Insurance Association[36] and Lloyd's issued Statements of Insurance Practice which they recommended their members to accept. In 1986, these Statements were revised to take account of criticisms of their terms and recommendations for law reform made by the Law Commission. Since the Statements of Insurance Practice arose from the avoidance of the use of The Unfair Contract Terms Act 1977 to insurance contracts, and the revised Statements in 1986 followed the Law Commission Report which regarded the duty of disclosure as unfair towards the consumer assured and not the

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[32] *Cleland v London General Ins. Co* [1935] 51 Ll LR 156.
[33] *Joel v Law Union and Crown Insurance Co* (1908) 2 KB 863 per Flecton Moulton L.J. "If a reasonable man would have recognised that the knowledge in question was material to disclose, it is no excuse that you did not recognise it." Nowadays, in non-business insurance contracts the reasonable insured's opinion is view by the Insurance Ombudsman as the decisive factor. (The Insurance Ombudsmand's Annual Report 1989, para. 2.16).
[34] *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd's Rep 496, 508 (CA).
[35] However, the 1999 Regulations regarding Unfair Consumer Contract apply to insurance contract.
[36] Now the Association of British Insurers (ABI).

professional assured, the Statements of Insurance Practice therefore are applied only to consumer insurance.

One statement refers to general insurance and the other to long-term insurance- life insurance. In both Statements, with respect to the duty of disclosure and misrepresentation, the insurers undertake not to rely on grounds of non-disclosure or misrepresentation if the assured could not reasonably be expected to have disclosed the material fact or does not deliberately or negligently misrepresent the material fact. In addition, there are requirements that proposers must be warned on the proposal form and on renewal notices of the need for disclosure. These statements of self-regulatory practice are not a substitute for reform of the law as they lack the force of law.[37]

At present, the insurance industry is regulated by the Financial Services and Markets Act 2000 (FSMA). As a result of this, most of rules and regulations in the form of self-regulation are replaced by the Financial Services Authority (FSA). On 14 January 2005, the FSA has replaced the Statement of General Insurance Practice with the Financial Services Authority's Insurance: Conduct of Business Rules (ICOB).[38] With respect to the duty of utmost good faith at the formation of contract ICOB rule 7.3.6 provides that:

"An insurer must not: 1. unreasonably reject a claim made by a customer; 2. except where there is evidence of fraud, refuse to meet a claim made by a retail consumer on the grounds: a. of non-disclosure of a fact material to the risk that the retail customer could not reasonably be expected to have disclosed; b. of misrepresentation of a fact material to the risk, unless the misrepresentation is negligent..."

ICOB rules also mention about the intermediary's duty of utmost good faith. Rule 4.3.2 (3) deals with advising and selling standards, and states that:

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[37] MacGillivray, 455 para. 17-103.
[38] The FSA follows the Insurance Mediation Directive (IMD). However, the FSA interferes only if they consider it is suitable and proportionate to do so.

"In assessing the customer's demands and needs, the insurance intermediary must...explain to the customer his duty to disclose all circumstances material to the insurance and the consequences of any failure to make such a disclosure, both before the...insurance contract commences and throughout the duration of the contract; and take account of the information that the customer discloses."

ICOB Rule 4.3 goes on to stress that:

"In relation to ICOB 4.3.2 (3), an insurance intermediary should make clear to the customer what the customer needs to disclose. For example, in relation to private medical insurance, this could include any existing medical condition where relevant, or in relation to motor insurance, any modifications carried out to the vehicle."

These mentioned ICOB rules focus mainly on consumer insurance, particularly ICOB Rule 7.3.6. This is because the FSA makes the rules according to its four objectives:[39] 1) market confidence; 2) public awareness;3) consumer protection and 4) the reduction of financial crime. As can be seen one of the objectives is to protect consumers. The FSA only interferes where they think it is appropriate to do so.[40]

To sum up, this deficiency of the assured's duty of disclosure is acknowledged but only with respect to the consumer. Hence, the prudent insurer test of materiality is still the test used in considering materiality of facts in commercial insurance without any relief from self-regulations by the insurance industry or by the legislation, the FSMA 2000.

In *Pan Atlantic* the judges were aware of the harshness of the prudent insurer test and added therefore the actual insurer inducement test with the intention to relieve the burden derived from the prudent insurer test. Generally, the onus is on the insurer to make out a case of non-disclosure on the balance of probabilities and, therefore, establish not only the materiality of the information undisclosed but also the

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[39] "FSA, statutory objectives,"< http://www.fsa.gov.uk/Pages/about/aims/statutory/index.shtml > (10 October 2005).

[40] "FSA, Insurance Conduct of Business rules (ICOB)," <http://www.fsa.gov.uk/pages/doing/ small _ firms/insurance/faq/ICOB.shtml> (10 October 2005).

inducement.[41] However, it was said that there was a presumption of inducement whereby an insurer who was able to demonstrate objective materiality would have the benefit of a presumption that, being a prudent person, he was himself induced by the presentation or non-disclosure. This seems to lighten the weight of actual insurer inducement requirement. The presumption of inducement was introduced in *Pan Atlantic* by Lord Mustill.[42] Presumption of inducement was confirmed in *St. Paul Fire & Marine Insurance Co (UK) Ltd v McDonnell Dowell Constructors Ltd.*[43]

From the facts of the *St. Paul Fire* case, it is understandable that presumption of inducement was required. There were four insurers who had agreed to give insurance cover. At the trial of the case, only three of them gave evidence, the fourth insurer having left his firm with a certain amount of ill will therefore refusing to give evidence. The three insurers gave evidence at a time when actual insurer inducement was not a legal necessity for breach of the duty of disclosure, since the trial took place after the Court of Appeal gave its decision in *Pan Atlantic* but before the House of Lord's decisions. As a result of the House of Lords' judgment, whereby actual insurer inducement was a requirement for there to be a breach of the duty of disclosure, inducement on behalf of the fourth underwriter was presumed.

The presumption of inducement is therefore useful where for good reason an insurer cannot be called to give evidence and other insurers on the risk have given satisfactory evidence that they were induced by the non-disclosure.[44] This means that it is sufficient that the non-disclosed fact was an inducement and not necessarily the inducement.[45] This is somehow difficult to accept considering the fact that actual inducement should be a subjective test not an objective test. Thus, there is no generalised presumption of inducement. Therefore, the insurers still have to prove that they are induced by the non-disclosure or misrepresentation to enter into the contract.

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[41] Clarke, 699 para. 23-2A1.
[42] [1994] 2 Lloyd's Rep 427.
[43] [1995] 2 Lloyd's Rep 116.
[44] *Marc Rich v Portman* [1996] 1 Lloyd's Rep 430, 440-442; *Sirius Insurance Corp v Oriental Assurance Corp* [1999] Lloyd's Rep IR 343, 351; *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins* [1998] 1 Lloyd's Rep 565, 597.
[45] Birds and Hird,122.

Nevertheless, it has been said that in practice it is not difficult for insurers to prove that they are induced by those facts once they can prove materiality of the facts, even in the case of incompetent insurers.[46] The presumption of inducement emphasises how easy it is for the actual insurers to prove that they are induced by the non-disclosed facts. Even though the presumption may be rebutted by contradictory evidence, it is hard for the assured to do.[47] However, these arguments are merely arguments about the earlier position of law regarding inducement before the existence of the recent cases which emphasis the importance of inducement.

Recent cases illustrate that materiality and inducement are entirely separate issues and it is not easy to prove an inducement. Indeed, it has been said that Lord Mustill's presumption of inducement cannot be inferred in law from proved materiality.[48] Lord Mustill drew the conclusion from "the general law". In a leading case in the general law Lord Jessel MR did not refer to a simple presumption but a qualified presumption that if it is a material presentation calculated to induce him to enter into the contract, it is an inference of fact that he was induced by the representation to enter into it.[49] That there is a material presentation calculated to induce the insurer illustrates that not simply because something is material it could be presumed to be an inducement.[50] Inducement is therefore a question of fact.[51]The onus of proof regarding inducement has been described by a recent case as "always difficult for an insurer or reinsurer to discharge".[52]

Assicurazioni Generali v Arab Insurance Group.[53]

The case concerned retrocession. One of the issues in dispute was whether there had been false statements relating to the participation of other reinsurers. It was alleged by the defendant that there was a misrepresentation by the claimant's broker of the

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[46] MacGillivray, 454 para. 17-100.
[47] Robert Merkin, ed., *Colinvaux & Merkin's Insurance Contract Law*, looseleaf (London: Sweet & Maxwell, 2002), 10754 para. A- 0779 (hereinafter in this thesis referred to as "Merkin, *Colinvaux & Merkin's Insurance Contract Law*").
[48] Clarke, 670 para. 23-2A1.
[49] *Redgrave v Hurd* (1881) 20 Ch D1, 21.
[50] Clarke, 699 para. 23-2A1.
[51] Lowry and Rawlings, 92.
[52] *Sirius International Insurance Corp v Oriental Insurance Corp* [1999] Lloyd's Rep IR 343, 354 per Longmore J.
[53] [2003] Lloyd's Rep IR 131.

percentage of other reinsurers' participation in the risk retroceded to the retrocessionaire, the defendant.

In the judgment, Clarke L.J. laid down principles on the relationship between materiality and inducement. In order to be entitled to avoid a contract of insurance or reinsurance, an insurer or reinsurer must prove on the balance of probabilities that they were induced to enter into the contract by a material non-disclosure or by a material misrepresentation. He confirmed that there is no presumption of law that an insurer or reinsurer is induced to enter into the contract by a material non-disclosure or misrepresentation. He continued to say that the facts may be such that it is to be inferred that the particular insurer or reinsurer was so induced even in the absence of evidence from him. In order to prove inducement, the insurer must show that the non-disclosure or misrepresentation was an effective cause of his entering into the contract on the terms in which 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. On the other hand he does not have to show that it was the sole effective cause of his doing so.[54]

The latest Court of Appeal case has made it even harder for insurers to prove actual inducement as the court took into consideration what would have happened had the non-disclosed fact been disclosed and reached its judgment by making speculation.[55]

Drake Insurance Plc v Provident Insurance Plc.[56]

This case concerned double insurance where an insurance company sought contribution from another insurance company. The loss fell under both policies. Each policy contained a rateable proportion clause in similar terms, which had the effect that if there was any other policy in force, each insurer was liable only for its proportionate part of any claim. The facts of the case were quite complex. The assured effected a comprehensive motor insurance with Drake, the appellant. When the assured first applied for insurance, he disclosed that there had been an accident. At

[54] Ibid., para. 62.
[55] Lowry and Rawlings, 92.
[56] [2004] 1 Lloyd's Rep 268.

that time, it had not been settled that it was a no fault accident; hence in the policy the accident was classified as a fault accident. On renewal of the policy, the assured failed to disclose a speeding offence. Taking these facts together would have caused Provident to increase the premium by twenty-five percent. Therefore this non-disclosure induced it to enter into the insurance contract with a lower premium. However, before the renewal, it was settled that the accident was a no fault accident, which meant that the combination of the accident and the speeding offence would not trigger the increased premium. In other words, the non-disclosure of the speeding offence made no difference to Provident's underwriting assessment and therefore could not be an inducement for the insurer to enter into the contract. The insurers would have entered into the contract with the same premium, had the material facts been disclosed. Despite this fact, Provident maintained its avoidance. Eventually, Drake took responsibility for the claim and sought to recover contribution from Provident, resulting in this case.

Moore-Bick J., the judge at first instance, dealt with the complex facts and held that what needed to be considered, when the risk was presented, was Provident's state of mind not the actual fact. It was legitimate to ask what would have happened in this case, had the assured disclosed his conviction at the time of renewal considering the fact that the insurers had to assess the risk basing on information which was presented to them by the assured. Moore-Bick J. speculated what the assured's reaction to the increased premium would have been and concluded that the assured might question the insurers or might not; there was nothing in the evidence that pointed either way. Moore-Bick J. speculated that the non-disclosure did therefore induce Provident to enter into the contract.[57]

It seemed that Moore-Bick J. needed to make this speculation because the fact that he thought should be considered was Provident's state of mind which contradicted the actual fact and obviously seemed to be unjust. However, his speculation was quite limited. He put the burden of proof upon the assured to prove that disclosure of the conviction would also have led to the disclosure of the information relating to the settlement of the earlier loss, resulting in Provident's accepting the risk on the same

[57] [2003] Lloyd's Rep IR 781 para. 28.

terms. He then held that Provident was induced to enter into the contract by the non-disclosed fact and allowed them to avoid the contract.

Drake appealed by alleging that what should be considered were the actual facts, not the facts apparent to be in Provident's mind and that the judge at first instance was wrong regarding the inducement issue in holding that there was no evidence supporting whether the assured might question the insurers or might not. In any event Drake argued that the trial judge applied the wrong burden of proof.

The judgments on this issue were not unanimous. Rix L.J. gave the main decision. He agreed with the first instance judge that it was necessary to consider what would have occurred had the speeding conviction been disclosed on renewal. However, he held that the burden of proving inducement is borne upon the insurer. It followed that Provident had to show that the issue of the accident would not have arisen, had the conviction been disclosed, that the trial judged had erred in his application of the burden of proof and in his speculation, and that inducement had not been demonstrated. Clarke L.J. followed this judgment. However, the view with respect to the speculation of inducement was merely *obiter dicta.*

The case was decided upon the inducement issue. Both of them agreed that what had to be considered were the actual facts, not the facts from Provident's state of mind. As at the time the contract was made it had been settled that the accident was a "no fault" accident of the assured, the conviction would make no difference to the assessment of the premium. The insurers would not have been induced to enter into the contract by non-disclosure of the material fact. Hence, they decided the issue based upon materiality and basic inducement. The broad speculation of inducement has not been made by the judges in this case.

The dissenting judgment was by Pill L.J. He thought that the trial judge ought not to have speculated as to what might have happened had the conviction been disclosed, nor should the Court of Appeal do the same and found that the burden was on Drake to show that events would have taken a different course which he failed to do, accordingly the Court of Appeal should not interfere. He agreed with the trial judge that Provident's state of mind must be considered and not the actual fact. In other

words, the assured could not rebut the inducement proved by the insurers. However, he continued to say that the actual fact should be considered when the court considers the insurer's duty of utmost good faith at the time of avoidance. This means that Provident would not be able to avoid the contract as at the time of avoidance Provident is no longer induced by the facts. To avoid the contract the insurers would be in breach of his post-contractual duty of utmost good faith.[58]

The important issue of the judgments at this stage is the inducement issue. The majority of the judges gave *obiter dicta* that to prove inducement, the insurers must prove what the assured would have or would not have done, had the material facts been disclosed. Hence, this seemed to entitle the court to make speculation as to what would have happened, had the non-disclosed fact been disclosed. This created uncertainty in considering the fact and it is said that this speculation comes perilously close to allowing a court to underwrite the policy itself.[59]

This statement can be seen from the judgment itself. The judges made speculations about evidence presented to the court in the trial.[60] From the fact, Rix L.J. emphasised the fact that the assured clearly informed the insurer that the accident was a no fault accident as soon as they knew that the reason for avoidance was the combination of a fault accident and the non-disclosed conviction. With due respect, avoidance of the policy had a much more severe effect upon the assured than just an increase of premium. Hence, what the trial judge said may also be seen as convincing since the assured might not make any enquiry at all regarding the increase of premium. Clarke L.J.'s speculation was more convincing: that if the conviction had been disclosed, the broker, as the assured's agent or the insurer's agent under binding authority would have been bound to consider and calculate the appropriate premium under Provident's system. Therefore it seemed to him that it was almost inevitable that the broker would have told the assured that the premium would have to be increased and the broker would either have told the assured the reason or the assured would have asked the reason. This speculation may be made upon a more plausible basis but as it is still a

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[58] This issue is considered closely under insurer's post-contractual duty of utmost good faith later in this chapter.
[59] R. Merkin, "Utmost good faith; Materiality and the right to avoid," *Insurance Law Monthly* 16 (2) Feb. (2004): 3.
[60] Lowry and Rawlings, 92.

speculation, it is hard to see how the insurers would be able to prove their inducement with certainty. Therefore, it has become harder for the insurer to prove actual insurer inducement requirement.

To sum up, even though speculation made by the court in considering the actual inducement would mitigate the harshness of the prudent insurer test and make it harder for the insurer to exercise his right unfairly under the duty of utmost good faith, it is doubtful whether the judges' views would be practical as this would allow the court to speculate which no one can prove for sure to be correct. From the decisions made by the judges it seems that they are more in favour of the assured than the insurers. The duty of utmost good faith therefore may no longer be as harsh towards the assured as it used to be.

The above explanation concerns the application of the corpus of the duty of utmost good faith itself without considering other factors arising from the market practice. Because of the special procedures in the commercial market, problems may arise when implementing the assured's duty of disclosure in the commercial market, for example, the use of slip to effect insurance in the commercial market. This procedure involves many underwriters, who act on behalf of certain insurers, underwriting the same risk. Each individual underwriter initials the slip at different time. In addition, the following underwriters often rely upon the judgment of the leading underwriter, the first underwriter who signs the slip before they sign the slip. This creates problems in relation to the assured's duty of disclosure. It is doubtful how the duty is applied to the assured and to each underwriter when insurance is effected by slip.

Another good example is when contracts for insurance are implemented to facilitate the making of insurance contracts. If a risk falls under the provided contract for insurance, the assured can make it the subject of insurance by way of a declaration to the contract. The right to make declarations may be given to the individual assured, the broker or the other insurers. These contracts for insurance can be in the form of open covers, floating policies, binding authorities or line slips. Problems with respect to the pre-contractual duty of utmost good faith occur in relation both to "contracts for insurance" and "contract of insurance". Under a contract for insurance it is doubtful whether the assured has to disclose material facts when an obligatory contract for

insurance is made, thereby discharging the assured from further duty of disclosure as under this type of contract the insurer is obliged to accept all risks declared under the contract provided they fall within its scope. Under a contract of insurance the question is whether an individual declaration attracts the duty of disclosure.

These two problems in applying the duty of utmost good faith in the commercial market are considered closely in chapter three and four respectively.

2.2.3 Conclusion of the assured's pre-contractual duty of disclosure

This part of the thesis illustrates the existence and importance of the pre-contractual duty of utmost good faith, especially the prominent obligation of the assured's duty of disclosure. The corpus of the assured's duty of disclosure at the formation stage has been regarded as unfair to the consumer assured which has resulted in suggestions to reform the law and has culminated in self-regulation by the insurance industry in the form of the Statements of Insurance Practice and now regulated by the FSMA 2000. Nowadays, the burden of disclosure upon the assured has been lightened by the common law judges paying attention to the proof of actual inducement by the insurers. It is suggested by the judges that the insurers must prove what the assured would have or would not have done, had the undisclosed facts been disclosed. What the assured would have or would not have done is based upon pure speculation which the court has the power to decide. At present, this broad scope of the proof of inducement is a mere *obiter dictum.* Future cases are awaited. If this broad proof of inducement is applied it would become much harder for the insurers to prove breach of duty of utmost good faith. The development of the duty of utmost good faith made through the common law judges together with the judge's call for legislative intervention[61] is indicative of an emerging judicial consensus over the question of reform, the momentum of which has persuaded the Law Commission of the need to revisit insurance law in the near future.[62] This is the corpus of the assured's duty of disclosure.

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[61] *Pan Atlantic Insurance Co Ltd v Pine Top Insruance Co* [1994] 2 Lloyd's Rep 427.
[62] Lowry and Rawlings, 93.

With respect to the commercial insurance market, there are no limitations in applying the pre-contractual duty of utmost good faith. The law applies as it is in commercial insurance contracts. Some examples are given to illustrate difficulties in applying the assured's duty of disclosure as a result of the way the market operates. This issue merits closer consideration and is considered throughout this thesis. Before doing that the post-contractual duty of utmost good faith must be considered to entail the understanding of the whole corpus of the duty of utmost good faith.

3 The post-contractual duty of utmost good faith

In the MIA 1906, there is no section specifically mentioning the post-contractual duty of utmost good faith. At the time the MIA 1906 was drafted, it could be argued that the duty of utmost good faith did not have a post-contractual dimension. There was no judicial support for the existence of the post-contractual duty of utmost good faith prior to the enactment of the MIA 1906. Since the MIA 1906 is a codification of the existing law, it was assumed that there had been no intention to insert this post-contractual dimension into the scope of the duty of utmost good faith. In addition, as s.17 is placed under the heading "Disclosure and Representation" and ss.18-20 expressly relates to matters arising before the making of the contract, it was therefore thought that s. 17 had been intended to have a pre-contractual role only.

However, there have been some contrary views. It has been said that during the enactment of the MIA 1906, a case was decided supporting the existence of the post-contractual duty of utmost good faith, *Boulton v Houlder Bros & Co.*[63] It has been therefore argued that the broad wording of s. 17 subsume the post-contractual duty of utmost good faith dimension and that possibly Parliament was influenced by the shift in judicial view. In addition, the comment made by Sir Mackenzie Chalmers, the drafter of the MIA 1906, seems to support this view. He said that: "the general principle is stated in this section because the special sections which follow are not

[63] [1904] 1 KB 784. It "is an essential condition of the policy of insurance that the underwriters shall be treated with good faith, not merely in reference to the inception of the risk, but in the steps taken to carry out the contract."

exhaustive".[64] It has been said that the duty continues throughout the contractual relationship at a level appropriate to the moment.[65]

The common law cases follow this latter view. The first mainstream authority in relation to the post-contractual duty of utmost good faith was *Black King Shipping Corp v Massie (The Litsion Pride).*[66] After that the scope of the post-contractual duty of utmost good faith has been restricted by a trio of subsequent decisions in the last decade, namely *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd and Others (The Star Sea),*[67] *K/S Merc-Scandia XXXXII v Underwriters of Lloyd's Policy & Others (The Mercandian Continent)*[68] and *Agapitos v Agnew (The Aegeon).*[69]

All these cases dealt with the issue of the assured's post-contractual duty of utmost good faith. Hence, in order to capture the present status of the assured's post-contractual duty of utmost good faith, the judgments of these four cases are analysed. This is done by considering situations that the courts regarded as attracting the assured's post-contractual duty of utmost good faith.

3.1 The assured's post-contractual duty of utmost good faith

3.1.1 Situations attracting the duty

In *The Litsion Pride*, Hirst J. relied upon s. 17 as the source of the post-contractual duty of utmost good faith.[70] The wording of s. 17 is very broad and does not provide a good clarification as to its scope and its extent. Hirst J., therefore, referred to existing cases to circumscribe the scope of the post-contractual duty of utmost good faith. He concluded that there were three situations which attract the post-contractual duty of

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[64] M.D. Chalmers and D. Owen, *The Marine Insurance Act 1906* (London, 1907).
[65] Clarke, 880 para. 27-1A1.
[66] [1985] 1 Lloyd's Rep 437.
[67] [2001] 1 Lloyd's Rep 389.
[68] [2001] 2 Lloyd's Rep 563.
[69] [2002] 2 Lloyd's Rep 42.
[70] Section 17 of the MIA 1906 provides: "A contract of marine insurance is a contract based on 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."

utmost good faith, namely fraudulent claims; held covered clauses including variation of the risks; and ship's papers.

Later in *The Mercandian Continent,*[71] Longmore L.J. classified situations indicating the development of the post-contractual duty of utmost good faith. These situations concern both the assured's and the insurer's post-contractual duty of utmost good faith. At this stage, only situations in relation to the assured's post-contractual duty of utmost good faith are considered.

3.1.1.1 Fraudulent claims

1) The scope of fraudulent claims

In *The Litsion Pride*, Hirst J. considered the obligation not to make a fraudulent claim as an element of the post-contractual duty of utmost good faith.[72] He then continued to say that: "...the duty in the claims sphere extends to culpable misrepresentation or non-disclosure".[73] This is inconsistent with the authorities regarding fraudulent claims considering a tighter definition of fraud as "recklessly, not caring whether it is true or false, but only seeking to succeed in the claim".[74] This analysis of Hirst J. has changed the scope of fraudulent claims, resulting in a broader duty which put an excessive burden upon the assured.

In *The Star Sea*[75] the House of Lords had the opportunity again to consider the issue of fraudulent claims in relation to the post-contractual duty of utmost good faith. Expectations were high.

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[71] [2001] 2 Lloyd's Rep 563 para. 22.
[72] *Britton v Royal Ins Co* (1866) 4 F&F 905, 909 per Willes J.; *Continental Illinois National Vank & Trust Co of Chicago v Alliance Assurance Co Ltd (The Captain Panagos DP)* [1986] 2 Lloyd's Rep 470, 512 per Evans J; *Harris v Waterloo Mutual Fire Ins Co* (1886) 10 OR 718, 723 are some of the cases where the duty of good faith between insurer and insured is specified as the foundation, although not the only foundation, of the rule that fraud in a claim by the insured defeats the claim and terminates the contract of insurance.
[73] [1985] 1 Lloyd's Rep 437, 512.
[74] *Lek v Matthews* [1927] 29 LILR 141, 145 per Viscount Sumner; *Derry v Peek* [1889] 12 App Cas 337.
[75] [2001] 1 Lloyd's Rep 389.

In this case, the assured claimed under the policy for constructive total loss of the vessel 'Star Sea' resulting from fire. The insurers had two defences. First, it was alleged that the assured had been privy to the vessel putting to sea in an unseaworthy condition amounting to a breach of s. 39 (5). Secondly, the assured was in breach of the duty of utmost good faith in presentation of the claim. It was alleged by the insurers that there was a misrepresentation in the witness statements by the assureds and their solicitors as well as a non-disclosure of expert reports relating to previous fires occurring on other vessels under the same fleet - material information in relation to the claim. These expert reports were privileged but that privilege was later waived on the second day of the trial by the assured. The defence raised by the insurers was based on the judgment in *The Litsion Pride.* They alleged that the assured acted fraudulently while submitting the claim under the policy and this amounted to breach of s. 17 of the MIA 1906. In the alternative even if the assured did not act fraudulently, the duty was broken by culpable conduct falling short of fraud.

The court held that in the claim context fraud must be identified. Since there was no fraud, there was no breach of s.17. Hence, the scope of fraudulent claims was clarified to mean that only fraud can give rise to fraudulent claims. However, even though the assured was fraudulent, this did not assist the insurers in defending the claim. Their Lordships held that when litigation begins, any duty previously owed under s.17 is superseded by the rules which govern litigation.

It was a pity that their Lordships did not go further to make conclusive remarks that fraudulent claims could be considered as part of the post-contractual duty of utmost good faith or what should be the remedy for an insurer in circumstances where a fraudulent claim had been made.

2) Remedy for making a fraudulent claim

According to s.17 of the MIA 1906, which is regarded as the foundation of the post-contractual duty of utmost good faith,[76] the only remedy for breach of the duty of

[76] *The Litision Pride* [1985] 1 Lloyd's Rep 437.

utmost good faith is the resulting entitlement of the innocent party to avoid the contract *ab initio.*

The authorities on fraudulent claims illustrate other remedies even though sometimes in those cases the duty of utmost good faith is regarded as the basis of fraudulent claims rule. Indeed, it is said that the same cannot be said for breach of the duty even in a case of fraud, which occurs later, perhaps some months into the period of cover.[77] The authorities can be seen in the following cases:

In *The Litsion Pride*, Hirst J. held that the assured claim was fraudulent. There was therefore a breach of the post-contractual duty of utmost good faith under s.17 of the MIA 1906 which entitled the insurer to avoid the policy. However, the remedy was not confined to electing to avoid the policy. The insurer had the option to reject the claim without avoiding the policy in "commercial good sense". From the facts of the case, the insurer indeed selected not to avoid the policy.

In *Orakpo v Barclays Insurance Services,*[78] in relation to the issue of fraudulent claims, Hoffmann L.J. opined that the duty of utmost good faith exists after the conclusion of the contract and applies also in the claim stage. He was of the view that the rationale of the duty of utmost good faith at the claim stage is analogous to the pre-contractual duty. He said that "...just as the nature of the risk will usually be within the peculiar knowledge of the insured, so will the circumstances of the casualty...".[79] However, with respect to the remedy for breach he did not regard avoidance *ab initio* as the remedy. Instead he seemed to resort to contractual remedies by saying that "any fraud in making the claim goes to the root of the contract and entitles the insurer to be discharged".[80] Whatever the real meaning of the wordings "the insurer entitles to be discharged" may be,[81] it does not have the meaning of retrospective avoidance of the policy under s.17 of the MIA 1906 which stems from

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[77] Clarke, 899 para.27-2C3.
[78] [1995] LRLR 443.
[79] Ibid.,451.
[80] Ibid.
[81] Hoffmann L.J. mentioned in his judgment text book written by Malcolm Clarke, *The Law of Insurance Contracts*, 1st ed. (London: LLP, 1989), 434, as the relevant principle, which mentioned about the consequence of the fraudulent claims that the assured will forfeit all benefit under the policy. Hence, it might be said that the word "discharge" should bear the meaning discharge from liabilities under policy.

the rule of law.[82] The wordings indicated that he adopted a contractual analysis which provides a prospective remedy.

Sir Roger Parker agreed with Hoffmann L.J. that the consequence of fraudulent claims is that the claims must fail in *toto*. However, he made his own observations in relation to fraudulent claims. He was of the view that he saw no reason why a mere misrepresentation or non-disclosure on inception or renewal would result in avoidance *ab initio,* while no similar remedy is provided in the making of a fraudulent claim.[83] He said that both at the inception and at the claim stage, the insurer has to a large extent to rely on what the assured tells him. To create an incentive to honesty, the assured should not be allowed to recover anything to a substantial context if he is fraudulent. To allow the contrary would provide no incentive to honesty and almost encourage fraud. It can be said from this argument that he was of the view that a fraudulent claim entitles the insurer to avoid the policy *ab initio*.

In *The Star Sea*, the House of Lords had a chance to consider the issue but left it untouched. Lord Hobhouse mentioned that the "*Orakpo* case cannot be treated as fully authoritative in the view of contractual analysis there adopted".[84] He was of the view that fraudulent claims stem from another rule of law; that the person should not benefit from his own wrong and the remedy for breach has only prospective effect. The wordings that the judges commonly used were "the assured forfeits all claims under the policy" or "all benefit under the policy" not avoidance *ab initio*.[85]

Hence, as long as fraudulent claims are considered as an element of the duty of utmost good faith, it is not clear what the consequence of a breach of the duty should be.

The tendency of removing fraudulent claims from the scope of the post-contractual duty of utmost good faith can be seen in the recent cases. This would get rid of the remedy of avoidance *ab initio* and entail the more flexible remedy of making a fraudulent claim that would be more just to the assured.

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[82] *Banque Financiere de la Cite v Westgate Insurance Co* [1989] 2 All ER 952 affirmed by the House of Lords [1990] All ER 947; *The Star Sea* [2001] 1 Lloyd's Rep 389.
[83] [1995] LRLR 443, 452.
[84] [2001] 1 Lloyd's Rep 389 para. 66.
[85] Ibid., paras. 63-64.

3) Removal of fraudulent claims from the duty of utmost good faith

It can be seen in *The Star Sea* case that Lord Hobhouse considered good faith and fraudulent claims separately and opined that fraudulent claims derived from the principle that a person should not benefit from his own wrong.[86]

Subsequently, the Court of Appeal in *The Aegeon*[87] decided this issue in a more decisive manner. The issue in the case was whether the use of a fraudulent device or means to promote a legitimate claim would make the claim a fraudulent one.

From the case, the assured insured the vessel with a policy against hull and machinery port risks policy that "warranted LSA certificate and recs. complied with prior commencement of hot work". A fire occurred on board during hot works. The underwriters alleged breach of warranty. The dates of the commencement of hot works given by the assured and the underwriters were different. The underwriters sought to resolve the proceedings by proposing a preliminary issue to establish the date when hot works began. Disclosure of sworn statements taken from two workmen immediately after the casualty established that hot work had been carried out on a different date from that pleaded by the assured. The claim was a valid one as the loss was caused by the insured risks. However, the assured was fraudulent by telling a lie about the commencement of hot works after litigation had begun. In the light of this the underwriters sought to amend their defence to include the defence of breach of the duty of utmost good faith under s.17of the MIA 1906 by the assured.

Mance L.J. gave his tentative view of an acceptable solution,[88] which has an impact upon the relationship between the fraudulent claims rule and the duty of utmost good faith. He said that the claim was valid but there was a making of a fraudulent device or means to promote the claim by the assured. There would be a fraudulent device or means if it was intended to improve the assured's prospects of obtaining a settlement or winning the case and would have tended objectively, prior to any final determination at trial of parties' right, to yield a not insignificant improvement in the

[86] Ibid., para. 621.
[87] [2002] 2 Lloyd's Rep 42.
[88] Ibid., para. 45.

insured's prospects. He treated the use of fraudulent device or means as a sub-species of making a fraudulent claim, at least regarding the forfeiture of the claim itself in relation to which the fraudulent device or means was used. He continued to say that the fraudulent claims rule falls outside the scope of the duty of utmost good faith. This was because he realised that the test for there to be a remedy of avoidance under s.17 of the MIA 1906 set up by Longmore L.J. in *The Mercandian Continent,*[89] that the fraudulent conduct must have an effect upon the insurers' ultimate liability and the gravity of the breach must entitle the insurer to terminate the contract, would hardly be plausibly met in the case of the making of a fraudulent device or means to promote a claim, as in this type of case the claim made was a good claim. For example, in *The Litision Pride,* the claim made was a good claim, the fraudulent letter concocted by the assured had no impact on the assured's ultimate liability and the gravity of the breach did not entitle the insurer to terminate the contract. Lord Hobhose in *The Star Sea* considered this case as not being a good example of a situation where a fraudulent claim was made. He said that "the decision is questionable upon the facts since the actual claim made was a valid claim for a loss which had occurred and had been caused by a peril insured against when the vessel was covered by a held covered clause".[90] If Lord Hobhouse was correct, fraudulent conduct committed by the assured would not provide the insurers with any defence. The insurers would not be able to avoid the policy as the breach did not meet the criteria set up by Longmore L.J. in *The Mercandian Continent* and there would not be fraudulent claims as the claim made in *The Litsion Pride* case was correct.

The judgment made in *The Aegeon* has created a balance between the nature of misconduct committed and the remedies available and therefore is very welcome. The result of Mance L.J.'s view would be that there would no longer be a remedy of avoidance *ab initio* when a fraudulent claim has been made. Minor fraud by using a fraudulent device or means to promote a claim[91] would be regarded as a sub-specie of

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[89] [2001] 2 Lloyd's Rep 563.
[90] [2001] 1 Lloyd's Rep 389, 405 para. 71.
[91] [2002] 2 Lloyd's Rep 42 para 45 per Mance L.J.: "...any lie, directly related to the claim to which the fraudulent device relates, which is intended to improve the insured's prospects of obtaining a settlement or winning the case, and which would, if believed, tend, objectively, prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects – whether they be prospects of obtaining a settlement, or a better settlement, or of winning at trial."

fraudulent claim rendering the assured liable for that fraudulent conduct. In *The Aegeon*, the giving of the wrong date of the commencement of hot works by the assured would raise a defence which ought to be tried.[92] Hence, making a fraudulent claim or using a fraudulent device or means to promote a claim would therefore be condemned but at the same time proper remedies would be available for the making of fraud, namely, forfeiture of the claim itself[93] or the insurer being prospectively discharged from liabilities under the policy. By considering the use of a fraudulent device to promote the claim as a sub-species of fraudulent claim would solve the problem which resulted from Lord Hobhouse's view in *The Star Sea* as aforementioned. As a result of *The Aegeon,* fraudulent conduct in *The Litsion Pride* would be considered as a fraudulent means or device to promote the claim, which is a sub-species of fraudulent claims. Hence, *The Litsion Pride* is therefore good law in holding that there was a fraudulent claim.

However, this is merely the tentative view of the judge and is not authoritative.

3.1.1.2 Variation of risks and held covered clauses

After the insurance contract has been entered into, the assured may seek additional cover or variation of the risks. The policy sometimes provides a held covered clause, which is designed to ease the process of extension or amendment of cover under an insurance policy. Under a held covered clause the assured is entitled to obtain an extension to his coverage where particular events occur subject to giving prompt notice to the insurer and paying any additional premium demanded by the insurer. If one of these situations happens, the assured is under the duty of utmost good faith to disclose to the insurer any material fact relating to that application as the insurer has to reassess the risk and the premium.[94]

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[92] In other words, there would be a trial on the issue whether there was a use of fraudulent means of device to promote a claim. This trial has not been made as the case was decided on the issue of the application of the fraudulent claim rule after litigation. The judgment was that fraudulent claim rule does not apply when litigation has commenced.

[93] *Alfred Mc Alpine v BAI* [2000] 1 Lloyd's Rep 437.

[94] See H. Bennett, "Mapping the Doctrine of Utmost good faith in Insurance Contract Law," *Lloyd's Maritime and Commercial Law Quarterly* [1999]: 165, 204. See also *Bank of Nova Scotia v Hellenic Mutual War Risk Association (The Good Luck)* [1988] 1 Lloyd's Rep 514, 545-546, per Hobhouse J., the Court of Appeal judgment in *The Star Sea* [1997] 1 Lloyd's Rep 360, 370.

1) Nature of the agreement to vary or extend the existing policy and nature of the held covered clauses

There are three different views as to the nature of the agreement to vary the policy and the nature of the held covered clauses as follows:

(1) Variation of risks and held covered clauses are a modification of the existing contract which would attract the post-contractual duty of utmost good faith

It has been said that in the case of modification or extension of the existing contract, the contract continues as modified and if the modification affects the risk there is a limited duty of disclosure as regards the change in the risk, and only facts material to the change have to be disclosed.[95] With respect to the breach of the duty, it has been said that the law is not clear but the probable answer may be that the remedy of rescission is available only in respect of the extension or modification.[96] Since there is already an existing policy, held covered clauses have been considered an element of the post-contractual duty of utmost good faith[97] and s. 17 of the MIA 1906 was regarded as the source of the duty of utmost good faith in this context.[98] The scope of the duty of disclosure is limited to material facts that are important to the variation of risks [99] as there is indeed authority indicating that the duty of disclosure under s.17 is limited.[100]

(2) The endorsement of the contract should amount to the termination of the old contract that is replaced by a new one consisting of the original terms as endorsed.[101]

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[95] Clarke, 704 para. 23-4B. A new contract is, however, being made and the proposer is under a duty to disclose if a change in an existing insurance is agreed of such a kind "as to substantially alter the nature of the bargain as affecting both sides".
[96] Clarke, 705 para. 23-4B .
[97] *Liberian Insurance Agency Inc. v Mosse* [1977] 2 Lloyd's Rep 560; *Overseas Commodities Ltd v Style* [1958] 1 Lloyd's Rep 546.
[98] *The Litsion Pride* [1985] 1 Lloyd's Rep 437.
[99] *The Good Luck* [1998] 1 Lloyd's Rep 514, 545-546.
[100] Section 17 might have limited application at the pre-contractual stage as illustrated in *Container Transport International Inc(CTI) & Reliance Group Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd's Rep 476.
[101] Merkin, *Colinvaux and Merkin's Insurance Contract Law*, 10680 para A-0706. He mentioned this analysis to compare with distinct contract analysis which was his preferred view.

(3) Distinct contract analysis[102]

The wordings of *Arnould,* the leading marine insurance text, confirm this analysis.[103] He said that by agreeing to the alteration the insurer is really making a new and distinct insurance policy. This fresh agreement analysis is supported by additional consideration, namely the payment of an additional premium or agreement on an additional survey. Hence, non-disclosure of material facts by the assured should result in avoidance of the endorsement agreement only, as it is clearly a separate new and distinct contract from the original contract. The extent of the duty of utmost good faith should be determined by the MIA 1906 ss. 18-20 rather than s. 17.

2) What should be considered as the nature of the agreement to vary or extend the existing policy and the held covered clauses?

The aforementioned different analysis affects the consequence of the breach of the duty of utmost good faith by the assured. The question at this stage is therefore, what should be the best analysis that would bring justice for the parties?

With respect to the remedy for breach of the duty, it is not clear what the remedy should be. The wording used by the court is unclear regarding the result for breach of the duty in this position. In *Fraser Shipping Ltd v Colton,*[104] it was held that the insurers were entitled to "avoid the policy, as varied by the endorsement". In *Lishman v Northern Maritime Insurance Co*[105] Blackburn J. held that "...if the alteration were such as to make the contract more burdensome to the underwriters, and a fact known at that time to the assured were concealed which was material to the alteration, I should say the policy would be vitiated". The wordings used by the court are consistent with the three analyses above but which should be the best solution must be decided.

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[102] Term used by Baris Soyer, "Continuing duty of utmost good faith in insurance contracts: still alive?," *Lloyd's Maritime and Commercial Law Quarterly* 1 Feb. (2003): 39, 64.
[103] M.J. Mustill and J. C. B Gilman, eds., *Arnould's Law of Marine Insurance and Average*, 16th ed. (London: Stevens, 1981), para. 630: "...by (agreeing the alteration) the insurer is really making a new and distinct insurance. If, on the other hand, the alteration does not make a new contract, but merely declares the rule meaning of the contract already concluded, this reasoning does not apply, and there is no necessity to disclose the information acquired after the making of the contract".
[104] [1997] 1 Lloyd's Rep 586.
[105] [1875] LR 10 CP 179,182.

Under the first analysis, variations of the risks or held covered clauses are regarded as modifications of the existing contract. As there is an existing contract, the only section that can be applied to this situation is s. 17 of the MIA 1906. This allows the insurer to avoid the contract *ab initio.* It is hard to understand why non-disclosure of material facts to variation of the risks occurring at a later stage should entitle the insurer to claim money he paid for a legitimate loss, which had occurred before the non-disclosure. It would mean that the whole policy could be avoided *ab initio.* It should be noted that there have been no cases that specifically state that non-disclosure of facts material to the variation of risks amount to avoidance of the contract *ab initio.*[106] Indeed Malcolm Clarke,[107] who supported the first analysis, that variation of the risks did not create a fresh agreement, limited the scope of the duty of disclosure and the rescission of the policy to the extension of the modification. With respect to a failure to provide information indicating alteration of the risk, he was of the view that the insurer should be entitled to charge (retrospectively) a premium that reflects the alteration of risk. In each case the insurer is to be put in the position as if the breach had not occurred.[108] It can thus be said that the first analysis does not provide a good justification.

Under the second analysis, there is a new contract with the endorsement. Hence, if there is a breach of the duty of utmost good faith the entire new policy would be avoided. The existing claim made under the old policy would not be avoided but the original risks that are now covered under the new contract would also be avoided even though the non-disclosure is related to the additional risk and not the original risk. This analysis is less severe than the first analysis as the claim made under the old policy would not be affected. However, there are no cases that support this analysis and it is hard to see why the original risks should be affected.

The third analysis, the distinct contract analysis, would be more just towards both parties and provide a better analysis as there is no reason to deprive the assured of any benefit within the contract as originally placed. Breach of the duty of utmost good

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[106] *The Mercandian Continent* [2001] 2 Lloyd's Rep 563, para.22 (4).
[107] Clarke, 705 para. 23- 4B.
[108] Clarke, 883 para. 27-1A2.

faith would entitle the insurer to avoid the contract regarding that additional risk but the assured would still be covered under the original policy.

Recent cases have not mentioned directly that the distinct contract analysis should be applied but they have illustrated that held covered clauses and variation of risks should attract the pre-contractual duty of utmost good faith under ss. 18-20 of the MIA 1906.

In *The Star Sea,* Lord Hobhouse was of the opinion that the obligation arising during variation is similar to the obligation arising during the formation of the contract and is distinct from the post-contractual duty of utmost good faith.[109] He regarded the making of the contract and variation of the contract as in the same category distinguishing from lack of good faith during the performance of the contract.

Longmore L.J.'s view in *The Mercandian Continent*[110] followed Lord Hobhouse's view and concluded while analysing the development of the post-contractual duty of utmost good faith that variations to the risk, held covered clauses and renewals of the policy should be regarded as parts of the pre-contractual duty.[111]

It should however be noted that Longmore L.J. doubted whether the held covered clauses merely allow the insurer to exercise the right he has under the original contract.[112] A good example of this type of held covered clause can be seen in the Institute Time Clauses (01/11/03), clause 12 which provides that:

"Should the vessel at the expiration of this insurance be at sea and in distress or missing, she shall be held covered until arrival at the next port in good safety, or if in port and in distress until the vessel is made safe, at a pro rata monthly premium, provided that notice be given to the Underwriters as soon as possible".

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[109] [2001] 1 Lloyd's Rep 389 para. 52. He said: "A coherent scheme can be achieved by distinguishing a lack of good faith which is material to the making of the contract itself (or some variation of it) and a lack of good faith during the performance of the contract which may prejudice the other party or cause him loss or destroy the continuing contractual relationship. The former derives from requirements of the law which pre-exist the contract and are not created by it although they only become material because a contract has been entered into....".
[110] [2001] 2 Lloyd's Rep 563.
[111] Ibid., para 27.
[112] Ibid., para. 22 (4).

Hence, the risk insured in this situation is still the same and there is no occurrence of particular eventualities, which would require the insurer to reassess the risk and the premium. This might be the situation where the change is not such a kind that substantially alters the nature of the bargain. This situation should not attract the duty of utmost good faith.

As to the consequence of breach, Longmore L.J. said in *The Mercandian Continent* that variations to the risk, renewals of policy and held covered cases, the original contract is not avoided *ab initio*.[113]

Recent cases are therefore consistent with the second and the third analysis. It would be better if distinct contract analysis was followed as this way the original contract would still exist and not be affected by the non-disclosure of material facts in relation to additional risks. So far what can be said for certain is that variation of the risks and the traditional held covered clauses, which under an eventuality require the insurer to reassess the risk and the premium, should be regarded as attracting the pre-contractual duty of utmost good faith and not be regarded as an aspect of the post-contractual duty of utmost good faith under s.17 of the MIA 1906.

3.1.1.3 Renewals and notice of cancellation clauses

Normally renewal of an insurance contract creates an entirely fresh contract to which the duty of utmost good faith is applied. Thus, the assured is under the duty of disclosure of material facts when he applies for renewal. The assured is expected to disclose all material facts which have arisen during the currency of the contract to be renewed. Renewals are regarded as an example of the post-contractual duty of utmost good faith because there is already an existing contract during the currency of which the breach takes place.[114] However, since the renewal is regarded as creating a fresh agreement, what should be applied is the pre-contractual duty of utmost good faith under ss.18-20 of the MIA 1906.[115]

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[113] Ibid., paras. 22 (2)-(4).
[114] Ibid., para. 22 (3).
[115] Ibid., para. 27.

A problem arises when a certain type of insurance policy is written on a long-term basis but subject to "notice of cancellation at anniversary date". This wording operates to confer upon the insurers the right to bring the cover to an end on each anniversary date. In other words, instead of having a fresh cover and a fresh contract every year, the insurer provides that the existing contract should go on until terminated by notice of cancellation. It is said that the insurers might not appreciate the difference in the position they were making by the alteration in the form of the contract.[116]

It was clearly held that a notice of cancellation clause does not attract the post-contractual duty of utmost good faith in *New Hampshire Insurance Company and Others v MGN Ltd and Others (New Hampshire).*[117]

In this case, the policy contained a notice of cancellation clause.[118] The insurers argued that they were entitled to disclosure of any new information that had become available in order to determine whether to exercise their right to cancel. In other words, the notice of cancellation clause revived the duty of utmost good faith. The insurer referred to Hirst J.'s judgment made in *The Litsion Pride*[119] that "...the information is material because it is required to enable the underwriter to make a decision as to the rate of additional premium, as to facultative reinsurance, and ...possibly even as to cancellation under the 14 day notice clause". Thus, Hirst J. seemed to be of the view that the assured was under the duty of disclosure of facts that were material to the possible cancellation that can be made by the insurers provided notice was given. However, Hirst J. held that: "the duty of utmost good faith applied with its full rigour in relation to the giving of information of the voyage under the warranty".[120] In other words, *The Litsion Pride* was said to be a case in circumstances where the insurers had an intervening decision to make. The result of

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[116] *Commercial Union Insurance Co v The Niger Co Ltd* [1921] 1 Lloyd's Rep 239, 245 per Bankes L.J.
[117] [1997] LRLR 24.
[118] "Section 16. This Policy or any Insuring Agreement may be cancelled by the insured by mailing to the Company written notice stating when thereafter the cancellation shall be effective. This Policy or any Insuring Agreement may be cancelled by the Company by mailing to the Insured at the address shown in this Policy written notice stating when not less than fifteen days thereafter such cancellation shall be effective".
[119] [1985] 1 Lloyd's Rep 437.
[120] Ibid., 512.

the decision would affect the premium rate, which can be regarded as consideration of the assured. Indeed in *NSW Medical Defence Union Ltd v Transport Industries Insurance Co Ltd*[121] Roger J. rejected the argument that notice of cancellation would attract the duty of utmost good faith and observed that *The Litsion Pride* was concerned with an express obligation in the policy to supply information if trading in an excluded zone.

Staughton L.J. finally held, by relying on *Commercial Union Insurance Co v The Niger Co Ltd,*[122] that no continuing duty of disclosure existed by reason of the right to cancel. However, he remarked that there was a continuing duty of utmost good faith only that the notice of cancellation clause would not revive the duty.

Considering the fact that under a notice of cancellation clause the assured does not provide the insurers with any consideration, it is correct that it cannot be regarded as a new agreement, unlike a situation where the assured seeks to renew or vary the policy or exercises his right under the held covered clauses.

3.1.1.4 Express contractual terms providing the insurer with a right to information

From Longmore L.J's view in the *The Mercandian Continent,*[123] this seems to be the only situation justifying avoidance *ab initio* of the policy, provided there is a breach of the duty of utmost good faith by fraudulent non-disclosure which affects the insurer's ultimate liability, and the gravity of the breach would entitle the insurer to terminate the contract.

The case concerned a ship repairer's liability insurance policy that contained a notice of claim clause providing that: "in the event of any occurrence which may result in a claim...the assured shall give prompt written notice...and shall keep underwriters fully advised". The claimant of the case was the ship owner who suffered loss resulting from negligent repair of the assured. The ship owner sued the assured for the

[121] [1985] 4 NSWLR 107.
[122] [1921] 1 Lloyd's Rep 239 (CA); [1922] 13 Lloyd's Rep 75 (HL).
[123] [2001] 2 Lloyd's Rep 563.

loss. Notice of a potential claim on the liability insurance was given to the insurers and they agreed to take over the defence of the claim. During that litigation, the assured ship-repairer produced a forged document with regard to an alleged agreed jurisdiction clause in the repair contract. The assured went into liquidation and the owner of the vessel sued the liability underwriters. They denied liability upon discovery of the forgery by the assured, and alleged either a breach of a contractual term to keep the underwriters fully advised in relation to the claim under the insurance policy or a breach of s. 17 of the MIA 1906.

From the facts, the assured had to give a notice of claim. Thus, it cannot be said that there was a new contract arising as the assured did not provide the insurer with any consideration. The assured was therefore obliged to disclose material facts during the existence of the policy as a result of that express clause in the policy.

Longmore L.J. considered the case by starting with the contractual defence. He paid attention to the fact that the contract had already been entered into and was of the view that the contractual defence should be considered prior to the utmost good faith defence. From his view the duty of utmost good faith is traditionally applicable mainly to the pre-contractual stage.[124] It turned out that there was no breach of that contractual term requiring the assured to keep the insurer fully advised. That contractual term was regarded as an innominate term, the consequences of breach of the term depending on the nature and the gravity of the breach. If the breach is sufficiently serious or the consequences of the breach are so grave that the innocent party is seriously prejudiced, he can accept the breach as repudiatory and terminate the contract [125] or at least reject the claim.[126] The forged letter did not have any effect upon the liability of the insurers; therefore, there was no breach of that contractual term.

Longmore L.J. continued to consider the utmost good faith issue. He was of the view that:

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[124] Ibid., para. 9.
[125] Ibid., para.13.
[126] Ibid., para. 14, case cited was *Alfred McAlpine Plc v BAI (Run Off) Ltd* [2000] 1 Lloyd's Rep 437. However, the judgment given in *Alfred McAlpine* was doubted by the majority of the Court of Appeal in *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp* [2005] 2 All ER 145 (Comm).

1) There was a continuing duty on the assured to refrain from a deliberate act or omission intended to deceive the insurer through either positive misrepresentation or concealment of material facts. He therefore seemed to limit the scope of the post-contractual duty to fraudulent conduct, even though he did not directly say so. This view is parallel with Lord Hobhouse's judgment in *The Star Sea* that fraud was a requirement for there to be a fraudulent claim. In other words, the assured must be fraudulent in misrepresenting or concealing the facts. With respect to materiality of facts, he said that facts would only be material, if they had ultimate legal relevance to a defence under the policy.[127]

2) He realised that the remedy of avoidance *ab initio* is harsh towards the assured and is a more extreme form of contractual termination than an acceptance of repudiatory conduct. Thus, since this situation that attracts the post-contractual duty of utmost good faith stems from contractual terms the breach of which would provide the insurer with contractual remedy, for the extreme remedy of avoidance to be available there must be at least the same quality of conduct as would justify the insurer in accepting the assured's conduct as a repudiation of the contract. He therefore aligned remedy of avoidance *ab initio* with contractual remedy. In addition to the materiality test that the fraudulent conduct must have an effect upon the insurers' ultimate liability, the gravity of the breach must be such as would enable the insurers, if they wish to do so, to terminate the contract.[128]

3.1.2 Conclusion of the assured's post-contractual duty of utmost good faith

It can thus be said that the courts recognise the existence of the post-contractual duty of utmost good faith although with reservations.[129] From the cases mentioned and analysed above, the scope and consequence of a breach of the assured's post contractual duty can be summarised in a nutshell as follows:

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[127] [2001] 2 Lloyd's Rep 563 para. 26.
[128] Ibid., para. 36.
[129] *The Star Sea* [2001] 1 Lloyd's Rep 389 para. 5 per Lord Clyde.

First, the assured's post-contractual duty of utmost good faith has been fragmented[130] by the suggested removal of fraudulent claims from the duty of utmost good faith. The true circumstance that would attract the post-contractual duty of utmost good faith is where the policy contains contractual terms requiring the assured to provide information.

Secondly, the scope of the duty is more refined[131] and the remedy of avoidance *ab initio* is now aligned with contractual remedy.

Thirdly, the post-contractual duty ends when litigation commences.

3.1.3 Problems arising from the application of the criteria set out by Longmore L.J. in *The Mercandian Continent*

Contractual terms attracting the post-contractual duty of utmost good faith in *The Mercandian Continent* were notice of claim and claim co-operation clauses - the claims conditions.

Under the law of contract there are different types of terms and conditions, the breach of which entails different types of remedies. Claims conditions are considered innominate terms. The remedy for breaches of an innominate term depends upon the nature and the gravity of the consequences of the breach. If the breach is sufficiently serious or the consequences of the breach are so grave that the innocent party is seriously prejudiced, that innocent party can accept the breach as repudiatory and terminate the contract. Longmore L.J. mentioned the decision of the court in *Alfred McAlpine v BAI (Run off) Ltd.*[132] indicating another type of contract term. Breach of this type of term would allow the insurers to reject merely the claim without having to accept the breach of contract as being repudiation of the contract as a whole.[133] The decision in this case was doubted by the majority in the recent Court of Appeal case,

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[130] The term "fragmentation" was used by Andre Naidoo and David Oughton, "The confused post-formation of duty of good faith in insurance law: from refinement to fragmentation to elimination?," *Journal of Business Law* May (2005): 346-371.
[131] The term "refinement" was also used in Naidoo and Oughton.
[132] [2000] 1 Lloyd's Rep 437.
[133] [2001] 2 Lloyd's Rep 563 para. 14.

Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp.[134] However, the minority Court of Appeal judge, Waller L.J., followed the case.

If the claim conditions fall under this type of contract term, breach of which merely allow the insurers to reject the claim, a problem in applying the criteria set out by Longmore L.J. in *The Mercandian Continent* may arise. In particular, one of the criteria was that the gravity of the breach would entitle the insurers to terminate the contract but not the claim. Therefore, if a breach of claims conditions merely gives rise to termination of the claim, how would the contract be terminated and how would the criteria ever be met?

Nevertheless, if breach of this type of contract term does not allow the insurers to reject the claim as said by the majority judges in *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp,*[135] breach of this type of term can hardly give rise to repudiation of contract. Damages can be given for breach of an innominate term without the need to repudiate the contract. *The Mercandian Continent* should be an example of facts where damages should be awarded to the insurers although they were not claimed in that case. From the facts of the case, breach of the terms providing the assured to keep the insurers fully advised in relation to the possible claim made against the assured merely require the insurers to maintain the case in the English court longer than expected. This may create extra expenses. In addition, the insurers are normally protected by contractual terms that provide them with a contractual remedy. The breach, if serious, would entitle the insurers to reject the claim or repudiation of the policy or if less serious, to a claim for damages. It has thus been said that "in theory the continuing duty of utmost good faith is still alive, but in practice it is just like a barking dog: it barely bites..."[136]

The next question which must be considered is where insurance contains a warranty, would the post-contractual duty of utmost good faith be applied to a contractual term that was a warranty entitling the insurers to automatic discharge of liability in the case of breach?

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[134] [2005] 2 All ER 145 per Mance L.J. and Sir William Aldous.
[135] [2005] 2 All ER 145.
[136] Baris Soyer, "Continuing duty of utmost good faith in insurance contracts: still alive?," 79.

It is clear that breach of a warranty would meet the criteria set out by Longmore L.J., as the breach definitely affects the insurers' ultimate liability. It can also be considered a repudiation of the policy by the assured that would entitle the insurer to terminate the contract. Would this mean that the insurer would be able to enjoy the remedy of avoidance as well?

The judge at first instance, Toulson J., in *The Aegeon,* was aware of this possibility and held that if the insurers had a valid defence of breach of warranty, any continuing duty of utmost good faith would be superfluous. There are no other authorities supporting this view. It might be said that this is analogous to the exclusion of the assured's pre-contractual duty of disclosure provided in s.18 (3) (d) of the MIA 1906 which provides that "in the absence of inquiry the following circumstances need not to be disclosed namely:...(d) any circumstance which it is superfluous to disclose by reason of any express or implied warranty".

However, it is curious why an innominate term that is normally not as important as a warranty in insurance law should give the insurer a retrospective remedy of avoidance while a breach of warranty provides a less severe consequence.

3.1.4 Alternative remedies to the duty of utmost good faith when there is a breach of contractual terms requiring the assured to give information or when fraudulent claims are made

As said above, the only true example that would attract the post-contractual duty of utmost good faith is where there is a contractual term requiring the assured to provide information. Hence, the insurers are already protected by a contractual remedy. The insurers may claim damages, decline to claim or repudiation of the policy, which would be considered as just. It is unnecessary to resort to the post-contractual duty of utmost good faith, which has the draconian remedy of avoidance *ab initio* as it may make things more complicated.

In the case of fraudulent claims, even though Mance L.J. in *The Aegeon* suggested the removal of fraudulent claims from s. 17 of the MIA 1906, it was merely a tentative view, and the issue is therefore not yet settled.

In practice, the insurers can resort to three protections from fraudulent claims:

1) Contractual protection

It is common for an insurance contract to have a fraudulent claims clause, the breach of which would deprive the assured of "all benefits under the policy". According to the authorities, this would not have a retrospective effect but merely give rise to the right of the insurer to treat the policy as terminated for breach. The obligation not to make a fraudulent claim derives from an express or implied term which goes to the root of the contract.[137]

2) Common law rule protection

This protection can be extracted from Lord Hobhouse's judgment in *The Star Sea.* He was of the view that fraudulent claims rules should stem from the principle that a person should not benefit from his own wrong.[138] The remedy under common law protection can be the rejection of the claim, as in the case where a fraudulent device to promote a claim has been used[139] or in the case of termination of the contract for repudiation by the assured.[140] What remedy should be used depends upon the seriousness of the assured's breach of contract.

3) The post-contractual duty of utmost good faith

There is no authority suggesting avoidance *ab initio* as the remedy for making a fraudulent claim even though the authorities sometimes link the making of a fraudulent claim with the duty of utmost good faith principle.[141]Indeed, *The Star Sea*

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[137] *Orakpo v Barclays Insurance Service* [1995] LRLR 443.
[138] [2001] 1 Lloyd's Rep 389 para. 61.
[139] *The Aegeon* [2002] 2 Lloyd's Rep 42.
[140] *Britton v Royal Insurance Co* [1866] 4 F & F.
[141] Ibid.

left the issue open and the judges in the case seemed to be of the view that avoidance *ab initio* should not be a proper remedy. *The Aegeon* considered fraudulent claims as falling outside the scope of the post-contractual duty of utmost good faith.

In summary the insurers are protected by the contractual terms and the common law rule if there is a making of fraudulent claim. Resorting to the remedy of utmost good faith would therefore be unnecessary and entail complication regarding any retrospective remedy.

From the ineffective application of the post-contractual duty of utmost good faith mentioned above and other possible protection available under contract law or other common law rules, it is worth questioning the necessity of the assured's post-contractual duty of utmost good faith.

3.1.5 Possible solutions to the arising problems

1) Contractual basis for the assured's post-contractual duty of utmost good faith

It is obvious that the judgments in the cases concerning the post-contractual duty have been affected by the draconian remedy of avoidance *ab initio.* But it is also clear that the courts support its existence.[142] A compromise solution would therefore be to find a way to keep the obligation under the duty of utmost good faith but at the same time provide a more effective remedy.

This can be done by basing the basis of the duty upon the express or implied terms of the contract instead of s. 17 of the MIA 1906.[143] This idea was suggested by Lord Hobhouse in *The Star Sea.* He said that:[144]

"A coherent scheme can be achieved by distinguishing a lack of good faith which is material to the making of the contract itself (or some variation of it) and a lack of

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[142] These can be seen from the judgments of the trilogy of cases mentioned earlier; *The Star Sea; The Mercandian Contintent* and *The Aegeon.*
[143] This idea is also supported by Howard N. Bennett, "Mapping the doctrine of utmost good faith in insurance contract law, " *Lloyd's Maritime and Commercial Law Quarterly* (1999):165.
[144] [2001] 1 Lloyd's Rep 389 para. 52.

good faith during the performance of the contract which may prejudice the other party or cause him loss or destroy the continuing contractual relationship. The former derives from requirements of the law which pre-exist the contract and are not created by it although they only become material because a contract has been entered into. The remedy is the right to elect to avoid the contract. The latter can derive from express or implied terms of the contract; it would be a contractual obligation arising from the contract and the remedies are the contractual remedies which are provided by the law of contract..."

This would get rid of the remedy of avoidance *ab initio* and provide the insurers with a more flexible remedy. This view is very plausible considering that Longmore L.J. in *The Mercandian Continent* was of the view that the true instance of the post-contractual duty of utmost good faith was in the situation where the contractual terms required the assured to give notice of claims or assist the insurers in the claims.

In addition, resorting to express or implied terms of contract would also solve the problem of when fraudulent claims have been made, if fraudulent claims are still considered a breach of the duty of utmost good faith. This would be consistent with the *obiter* given by Hoffman L.J. in *Orakpo* that making fraudulent claims would go to the root of the contract and entitle the insurer to discharge.[145] In other words, making a fraudulent claim would then be regarded as breaching the terms of the contract. This term would be a condition of the contract the breach of which would entitle the insurer to repudiate the contract and discharge himself from liability.

With respect to a fraudulent device or means to promote the claim, it might be said that there is a breach of an innominate term, the remedy of which might be only the rejection of the claim itself or repudiation of the policy. There are, however, no authorities or *obiter dicta* supporting this solution. Recently, the International Hull clauses (01/11/03) ("IHC 2003") have regulated the issue of fraudulent devices or means to promote a claim by incorporating express contractual obligations. Clause 45.3 deals with fraudulent conduct. In particular, this clause provides that there is a condition precedent to the insurers' liability; the assured should not use fraudulent

[145] [1995] LRLR 443, 451.

means or devices to promote the claim.[146] This illustrates that the duty not to use fraudulent means or devices to promote the claim can stem from contract law. This is consistent with the suggestion of the application of express or implied terms of contract as the basis of the post-contractual duty of utmost good faith. However, the IHC 2003 merely indicates the uncertainties of the law and tries to regulate the matter by contract.[147] They do not say that fraudulent claims or using fraudulent devices or means to promote the claim should be regarded as a breach of the duty of utmost good faith.

The judges in recent cases seem to prefer the view that the fraudulent claims rule should fall outside the scope of the post-contractual duty of utmost good faith. This hints at the fragmentation of the duty or the possibility of the disappearance of the post-contractual duty of utmost good faith as a whole.

2) Fragmentation of fraudulent claims from the duty of utmost good faith

This view, as aforementioned, has been introduced by Mance L.J. in *The Aegeon.*[148] There is a subsequent case that clearly follows Mance L.J.'s view indicating the acceptance of the common law judges of this view. The case was *Axa General Ltd v Gottlieb.*[149]

In this case, the assured, Mr. and Mrs. Gottlieb obtained a building policy with Axa, the insurer. The assured had made four claims in respect of damage and payments by the insurer were made for repairs and alternative accommodation. The insurer brought proceedings to recover all payments made on the basis that the assured acted fraudulently in two separate respects in the pursuit of the first two claims. The trial

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[146] The clause does not use the words fraudulent means or devices to promote the claims as such but the contents of the clause seem to refer to them. It provides as follows:
"45.3 It shall be a condition precedent to the liability of the Underwriters that the Assured shall not at any stage prior to the commencement of legal proceedings knowingly or recklessly
45.3.1 mislead or attempt to mislead the Underwriters in the proper consideration of a claim or the settlement thereof by relying on any evidence which is false
48.3.2 conceal any circumstance or matter from the Underwriters material to the proper consideration of a claim or defence to such claim."

[147] Lynne Skajaa, "International Hull Clauses 2002: a contractual solution to the uncertainty of the fraudulent claim rule?," *Lloyd's Maritime and Commercial Law Quarterly* 2 May (2003): 279-288.

[148] [2002] 2 Lloyd's Rep 42.

[149] [2005] Lloyd's Rep IR 369.

judge held that the first two claims were tainted by fraud but the later two claims were not. The assured argued that a fraudulent claim had no effect on interim payments made under the first two claims, prior to any fraud, in respect of genuine loss incurred. The insurer argued that monies paid prior to the fraud in respect of genuine losses suffered by the assured on the two subsequent insurance claims were recoverable.

The Court of Appeal judges Mance L.J., with whom Pill and Kenne L. JJ. agreed, continued the idea of removing the fraudulent claim from the post-contractual duty of utmost good faith. It was held that where all or part of a claim was fraudulent,[150] or where fraudulent devices were used to promote a genuine claim,[151] the assured could not recover in respect of any part of the claim. This rule applies to the situation where a claim was initially honest, but later became fraudulently exaggerated or supported by fraudulent devices. All the sums paid were recoverable even the sums paid relate to genuine loss. The judges relied upon public policy that an insured should not have the settled expectation that, even if the fraud failed, he would lose nothing. Based upon this public policy the assured's appeal was dismissed. As a result, the whole of the claim to which the fraud related was forfeited including any interim payments made on that claim and they were recoverable. With respect to the insurer's cross-appeal, it was held that there was no basis or reason for giving the common law rule relating to fraudulent claims a retrospective effect on prior separate claims which had already been settled under the same policy before any fraud occurred. This shows that the juristic basis of the fraudulent claims jurisdiction does not lie in s.17 of the MIA 1906 but rather based upon public policy. It should, however, be noted that the judges did not go further to the effect of fraudulent claims upon the future of the policy itself. At present it is not certain whether fraudulent claims amount to repudiation of the policy by the assured which entitles the insurers to terminate the policy. [152] Nevertheless, one thing is certain from this case; remedy for fraudulent claims do not have retrospective effect on the policy. The genuine claims paid under the policy are not affected as long as they are not part of the fraudulent claim.

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[150] *The Star Sea* [2001] 1 Lloyd's Rep 389.
[151] *The Aegeon* [2002] 2 Lloyd's Rep 42.
[152] Mance L.J. mentioned in this judgement that there were "some force in the argument that the common law rule relating to fraudulent claims should be confined to the particular claim to which any fraud relates." This means that the policy is not terminated.

However, the fragmentation of fraudulent claims from the duty of utmost good faith is subject to uncertainties. One uncertainty is that in some situations the judge is not ready to strike out the duty of utmost good faith even though the issue relates to a fraudulent claim. This can be seen in *Marc Rich Agriculture Trading SA v Fortis Corporation Insurance NV*[153] which refused to strike out a defence by the insurers who pleaded that failure to disclose material facts in the claims process amounted to a breach of the duty.

The case concerned cargo insurance from warehouse to warehouse. The insurers were informed of the loss by means of a fax from the assured's brokers, which stated that further information was to follow. Indeed, the assured later notified the insurers that he intended to conclude an agreement with a third party who was responsible for removing the cargo under which the third party would pay for the cargo. The insurers refused an indemnity. One of the defences they relied upon was that there had been a fraudulent claim. In particular, the assured had, when presenting his claim, deliberately concealed from the insurers the fact that the loss had been discovered at an earlier date but there had been no notification at that stage and that the assured had on discovering the loss initially attempted to prevent further removals of cargo by the third party but had subsequently abandoned that attempt on the basis that it could prejudice negotiations for future payment by the third party.

In this case, the assured sought to have this defence struck out. Cooke J. referred to the duty of utmost good faith and applied *The Aegeon*[154] that there was no room for the operation of s.17 in the claims process and accordingly there was no duty of disclosure based on the duty of utmost good faith. However, instead of following the view of Mance L.J. in *The Aegeon,* and held that from the facts of this case there was no fraudulent conduct by the assured, the assured merely withheld certain facts, therefore there were no fraudulent claims, Cooke J. considered that the issue before him was a striking out and it was inappropriate in such proceedings to strike out a defence which was in the context of "a difficult, contentious and developing area of the law". He recognised what had been said in *The Aegeon* as *obiter dicta,* and therefore was not bound by Mance L.J.'s comment in that case. In addition, the facts

[153] [2005] Lloyd's Rep IR 396.
[154] [2002] 2 Lloyd's Rep 42.

of the case had to be fully ascertained. He thus concluded that it was at least arguable that there was a duty on the assured not to conceal or to fraudulently withhold material facts.

Another uncertainty is the efficiency of the principle itself. This can be seen in *Interpart Commercio e Gestao SA and another v Lexington Insurance Co.*[155]

In this case a cargo policy was issued by the insurers which included a warranty to the effect that quantity and quality surveys had to be undertaken at the assured's expense before the policy attached to any one cargo. The assured presented a fraudulent certificate to the insurers. Later a loss had occurred and a claim was then made against the insurers. The insurers denied liability. One of the defences was that the submission of a fraudulent inspection certificate amounted to the use of fraudulent means in the promotion of the claim.

The Court accepted that the fraudulent inspection certificate had been used as a part of the documentation that founded the assured's claim. It was common ground that the fraud was not required to have any inducing effect on the insurers, as the law sought to punish fraud in order to deter others. However, the court was not satisfied that there was a sufficient connection between the fraudulent conduct and the promotion of the claim. Hence, not every fraud would amount to fraudulent means or devices to promote a claim. The Court concluded that: "It is not yet established how close must be the relationship between the fraud relied upon and the claim."

As a result of this case, it does not mean that every type of fraud can be captured by the view of Mance L.J. in *The Aegeon.* This means that the fragmentation of fraudulent claims from the duty of utmost good faith still leaves a loophole for there to be a fraudulent conduct by the assured.

However, it should be noted that both cases illustrating the uncertainties are not common cases. *Marc Rich Agriculture Trading SA v Fortis Corporation Insurance*

[155] [2004] Lloyd's Rep IR 690.

NV[156] concerned a strike out of defence case and where the facts of the case had not been fully ascertained. Cooke L.J. indeed stated that at trial he would follow Mance L.J.'s view. In *Interpart Commercio e Gestao SA and another v Lexington Insurance Co.*[157] the insurers sought summary judgement. The task of the Court was not therefore to produce a definitive view of the law but merely to ascertain whether the claimants under the policy had a prospect of success. It can therefore be said that Mance L.J.'s view that fraudulent claims should fall outside the scope of the duty of utmost good faith is still convincing.

3) The elimination of the post-contractual duty of utmost good faith

As mentioned above, under current law, the application of the assured's post-contractual duty of utmost good faith is limited to the terms of the policy that require the assured to provide the insurers with information. The judges seem to prefer the view that the fraudulent claims rule should fall outside the scope of the post-contractual duty of utmost good faith. As a result, a breach of the post-contractual duty that would result in avoidance of the policy *ab initio* still arises and when it arises, it is bound with the contractual remedy. In other words, breach of the post-contractual duty therefore gives rise to contractual remedy.

It is hard to see situations in which avoidance *ab initio* would benefit the assured, especially when the loss has already occurred. When the contract is entered into the contractual remedy should be considered as just. Allowing the post-contractual duty of utmost good faith to exist opens an opportunity for the insurer to resort to avoidance *ab initio* as a remedy. This would create injustice towards the assured and thus should be avoided.

In *The Star Sea* Lord Hobhouse referred to the public policy rule of law that a person should not benefit from his own wrong.[158] Mance L.J. followed this view and opined that the rules on fraudulent claims were beyond the scope of s. 17 of the MIA 1906.[159] It is a paradox to consider fraudulent claims involving fraudulent conduct as falling

[156] [2005] Lloyd's Rep IR 396.
[157] [2004] Lloyd's Rep IR 690.
[158] [2001] 1 Lloyd's Rep 389 para. 62.
[159] *The Aegeon,* [2002] 2 Lloyd's Rep 42 para.45.

outside the scope of the duty of utmost good faith that requires the parties of insurance contracts to act in utmost good faith. However, this illustrates that the post-contractual duty of utmost good faith is not an overarching principle and does not have to be applied to every situation involving fraudulent conduct.

Therefore, it was suggested that an alternative approach with the same result might be reached in *The Mercandian Continent.* This would get rid of the residual post-contractual duty of utmost good faith. This can be done by extending the rules on fraudulent claims to encompass materially fraudulent conduct during performance, attributing such cases to a rule of law based on public policy.[160]

This is quite welcome as the clause regarded as attracting the post-contractual duty of utmost good faith is the claims conditions clause. It is said that any material falsehood in the notice of claim clause is likely to be repeated in a subsequent claim in respect of that loss and will be categorised as a breach of utmost good faith in the claim.[161] In other words, the claims conditions are relevant to the making of claim and non compliance of the clauses would affect the claim made by the assured. The claims made by the assured would not be considered as a good claim.

To sum up, the assured's post-contractual duty of utmost good faith should be eradicated. There are enough protections for the insurers both by contract and other common law rules.

Since the duty of utmost good faith applies to both the assured and the insurer, it is important to look at the current status of the insurers' duty of utmost good faith and, in the same manner, whether there is a need for this duty at the post-contractual stage.

3.2 The insurer's post-contractual duty of utmost good faith

At the pre-contractual stage, the insurer's duty of utmost good faith hardly plays any role. The assured is the one who has the information concerning the risk which must

[160] Naidoo and Oughton, 346-371.
[161] Clarke, 880 para. 27-1A1.

be disclosed to the insurer. The notion of the insurer's post-contractual duty of utmost good faith was first mentioned in *The Good Luck.*[162] The Court of Appeal ruled that the insurer owed a continuing duty of utmost good faith but did not provide any guideline as to the scope of the duty.

More and more cases in this decade have dealt with the insurer's post-contractual duty of utmost good faith. It is submitted that the insurer's post-contractual duty of utmost good faith extends to his dealings with the assured rather than being confined to the duty of disclosure, like the assured's duty of utmost good faith.[163] This can be confirmed by considering the issues where the insurer's duty of utmost good faith comes into play, in particular, in situation where there is a use of follow settlements, claim cooperation or claim control clauses. Would the insurers be able to refuse to exercise their rights under those clauses and then deny liabilities under any settlement made by the assured? Must the insurers' withholding of approval be done in good faith? Or in situations where the non-disclosed facts relate to rumours or allegations which later become immaterial during the contract or to material facts which appear to be inducement in the insurers' eyes but are actually not. Would the insurers be in breach of the duty of utmost good faith if they seek to avoid the policy based upon non-disclosure of these material facts?

These situations merit a closer consideration in order to understand the scope of the insurer's duty of utmost good faith and its role in insurance contract. This culminates in the answer to the question of its necessity to the insurance contract.

3.2.1 Follow the settlements, claim cooperation and claims control clauses

In *The Mercandian Continent,*[164] Longmore L.J., who classified situations attracting the post-contractual duty of utmost good faith briefly mentioned the insurer's duty of utmost good faith under liability policies that:[165]

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[162] [1998] 1 Lloyd's Rep IR 514.
[163] Merkin, *Colinvaux and Merkin's Insurance Contract Law*, 10966.
[164] [2001] 2 Lloyd's Rep 563.
[165] Ibid., para.22 (7).

"...Such other situations may arise under liability polices, particularly if the insurers decide to take over the insured's defence to a claim. Interests of the insured and the insurers may not be the same but they will be required to act in good faith towards each other. If for example the limit of indemnity includes sums awarded by way of damages, interest and costs, insurers may be tempted to run up costs and exceed the policy limit to the detriment of the insured. The insured's protection lies in the duty which the law imposes on the insurer to exercise his power to conduct the defence in good faith. In such circumstances Sir Thomas Bingham, M.R. could not "for one instance accept...[the] suggestion that a breach of this duty, by an insurer, once a policy is in force, gives the assured no right other than rescission", see Cox v. Bankside Agency Ltd., [1995] 2 Lloyd's Rep. 437 at p. 462"

He therefore was of the view that under liability policies, particularly in the situation where the insurers decide to take over the assured's defence to a claim, the assured and the insurers will be required to act in good faith towards each other and the insurer must exercise his defence in good faith. However, he did not specify the remedy for breach of the duty but quoted Sir Thomas Bingham, M.R. in *Cox v Bankside Agency Ltd.,* that it is hard to accept that there is no other remedy than rescission. Thus, Longmore L.J. again accepted the existence of the insurer's post-contractual duty of utmost good faith but did not go into further detail as to the scope and the remedy for breach of the duty.

In a reinsurance contract there are normally standard clauses in the contract. These are follow settlements, claim cooperation or claim control clauses. Most facultative reinsurance agreements today contain "follow the settlements" clauses. They originally appeared in facultative agreements in the 1930s, in order to prevent the reinsurers from reopening the reinsured's settlements.[166] "Claim cooperation" clauses require the reinsured to provide information to reinsurers and will generally give the reinsurers the ultimate right to consent to any settlement in order to be bound by it at

[166] Lowry and Rawlings, 401. *Assicurazioni Generali Spa v CGU International Insurance plc* [2004] Lloyd's Rep IR 457. The reinsurer must follow the settlements made by the reassured with the assured if: 1) the settlement was bona fide and business like; and 2) the basis on which the claim was accepted by the reinsured was one which fell, or at least arguably fell, within the scope of the direct policy and the reinsurance.

the reinsurance level.[167] "Claim control" clauses take negotiations with the assured out of the reinsured's hands and confers upon reinsurers the right to negotiate with the assured.[168]

The role of the insurers' duty of utmost good faith relating to these clauses was mentioned by Rix L.J. in *Eagle Star Insurance Co Ltd v Cresswell and others (Cresswell).*[169]

This was a reinsurance case in which the claimant, the reassured, was the excess layer insurer of a US company and reinsured part of its liability with the defendants. The reinsurance provided that the reinsurers would follow the settlements of the reassured. The reinsurance provided the following clauses under which the reassured agreed:

"(a) To notify all claims or occurrences likely to involve the Underwriters within 7 days from the time that such claims or occurrences become known to them.
(b) The underwriters hereon shall control the negotiations and settlements of any claims under this policy. In this event the underwriters hereon will not be liable to pay any claim not controlled as set out above.
Omission however by the Company to notify any claim or occurrence which at the outset did not appear to be serious but which at a later date threatened to involve the Company shall not prejudice their right of recovery hereunder."

This was described as a claims cooperation clause, although the Court of Appeal commented that it was in the nature of a claims control clause. The distinction had not been drawn in this case.

The main issue in this case was whether the clauses were conditions precedent, a question answered in the affirmative. In other words, the claim-cooperation clause was a condition precedent of the liability of the reinsurers under the reinsurance contract. The reassured would not be able to claim if he did not follow the clause and

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[167] Ibid., 403.
[168] Ibid.
[169] [2004] Lloyd's Rep IR 557.

settled with the assured without the reinsurers' consent even though there was a follow settlements clause. The condition was precedent to the reinsurers' liabilities.

With respect to the duty of utmost good faith, the question was how a claims cooperation clause expressed in this fashion would operate where the reinsurers simply refused to exercise control. In this case, as it was held that the clauses are conditions precedent to the reinsurers' liabilities, if the reinsurers did not take part in controlling the negotiations and settlements of any claims by simply refusing to take part, would the reassured not be able to claim from the reinsurers at all?

Rix L.J. suggested two possible solutions to this problem. The first was waiver, in appropriate circumstances a refusal to participate by the reinsurers could be construed as a willingness to follow the reassured's settlements. However, waiver might not exist merely by a simple refusal to join the negotiations. This point was not amplified. Another solution was based upon an implied term whereby reinsurers would not exercise their discretion under a claims provision in bad faith, capriciously or arbitrarily. The test was that the reinsurers must not take into account considerations other than the merits of the claim. Rix L.J. then mentioned that the duty to act like this was "as a matter of law in the very essence of the reinsurers' mutual obligation of good faith", a suggestion made by Longmore L.J. in *The Mercandian Continent.*

As a result of Rix L.J.'s judgment, it seems that the implied term was an element of the duty of utmost good faith. However, if one looks at the case in which the reference to implied term appeared regarding the claims cooperation clause and reference has been made to good faith, it might be said that the good faith mentioned in this case is not the same as the duty of utmost good faith in insurance contract. The case was *Gan Insurance Company Ltd v Tai Ping Insurance Company Ltd (Nos. 2 & 3).*[170]

In this case, the reinsurance was placed in London by Tai Ping, a Taiwanese reassured with Gan, the reinsurer. The reinsurance was for the insurance underwritten by Tai Ping on an erection all risks and third party liability taken out by the assured. The reinsurance contained the standard Full Reinsurance Clause NMA 416, namely:

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[170] [2002] Lloyd's Rep IR 667. The issue also appeared in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2)* [2001] Lloyd's Rep IR 291.

"Being a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements..."

The reinsurer's obligation to follow settlements was qualified by a claims co-operation clause in the following terms:

"Notwithstanding anything contained in the reinsurance agreement and/or policy wording to the contrary, it is a condition precedent to any liability under this policy that:
(a) the reinsured shall, upon knowledge of any circumstances which may give rise to a claim against them, advise the reinsurers immediately, and in any event not later than 30 days.
(b) the reinsured shall co-operate with reinsurers and/or their appointed representatives subscribing to this policy in the investigation and assessment of any loss and/or circumstances giving rise to a loss
(c) no settlement and/or compromise shall be made and liability admitted without the prior approval of reinsurers. All other terms and criticisms of this policy remain unchanged."

At first instance, Longmore J.[171] with respect to the right of the reinsurers held that paragraph (c) did not give an unfettered right to the reinsurers to withhold its consent from a settlement between the reassured and the primary assured. There was an implied obligation on the reinsurers to act reasonably. This holding was upheld by the Court of Appeal. However, Mance L.J., with whom Latham L.J. agreed, said that, whereas the reinsurer is "entitled to exercise his own judgment", consent should not be withheld "arbitrarily"[172] and that "any withholding of approval by reinsurers should take place in good faith after consideration of and on the basis of facts giving rise to a particular claim and not with reference to considerations wholly extraneous to the subject matter of the particular reinsurance."[173] He however continued to say that: "...this conclusion does not involve an inadmissible extension of the duty of

[171] *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2)* [2001] Lloyd's Rep IR 291.
[172] [2001] Lloyd's Rep IR 667 paras 73 and 74.
[173] Ibid. para 67. See also para. 76.

good faith in insurance law or of the consequences of breach of any such duty. The qualification ...does not arise from any principles or considerations special to the law of insurance. It arises from the nature and purpose of the relevant contractual provisions..."[174] It can be seen therefore that the judge insisted that this proposition did not arise from any principles or considerations special to insurance law but from the nature and purpose of the co-operation clause. The good faith principle in this case is therefore not the same as the doctrine of utmost good faith in insurance law.

3.2.2 The scope of the insurer's duty to avoid the contract in good faith

Recent cases[175]dealing with the insurer's post-contractual duty of utmost good faith at the claim handling process have brought a novel scope to the insurer's post-contractual duty of utmost good faith. The issues arose were as follows:

1) Whether at the time of avoidance the insurer must exercise his right to avoid in good faith;

2) If the insurers had already avoided the contract but the facts has become immaterial at a later stage whether the right to avoid may be lost?

It might be said that these issues arose because of the facts involved in the cases. Rumours, allegations of criminal charges, acquittals and the like are not ascertainable at the time of formation of the contract. Problems therefore occur when at a later stage those facts turn out not to be true or substantiated. In addition, in some situations material facts might appear in the insurers' eyes to be the inducement but were in fact not. The concerning case analysed at the next stage illustrated that the last type of situation happens at the time the insurance policy is renewed, when facts have changed but the insurers still rely on the old information given by the assured. It is therefore argued that in both circumstances the basis for the insurers' entitlement to avoid the policy either no longer exists or has not existed at all.

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[174] Ibid at para. 68.

[175] *Strive Shipping Corporation v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)* [2002] 2 Lloyd's Rep 88; *Drake Insurance plc v Provident Insurance plc* [2004] Lloyd's Rep 268; *Brotherton v Aseguradora Colseguros SA and another* [2003] Lloyd's Rep IR 746 (CA).

In order to decide these issues, the judges were drawn between two principles of law. On the one hand, it is said that: "the sound philosophical basis of the duty of disclosure in an insurance context is that a true and fair agreement for the transfer of risk on an appropriate basis depends on equality of information".[176] Hence, the materiality and inducement of the facts should be assessed at the time of placement of insurance contract. Non-disclosure of material facts would entitle the insurers to avoid the policy *ab initio* even though the facts are subsequently proved to be untrue. On the other hand, the legal principle preventing reliance on facts that have in the event been proved to be immaterial is quite welcome. It has often been said that the duty of utmost good faith has no punitive effect upon the assured[177] and the assured's duty of utmost good faith should not be used by the insurer as an instrument for enabling the insurer himself to act in bad faith. This appeared in Lord Hobhouse's speech in *The Star Sea.*[178]

The judge tried to maintain these two principles, by regarding rumours, allegations, criminal charges or acquittals and the like as material facts that have to be disclosed. However, the insurers may not be entitled to avoid the policy for non-disclosure if those facts are no longer material or the insurers are no longer induced. The answers to the questions can be derived from recent cases.

3.2.2.1 *The Grecia Express*

The judgment was made by Colman J. in *Strive Shipping Corporation v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express).*[179]

In this case, the vessel, *Grecia Express,* was insured under a marine war risks policy that covered loss caused by "any terrorist or any person acting maliciously, or from a political motive, and excluded loss caused by barratry of master officers or crew". The assured alleged that the vessel was sunk by unknown persons acting maliciously.

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[176] *Brotherton v Aseguradora Colseguros SA and another*[2003] Lloyd's Rep IR 746 para. 24 per Mance L.J. followed *Lynch v Dunsford* (1811) 14 East 494 and *Carter v Boehm* (1766) 3 Burr 1905.
[177] *Pan Atlantic v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep 427; *The Star Sea* [2001] 1 Lloyd's Rep 389.
[178] [2001] 1 Lloyd's Rep 389.
[179] [2002] 2 Lloyd's Rep 88.

The insurers denied liability on a number of grounds, one of which was that the assured failed to disclose certain facts in relation to four previous losses of vessels in which the assured had been interested. Those facts went to moral hazard or magnitude of the risk of sabotage and therefore were material and had to be disclosed by the assured.

Colman J. accepted that the undisclosed facts were material but from the facts, the assured could rebut all suggestions of fraud in relation to those four vessels in which the assured was interested. In other words, the material facts were no longer material at the time avoidance was sought by the insurers. Therefore they were unable to rely upon their right of avoidance.

He relied upon two principles of law in rejecting the insurers' avoidance:

1) Since avoidance *ab initio* is an equitable remedy which is discretionary, a court could refuse to grant the remedy of avoidance if, at the time the remedy was sought, the facts relied upon were not in reality material.

2) The insurer owed a duty of utmost good faith to the assured; therefore he must exercise his right of avoidance in good faith or this right may be lost. This could mean that at the time of avoidance the insurer must exercise his right to avoid in good faith. It could also mean that if the insurer had already avoided the contract but the facts later became immaterial, the right to avoid may be lost as avoidance of the policy has no longer been made in good faith.

3.2.2.2 Rejection of *The Grecia Express*'s decisions

Subsequent case that rejected the first reason given by Colman J. based upon equitable jurisdiction and part of the second reason based upon the duty of utmost good faith was *Brotherton v Aseguradoa Colseguro SA and another (Brotherton).*[180]

[180] [2003] Lloyd's Rep IR 746.

This was a reinsurance case. The defendant, reassured, had issued a banker's blanket bond and professional indemnity policy to a Colombian bank. One of the risks insured was a loss caused by dishonest or fraudulent acts of its officers or employees. On renewal of the policy the reinsurers found out that there were allegations that appeared in the Colombian media concerning the propriety of the president of the bank and other senior officers at the time of placement, which were not disclosed to the insurers. They purported to avoid the reinsurances and commenced proceedings in the English courts for negative declaratory relief as to their entitlement to so avoid. The basis for avoidance was the reassured's failure to disclose rumours and allegations, which were material facts. The reassured admitted that reports existed and that they had been aware of those reports, but argued that what had been alleged in the reports was untrue. The allegations against the president of the bank had been cleared.

At a case management hearing before Moore-Bick J., the reinsurers sought to prevent the defendant from adducing evidence at the trial as to the truth or otherwise of the allegations. They argued that at the time the risk was placed the allegations, true or not, were material facts known to the defendant but that had not been disclosed, and that was enough to justify avoidance. It was not open to the defendant at the trial to attempt to show that facts, which at the time of placement were material, were in the light of subsequent knowledge not true.

Moore-Bick J. agreed with the reinsurer's argument and held that the facts were material and justified the right to avoid. Moreover, a court could not reopen the avoidance at any subsequent trial by taking account of evidence that showed that rumours or allegations were unfounded.

The Court of Appeal upheld the judgments and held that if the insurers had purported to avoid the policy prior to the matter coming to trial, the court could not reverse that avoidance. Avoidance for non-disclosure is in the nature of the right to rescind the contract. As the right to rescind is generally exercisable at the election of the injured party, there is no need for the intervention of the court.[181] Based upon this analogy to rescission, the Court of Appeal also rejected the allegation that the insurers would be

[181] *Drake Insurance plc v Provident Insurance plc* [2003] Lloyds Rep IR 781(Comm) para. 31; *Brotherton v Aseguradoa Colseguro SA and another*[2003]Lloyd's Rep IR 746 (CA) para. 27.

in breach of the duty of utmost good faith if they persisted upon avoidance of material facts which later proved to be non-existent. [182] Mance L.J. held that the insurers could not overturn a valid avoidance by reliance on the continuing duty of utmost good faith.[183] He said that: "rescission under English law is not generally subject to any requirement of good faith or conscionability".[184]To hold otherwise would require a trial within a trial. The insurers would be asked to pay the costs of the enquiry if the assured was able to show at trial that material facts that should have been disclosed had no foundation even though at the time of placement the assured had withheld material facts.

The Court of Appeal also held that even if the matter of avoidance arose at trial for the first time, the court would have no right to refuse the remedy of avoidance simply because the assured's failure to disclose material facts on placement had to some extent been exonerated in the light of information available at trial. Buxton L.J. gave his judgment that it is inept to extend the duty of utmost good faith to the enforcement of the contract in litigation. Indeed, this was the position of the assured's duty of utmost good faith as held by The House of Lords in *The Star Sea.*[185]

To sum up, the judgment of *Brotherton* overruled Colman J.'s judgments to the extent that there is no breach of the duty of utmost good faith by the insurer in insisting on their avoidance even though material facts have become no longer material. He also confirmed that the duty of utmost good faith ceases when litigation commences. This scope of the insurer's duty is parallel to the assured's post-contractual duty of utmost good faith.

The issue that was left open by the Court of Appeal in *Brotherton* was whether the insurers would be in breach of the duty of utmost good faith if they sought to avoid the policy even with the benefit of hindsight and knew that those material facts were no longer material or they were no longer induced at the time of avoidance.

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[182] Mance L.J. cited *Abram Steamship Co v Westville Shipping Co* [1923] AC 773; *Horsler v Zorro* [1975] 1 Ch. 302.
[183] [2003] Lloyd's Rep IR 746 para. 34
[184] Ibid.
[185] [2001] 1 Lloyd's Rep 389.

3.2.2.3 Acceptance of Colman J's judgment in *The Grecia Express* regarding the insurers' duty of utmost good faith at the time of avoidance

The case that dealt specifically with this issue was *Drake Insurance plc v Provident Insurance plc (Drake).*[186]

The case concerned double insurance where an insurance company sought contribution from another insurance company. The loss fell under both policies. Each policy contained a rateable proportion clause in similar terms, which had the effect that if there was any other policy in force, each insurer was liable only for its proportionate part of any claim. The case became complex when Provident avoided the policy for non-disclosure of material facts. But Drake alleged that Provident's right to avoid the contract was precluded by relying on Colman J.'s decision in *The Grecia Express* case. Avoidance was no longer valid as the non-disclosed facts were, at the time of placement, did not actually constitute inducement, even though they seemed to be the inducement in the insurers' state of mind.

The case was decided for the assured based upon materiality of facts and inducement. It was held that the non-disclosed facts had not induced the insurers to enter into contract with less preferable terms.

The Court of Appeal considered the utmost good faith issue and gave *obiter dicta* that the insurers are under the duty of utmost good faith at the time of avoidance. There was unanimity that an insurer who actually knew that the facts relied upon had been undermined would be in bad faith, with blind-eye knowledge sufficient for this purpose. It was, however, held on the facts of the case that actual or blind-eye knowledge on the part of Provident had not been established.

The unclear issue was whether the insurers' continuing duty of utmost good faith went any further. Rix L.J. thought that it might be so, if the insurer was on notice that there was a potential problem and "there were to be a general principle that at any rate where there is notice, it would not be in good faith to avoid a policy without first

[186] [2004] 1 Lloyd's Rep 268.

giving the insured an opportunity to address the reason for which the insurer is minded to avoid the policy".[187]According to him, the rationale behind the existence of this duty of utmost good faith is that the assured's duty of utmost good faith should not be used by the insurer as an instrument for enabling the insurer himself to act in bad faith, a principle which appeared in Lord Hobhouse's speech in *The Star Sea*[188] at paras. 54-56. Clarke L.J. supported this view but noted that there was at the present time: "...no authority for the proposition that an insurer owes the insured a duty to take reasonable care to make appropriate enquiries before avoiding the policy".[189] Pill L.J. went further in a more decisive manner that even in the absence of blind-eye knowledge; "a failure to make any enquiry of the insured before taking the drastic step of avoiding the policy was... a breach by the insurer of the duty of good faith".[190] From the facts, Pill L.J. found that Provident had not, when avoiding the policy, acted in good faith and therefore was not entitled to avoid the policy.

As a result of these *obiter dicta,* it can be said that there is a post-contractual duty of utmost good faith imposed upon the insurers. However, there are several points subject to criticism.

3.2.2.4 Criticisms

The non-disclosed facts of these three cases can be divided into two categories. The first category is those non-disclosed facts that are rumours and allegations that could not be substantiated at the time of placement but are later proved by the assured as non-existent, like those in *The Grecia Express* and *Brotherton.* The second category is those non-disclosed facts that appeared to constitute inducement under the insurers' eyes but were in fact not, as happened in *Drake.*

The acceptance of the existence of the insurer's post-contractual duty of utmost good faith at the time of avoidance was introduced in *Drake.* Applying the insurer's post-contractual duty of utmost good faith to the facts of the case would not create

[187] [2004] 1 Lloyd's Rep 268 para. 92.
[188] *The Star Sea* [2001] 1 Lloyd's Rep 389.
[189] [2004] 1 Lloyd's Rep 268 para. 145.
[190] Ibid., para. 177.

confusions in conceptual analysis. It was held by Rix L.J. and Clarke L.J. that materiality had to be assessed by reference to the actual facts as they existed at the date of presentation, rather than as they were presented. In other words, the facts did not induce the insurers to enter into the contract at the time of placement. Hence, avoidance by the insurers should not be justified and in any case, the assured would have been able to argue that there was a wrongful avoidance by the insurers amounting to repudiation of the policy by them. This wrongful avoidance entitles the assured to damages for any loss caused to him in addition to any sum due under the policy.[191]Pill L.J. dissented in this judgment and held that what needed to be considered, with respect to materiality of fact, were the apparent facts not the actual facts. According to him, actual facts must be considered when considering whether the insurers were in breach of the duty of utmost good faith at the time of avoidance. In other words, the insurers would be in breach of the duty of utmost good faith if they avoid the policy for non-disclosure of material facts which did not induce the insurers to enter into the contract. Hence, applying the duty of utmost good faith to this situation would be just, as in reality the insurers based their avoidance upon material facts which did not induce them to enter into the contract. However, the application of the duty is not free from criticism.

In *Drake,* Rix L.J. himself was of the view that if the insurers are under the duty of utmost good faith at the time of avoidance there might be uncertainty and dispute, including the issue of waiver.[192] In addition to this, he said that there might be difficulty in the conceptual analysis if the insurer's bad faith is used to render a non-disclosure immaterial in the first place because in that case no right to avoid ever arises. He cited again Lord Hobhouse's argument that the insurer should not be allowed to use the assured's duty of utmost good faith as an instrument for enabling the insurer himself to act in bad faith.[193] The same problems would arise if the insurer was under an obligation to make reasonable enquiries under the duty of utmost good faith before avoiding the contract as held by Pill L.J. The issue of waiver would definitely come into play e.g. whether the insurers by not asking the question have

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[191] R.Merkin, "Utmost good faith, Effect of avoidance on contribution of claims," *Insurance Law Monthly* 15(3) March (2003): 3.
[192] [2004] 1 Lloyd's Rep 268 para. 92.
[193] Ibid., para. 93.

waived the duty of disclosure by the assured that could create a long dispute between the parties.

In addition to Rix L.J's remarks, relying upon the insurers' post-contractual duty of utmost good faith would be inconsistent with the tendency in the present law regarding the assured's post-contractual duty of utmost good faith. Recent authorities have reduced the assured's post-contractual duty of utmost good faith nearly to nothing.[194] This was Mance L.J's view in *Brotherton* regarding the post-contractual duty of utmost good faith.[195] Moreover, the assured's post-contractual duty of utmost good faith applies only where there is fraudulent conduct by the assured. It must be severe enough to entitle the insurers to repudiate the contract and must also have an affect upon the insurers' ultimate liability. If this post-contractual duty of utmost good faith applies to the insurers, it should be based upon the same criteria. Hence, there must be fraudulent conduct by the insurers, it must entitle the assured to repudiate liability and have an effect upon the assured's claim. The insurers in this situation however were not fraudulent but merely acted in bad faith. Allowing the duty of utmost good faith to apply to this situation would expand the scope of the post-contractual duty of utmost good faith creating an imbalance in what is normally regarded as a parallel duty.

If the judgment in *Drake* regarding the insurers' duty of utmost good faith is applied to situations as in *The Grecia Express* or in *Brotherton,* the situation is less clear. It is settled that rumours, allegations, acquittals and the like are themselves material facts which have to be disclosed. The rationale behind this is that these facts go to the assured's moral hazard, something which the insurers would have wanted to know in considering the risk.[196]

In situations where the assured knows that the allegations or rumours were in fact not true, the assured should not actually have to disclose those facts as he did not rely

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[194] *The Star Sea* [2001] 1Lloyd's Rep 389; *The Mercandian Continent* [2001] 2 Lloyd's Rep 563; *The Aegeon* [2002] 2 Lloyd's Rep 42.
[195] [2003] Lloyd's Rep IR 746 para. 34.
[196] *March Cabaret Club & Casino Ltd v The London Assurance* [1975] 1 Lloyd's Rep 169; *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440; *Inversions Manria SA v Sphere Drake Insurance Co plc (The Dora)* [1989] 1 Lloyd's Rep 69.

upon those facts in making his bet.[197] The Court of Appeal in *Brotherton* however held that even these types of facts must be disclosed. That these facts are unsubstantial would be mitigated by the fact that the assured will presumably disclose not merely the facts but all matters supporting his statement, e.g. if the assured has to disclose convictions or acquittals, he is entitled to disclose his innocence or that he was wrongly convicted.[198] It is, however, difficult to see how the assured in reality would disclose outstanding charges and acquittals in the absence of prompting by express questions. The assured would not therefore be able to disclose evidence of his innocence as well as the fact of the charge.[199] In addition, it is difficult to see why acquittals of the assured should be disclosed considering the principle in criminal law that criminality must be proved beyond reasonable doubt. As a result of the judgments of Colman J. in *The Grecia Express* or Mance L.J. in *Brotherton* this principle of criminal law would not be sufficient for the purpose of a civil dispute.[200]

Nevertheless, it is the trend of the latest authorities that these types of facts are regarded as material. Indeed, because of this wide scope of moral hazard, the courts have tried to find a way to mitigate it subsequently by imposing the duty of utmost good faith upon the insurers at the time of avoidance.

Applying the duty of utmost good faith upon the insurers, at the time of avoidance, to these types of facts creates confusion. The facts that at the time the insurers avoid the policy, rumours and allegations have become no longer material should not have an effect upon their materiality at placement. There was no wrongful avoidance by the insurers. Applying the insurer's duty of utmost good faith at the time of avoidance would "alter the whole basis of the underwriting exercise and introduce an additional and unwelcome degree of uncertainty".[201] If material facts that were material at the formation stage can be challenged at a later stage by the assured, the assured would

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[197] Robert Gay, "Non-disclosure and avoidance; Lies, damned lies, and intelligence," *Lloyd's Maritime and Commercial Law Quarterly* Feb. (2004): 1-10, 3.
[198] [2003] Lloyd's Rep IR 746 para. 23.
[199] R. Merkin, "Utmost good faith; Reliance on disproved facts, " *Insurance Law Monthly* July (2003): 8
[200] Ibid.
[201] *Drake Insurance plc v Provident Insurance plc.* [2003] Lloyd's Rep IR 781, paras 30-32. At first instance there was a non-disclosure of material facts by the assured which later overruled by the Court of Appeal. However, this can be used as a hint what would have been the situation if there was a non-disclosure of material fact.

have the right to turn up at the court with information of which the insurers could not have been aware, and challenge the truth of those undisclosed facts. Every time when insurers accept the risk, they need to take into consideration the possibility of changes in circumstances.

It is said that this problem might be overcome by creating a narrower scope of material facts. From the assured's point of view the court could have gone further and held that rumours, acquittals and the like are immaterial at the outset. In other words, the narrower test of materiality focuses on actual facts withheld rather than allegations or rumours. By this way the truth of the facts would not change at a later stage. This would be an ideal solution from the assured's perspective as what the assured then needs to disclose would be actual facts. Nevertheless, this is inconsistent with the existing authorities that accept the materiality of moral hazard[202] and the fact that the assured sometimes bases his bet by relying upon rumours and allegation. For example, a ship has already been put to sea and there are reports which suggest that she may have been lost; in insuring this ship the assured is making a bet on the odds as to what may already have happened to this ship. Hence, limiting the scope of material facts might be a plausible solution but not one without obstacles.

To sum up, the facts of *Drake* allowed the insurer's duty of utmost good faith to be applicable. However, it is dubious whether it is right to rely upon the duty of utmost good faith as this might cause several problems. From the case, the avoidance was wrongfully made. It might be a better solution if the assured alleged that there was a wrongful avoidance amounting to repudiation of the contract by the insurers.[203]

In the case of non-disclosure of rumours, allegations, acquittals and the like, non-disclosure of these types of facts would not amount to wrongful avoidance. The non-disclosed facts were material at the time of placement even though they later have become non-existent or unsubstantial. The duty of utmost good faith should not therefore be applied to these types of facts.

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[202] *March Cabaret Club & Casino Ltd v The London Assurance* [1975] 1 Lloyd's Rep 169; *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440; *Inversions Manria SA v Sphere Drake Insurance Co plc (The Dora)* [1989] 1 Lloyd's Rep 69.

[203] Merkin, *Colinvaux's law of insurance*, 116 para. 5-03. The case cited was *Trasthene Packaging v Royal Insurance* [1996] LRLR 32.

Nevertheless, the idea of preventing insurers' reliance upon facts that they know to be no longer true or that no longer induce them to avoid the policy is quite welcome.[204] Since the facts in *Drake* justified the use of the duty of utmost good faith as indeed there was a wrongful avoidance, future cases that deal direct with rumours or allegations are awaited. With the above criticisms it seems that other principles of law should be relied upon rather than the duty of utmost good faith. However, it should be noted that recent case has again mentioned the insurer's duty to avoid the contract in good faith even though not concerning about rumours or allegations or facts which appeared to be the inducement in the insurers' eyes but were in fact not. In *Wise Underwriting Agency Ltd. v Grupo Nacional Provincial SA,*[205] Rix L.J, the minority in this case, took the insurer's duty to avoid the contract in good faith in considering waiver.

This case involved a reinsurance contract for cross-border shipments from Miami to Cancun. The goods stolen included Rolex and other high-value branded watches, which were more susceptible to theft. There appeared to be a mistake when the reinsurance documents were translated from Spanish to English: the list of goods-in-transit sent to the Mexican insurer, Grupo Nacional Provincial (GNP), contained the Spanish word "Relojes" (which could be translated as "watches" or "clocks") whereas the English version presented by the broker in London to WISE (the underwriting agents of the reinsurer) mentioned neither "watches" nor "Rolexs" in the consignment list. The presentation slip stated that large quantities of these clocks were regularly shipped to Cancun. The reinsurers avoided the contract on the basis of non-disclosure that the shipment contained Rolex watches. Materiality, waiver and affirmation issues were also considered. At first instance, the judge found that the fact that high values branded watches were being carried was a material fact to be disclosed and dismissed an argument that disclosure had been waived by the reinsurers. The reassured challenged the conclusion on waiver without challenging the materiality issue.

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[204] R. Merkin, "Marine insurance fraud, good faith and avoiding loss," *Insurance Law Monthly* 14 (11) Nov. (2002): 8.
[205] [2004] Lloyd's Rep IR 764.

Rix L.J. mentioned that: "...it would be unfair of the insurer to seek to avoid on a ground on which he was put on inquiry and should have satisfied himself".[206] He therefore resorted to insurers' duty to avoid the contract in good faith to dictate WISE's action. In other words, WISE ought to have acted fairly before deciding to avoid the contract. This means that in considering whether the assured is in breach of the duty of disclosure under the duty of utmost good faith, the insurer's avoidance in good faith must also be taken into account. This solution is consistent with the trend of recent judgments based on the mutual duty of utmost good faith. However, it is not easy to understand why in considering the assured's presentation, a process at the formation stage where no avoidance issue has arisen, the question whether the insurer is entitled to avoid the policy which is an issue at the claims stage has to be taken into account. Since Rix L.J. the minority in this case, it cannot be said that the judgement is authoritative.

4 Conclusion

The duty of utmost good faith is still a necessity in insurance contracts particularly in the pre-contractual duty. Even though nowadays information technology has developed dramatically rendering insurers to have more access to material information, the duty of disclosure of material fact is still a requirement in the insurance market, especially in commercial insurance. This is because in practice the market, which aims at accelerating the insurance process, insurance contracts are made very roughly e.g. by using a slip that contains limited detail. In addition, because commercial insurance is a global market, risks that occur in one country are insured in another country. It is hard for the insurers to have all the information. A very good example is the underwriting in the Lloyd's market where the underwriters underwrite risks all over the world in their underwriting box. The information they have is mostly documents and papers provided by the assured. The pre-contractual duty of utmost good faith is therefore very significant for insurance contract. Subsequent chapters will focus on the application of the pre-contractual duty of utmost good faith in practice.

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[206] Ibid., para. 62.

The role of the post-contractual duty of utmost good faith is still unclear. Even though, the assured's post-contractual duty of utmost good faith seems to be reduced almost to nothingness and the suggestion of the elimination of the assured's post-contractual duty of utmost good faith is very welcome as the duty hardly plays any role in insurance contracts and in those situations where it comes to play, contractual obligations, other common law rules and public policy provide adequate protection for the parties, the insurer's duty of utmost good faith seems to expand its scope. However, it seems that this expansion does not seem to be the correct way and is subject to several criticisms. Future cases are awaited, academic was of the view that the reasoning in *Brotherton* is to be preferred as Mance L.J. proceeded on the basis of case law.[207]This thesis agrees with the view of Mance L.J. in *Brotherton* that there should not be an insurer's post-contractual duty of utmost good faith parallel to the assured's post-contractual duty of utmost good faith.

[207] Lowry and Rawlings, 110 also preferred the reasoning in *Brotherton* given by Mance L.J.

Chapter 3

The use of slip at the placing process and the duty of utmost good faith

1 Introduction

Commercial insurance is usually high risk insurance involving great amounts of money underwritten in the London market by several insurers, usually by Lloyd's syndicates or insurance companies or a combination of both. With the exception of Lloyd's, an insurer must be a registered company,[208] an industrial and provident society or a body corporate established by charter or Act of Parliament.[209] Lloyd's itself is a unique organisation whereby its members are exempt from the need to obtain authorisation.[210] This automatic authorisation is now preserved under the Financial Services and Markets Act (FSMA) 2000. Lloyd's does not itself transact insurance business nor does it have any liability on policies issued by Lloyd's underwriters. Its function is to control the membership of Lloyd's, to provide facilities for the conduct of members' business and to regulate the Lloyd's market under the Lloyd's Acts.[211]

Insurance at Lloyd's is effected through so called "underwriters" acting on behalf of their syndicates. A syndicate is a group of individual real underwriters, passive investors called the "names". Hence, underwriting at Lloyd's is effected by private individuals. Unlike companies and partnership groups, private underwriters, on accepting a risk, bind themselves each for their own part not for one another and

[208] Under the Companies Act 1985 or one of its predecessors and it needs authorisation under the FSMA 2000 in the case of the U.K. companies. In the case of an E. C. insurance company carrying business via a U.K. branch, the company must be registered under the law of a member State other than the U. K., whose head office is in that member State and which is authorised in accordance with the general insurance Directive.

[209] The governing law of the insurer at present is FSMA 2000.

[210] It is, however, required that they must meet the solvency margin requirements.

[211] Now to be statutorily regulated under the Financial Services and Markets Act 2000.

without limit.[212] Lloyd's is a brokered market. Therefore, in order to purchase insurance from a Lloyd's insurer, the assured has to contact an appropriate broker.

The placing of an insurance contract at Lloyd's is done by using the "slip". Lloyd's uses the "slip" as a quick means enabling high risk insurance to be accepted by several underwriters within a short period of time. The use of the slip has become the most common means of effecting commercial insurance in the London market, even in cases where the insurance contract is effected by companies where Lloyd's underwriters are not actively involved in that risk.

The thesis focuses on the way the market operates and illustrates how it affects the implementation of the duty of utmost good faith. Indeed, the use of the slip in the placing process entails difficulties in applying the duty of utmost good faith. This chapter contemplates the following questions: whether the existing rules of law about the duty of utmost good faith in the Marine Insurance Act (MIA) 1906 are sufficiently comprehensive to encompass problems that might arise as a result of the placing process by the use of the slip; whether the common law judges can solve the problems; whether the use of leading underwriter clauses can mitigate the problems.

2 Placing process in the London market

The London market is a brokered market. Placing commercial insurance is thus normally done by a broker who is the intermediary between any potential assured and any potential insurer in the transaction. The place that best illustrates the operation of the market is Lloyd's.

The placing process at Lloyd's usually starts with the broker receiving an order from the potential assured. He then prepares the slip, a brief document containing all the particulars of the proposal necessary in accordance with the requirements of the potential assured. This information allows underwriters to make a decision as to whether the risk is acceptable and at what premium.

[212] Except those who invest on a limited liability basis at Lloyd's.

It should be noted that the broker may get quotations from the underwriters at the outset of the placing process if he wants. This can be done by using a "quotation slip". The quotation slip is actually a slip containing terms proposed by the assured, to the underwriters with the intention to receive quotations from the underwriters. These quotations given by the underwriters are not binding between the assured and the underwriter even though the underwriters have initialled the slip.[213]

After getting the quotations and preparing the slip, the broker subsequently approaches the leading underwriter. He usually exercises his discretion as to which underwriter to deal with as leading underwriter. A leading underwriter is the underwriter who the broker believes would subscribe to the risk with a reasonable amount of share and whose judgment is trusted by the following underwriters. Having a reputable leading underwriter initial the slip makes the risk attractive to the following underwriters. In the case where insurers are a combination of Lloyd's syndicates and insurance companies, a Lloyd's leading underwriter and an insurance companies' leading underwriter are both required.[214]

Next, the broker and the leading underwriter go through the slip together. They agree on any amendment to the broker's draft and fix the premium. When an agreement has been reached, the leading underwriter stamps the name of his syndicate on the slip and initials the slip (scratching) for his proportion of the cover either in percentage terms or in absolute financial terms.[215] The broker then takes the initialled slip around the market to the following underwriters. The following underwriters in turn initial the slip for the proportion they are willing to accept. They usually do so at least in part reliance on the leader's judgment in agreeing to the terms on the slip. The broker may cease presenting the slip to the market when he has received the requisite level of subscription. Nevertheless, it is not at all uncommon for the broker to continue presenting the risk to the market. This process is called "oversubscription". Even

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[213] Sometimes it is not apparent whether the slip is a final slip or a quotation slip and it is to be assumed that the slip is a full offer unless it specifically states otherwise.

[214] According to the London Market Principles 2001 only one leading underwriter has been recommended to create clarity and certainty of contract.

[215] There has to be an actual scratching or signature: the mere affixing of a stamp is not enough *Denby v English and Scottish Maritime Insurance Co Ltd* [1999] Lloyd's Rep IR 343. It was held in the case that the syndicate whose stamp had not been signed was not bound by the slip.

though oversubscription is accepted in the market, the principle of indemnity[216] renders any insurance in excess of 100% superfluous and a waste of premium. Therefore, it is necessary for the broker to reduce proportionately the subscription of each underwriter until the amount insured equals 100%. This practice is called "signing down" and is accepted from the authorities that Lloyd's custom and practice had conferred legal status on signing down.[217] That the amount of cover provided by each underwriter is subject to revision to an unknown degree may create difficulty in law to the extent that the contract lacks the certainty required by law.[218]This difficulty can be mitigated either by pointing to provisions in contracts (other than insurance) that allow one party to choose between a number of performance options, so that the final terms are left to him[219]or by the broker giving a "signing indication", a statement as to the total percentage subscription to the insurers.

The next stage, after the broker has ceased to show the slip around the market, is to prepare a "signing slip". This is a retyped slip bearing all the terms of the slip and a list of the subscribing underwriters with their signed down percentages. This document is shown to the leading underwriter and must be initialled by him. It is the leader's responsibility to check that the signing slip is in accordance with the original slip. In the case where there are both Lloyd's underwriters and insurance companies, members of the International Underwriting Association (IUA), on the original slip, separate signing slips are required.[220]

The wording is then presented to ' Xchanging Ins-sure' established in 2001 with the aim of joining the operations of the Lloyd's Policy Signing Office (LPSO) and the IUA's London Processing Centre (LPC), the London insurance market in general.

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[216] The principle that the insurer usually indemnifies the assured for what he actually loses by the happening of the event and not more than the insured amount.

[217] *General Reinsurance Corporation v Forsikringsaktiebolaget Fennia Patria (Fennia Patria)* [1983] 2 Lloyd's Rep 287. Mustill L.J. noted that if a loss occurred while the slip is being taken round the market, the extent of signing down is to be determined at the moment when the loss is known to the insured or the broker, since thereafter the risk can no longer properly be offered to further underwriters. Confirmed by the Court of Appeal in *General Accident Fire and Life Assurance Corporation v Tanter (The Zephyr)* [1985] 2 Lloyd's Rep 529.

[218] Clarke, 349 para 11-3C.

[219] Ibid. "The courts are slow to imply such provision, if the option could be exercised by one party in a manner prejudicial to the other".

[220] As a result of the London Market Principles 2001, there should be only one lead underwriter for the London market no matter whether they are underwriters from Lloyd's or insurance companies.

Xchanging Ins-sure will then issue a single policy on behalf of all the contributing underwriters,[221] representing the terms and conditions set out in the slip.

The nature of the policy is that it is a composite policy. This means that the contracts are made between the assured and a large number of individual insurers, namely, the syndicates, in particular, the members of the subscribing syndicates a "name", and/or companies or group of companies. Each one is jointly and severally liable for the full sum insured.

The Policy document can take a number of forms. Sometimes, especially at the reinsurance level, the parties may agree that no formal policy is to be issued, in which case the slip is referred to as a "slip policy". A slip policy is simply a slightly fuller form of the signing slip.[222]

This chapter focuses on problems arising from the use of a slip to place insurance. Normally an insurance contract exists under the policy. However, when the slip is signed both parties become bound. It is important therefore to understand the status of the slip and the policy. The question at this stage is whether the law regarding the status of the slip is consistent with the market practice.

3 The status of the slip and policy

From the explanation of the placing process as aforementioned, it can be seen that the slip represents a bundle of contracts. It is the law that the slip is an offer and subscription of the slip amounts to acceptance of that offer.[223] This constitutes a contract providing insurance cover in its own right.

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[221] Clarke, 347 para. 11-3A. Xchanging Ins-sure acts for Lloyd's syndicates, members of the IUA and for any other company authorising it.
[222] *The Zephyr* [1984] 1 Lloyd's Rep 58, 68 per Hobhouse J.
[223] The issue was first raised in *Jaglom v Excess Insurance Co Ltd* [1972] 2 QB 250. The decision in *Jaglom* was rejected by *General Reinsurance Corporation v Forsikringsaktiebolaget (Fennia Patria)* [1983] 2 Lloyd's Rep 287.

The modern authority that has accepted the contractual effect of a slip is *General Reinsurance Corporation v Forsikringsaktiebolaget (Fennia Patria).*[224]

This case concerned excess layer reinsurance. The defendant, Fennia, was a marine insurer and had reinsured its liability under two facultative reinsurance policies: a whole account cover, providing all risks protection, and a specific account cover, providing protection only against fire and flood damage to the goods while ware housed. The dispute was the result of an amendment made to the specific cover reinsurance. The excess under that policy was to be increased to 25 million Finmarks. This resulted in a loss of 27 million Finmarks. Instead of 15 million Finmarks being distributed to the specific loss reinsurers and 10 million Finmarks to the whole account reinsurers; 2 million Finmarks would have been distributed to the former and 10 million Finmarks to the latter.

The amendment slip was prepared by the reinsured's brokers. It turned out that only two out of twenty-eight of the specific loss reinsurers had signed the slip since the loss had taken place. The reinsured thereupon instructed the brokers to withdraw the amendment slip. The dispute was whether the two specific loss reinsurers were bound by the amendment and whether the reinsured was entitled to withdraw a partly subscribed slip.

At first instance, Staughton J. analysed the status of the slip in detail. He said that a slip is an offer and its initialling is an acceptance, therefore, binding the two claimants. However, he accepted that there was a custom which permitted an assured to withdraw a partly subscribed slip. In his view the right to withdraw could be exercised for any reason, and was subject only to the qualification that any cancellation had to be effected within a reasonable time. He then held that the defendant reinsured, Fennia, had effectively cancelled against the two specific loss reinsurers.

The case was appealed to the Court of Appeal where the judges reversed the ruling and held that there was no such alleged custom. The Court of Appeal's reasons were

[224] [1982] 1 Lloyd's Rep 87(Comm); [1983] 2 Lloyd's Rep 287(CA).

that a unilateral right to withdraw a partly subscribed slip is inconsistent with the basic position that a slip is a binding agreement. Moreover, the judgment at first instance would allow the reinsured to determine which of two groups of underwriters was to bear the loss.

From this case, it is crystal clear that the slip represents a bundle of contracts. Therefore, where a loss occurs between the date at which the slip has become fully subscribed and the date at which the policy is issued, the assured may recover.[225] The policy is thus in principle merely a formal representation of the agreement of the parties. The policy is, however, important as it must be issued before any action can be brought to court.[226] Therefore, it often occurs that the policy is issued only after the loss has happened.

However, when the policy is issued, the status of the slip as a contract itself is in doubt. It has been established that in the event of any conflict between the wording of the slip and the wording of the policy, the policy may be rectified following an application by the assured so that the policy accords with the original agreement in the slip.[227] But the matter is not clear in circumstances where the policy needs to be construed.

In *Youell v Bland Welch & Co (No1),*[228] reinsurance had been initiated by a Lloyd's slip and subsequently confirmed by the issue of a full policy. The dispute was about the policy period of cover provided under reinsurance. Although it was intended to restrict the reinsurers' cover to forty-eight months, the policy wording was ambiguous. Therefore the reassured that wanted unlimited cover to match its own

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[225] Section 21 of the MIA 1906 provides that: "A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract, [although it be unstamped]".

[226] Section 22 of the MIA 1906 provides that: "Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act. The policy may be executed an issued either at the time when the contract is concluded, or afterwards." The law was driven by stamp duty legislation in the past.

[227] *Symington & Cov Union Insurance Society of Canton Ltd (No.2)* [1928] 34 Com Cas 233, 235; *Wilson Hogate & Co Ltd v Lancashire & Cheshire Insurance Corp Ltd* [1922] 13 LlLR 486.

[228] [1990] 2 Lloyd's Rep 423.

liabilities, sought to justify its less generous interpretation of the policy wording by bringing into evidence the slip.

At first instance, Phillips J. rejected this attempt. He decided that the policy constituted an independent contract that had replaced the shorthand contract in the slip, so that the slip was immaterial and could not be used as an aid to construction. The Court of Appeal concluded that there was no ambiguity in the policy wording and that the reinsurance was indeed limited to forty-eight months. Had the policy been ambiguous, the judgments given by the judges at the Court of Appeal are divided as to resolution. While Beldam L.J. regarded the slip as merely a provisional contract which had been superseded by the policy itself, Staughton L.J. considered the terms of the slip but found it of no assistance on the facts of the case and Fox L.J. agreed with both judgments. Hence, until this time it had not been settled whether the slip would be excluded as a matter of law on the basis of the parol evidence rule[229] or would be accepted in the process of construction of the policy.

The most recent case dealing with this issue is *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co.*[230]

The facts of this case were rather complicated. The issue of whether the slip was superseded by the policy was one of the preliminary issues in the case. From the case the reinsurer denied liability under a reinsurance contract, claiming various reasons, one of which was that there was a breach of warranty. The dispute was whether the conditions under the direct insurance as expressed in the slip were a warranty and if they were, whether the subsequently issued direct insurance policies could be construed as including warranty by reference to the slip.

The direct insurance was meant to protect the investment of banks in film production companies. It was effected by means of two slips called slip policies, which specified that a given number of films were to be made. The formal insurance policies were subsequently issued. However, they did not make any reference to the number of

[229] Parol testimony cannot be received to contradict, vary, add to or subtract from the terms of a written contract, or the terms in which the parties have deliberately agreed to record any part of their contract.
[230] [2001] Lloyd's Rep IR 224 (Comm); [2001] Lloyd's Rep IR 596 (CA).

films to be made. The reinsurer alleged that a given number of films were a warranty in the reinsurance slip policies. The reassured argued that it was not a warranty since the conditions did not appear in the subsequently issued direct insurance policies. Hence, one of the numerous issues was whether the direct insurance contract contained the number of films to be made, which, if it was so, would also appear in the reinsurance contract.

At first instance, David Steel J. held that the two slip policies had not been superseded by the formal policies, and that it was necessary to read the two agreements together. However, his decision was affected by the fact that the structure of the insurance made sense only if a specific number of films were to be made, as otherwise there was a reduced possibility of revenue targets being met and thus the assured could suffer losses. Therefore, it could not be said that he decided the case on a rule of construction.

However, the Court of Appeal did consider this issue. Rix L.J. divided the issues into two circumstances.

First, where the policy was intended to supersede the slip, it followed that the intentions of the parties were to be found in the policy alone and the slip could be used only to add or modify the policy. He rejected any rule of law that the slip was immaterial once the policy had been issued. Hence, if the policy and slip are in the same terms, the slip adds nothing. If the policy and the slip are in different terms, however, then the parties must have intended those differences to be meaningful and the court should be cautious in giving weight to the slip.

Second, where it was not common ground that the slip was intended to be superseded by the policy, then it was necessary to consider both the slip and the policy.

As a result, he held on this issue that the slip had not been superseded. The slip was called a slip policy, which immediately questioned any presumption that the slip is intended to be superseded. Moreover, the policy wording itself was deficient in a number of respects; namely, it contained nothing about premiums, caps on recovery and cross-collateralisation.

In conclusion, it can be said that the law in relation to the status of the slip is settled. The contract of insurance arises as soon as the underwriter initials the slip. The slip has its own autonomy as a legally binding insurance contract even though a subsequent policy has been issued. The slip remains relevant. It is for the court to assess the parties' intentions from the wording of the two documents.

Regarding the slip as containing a bundle of contracts is consistent with the market practice for two reasons:

Firstly, the special characteristic of commercial insurance is in having many underwriters insuring the same risk. These underwriters are separate entities and each is liable only for his own part. Hence, when the broker acting on behalf of the assured approaches each of them with the slip containing all the risk details with the intention to make the insurer accept that risk, it should be regarded as an offer made by the assured to each of them. Therefore the initialling by each of them should be recognised as the acceptance of that offer.[231]

Secondly, as a result of the above reason, the slip represents contracts between the assured and each underwriter. Being an insurance contract, it should have its own autonomy. Hence, since the slip contains the agreement between the assured and each underwriter at the time the contract is entered into, the slip should be taken into consideration for rectification or construction of the policy even when the parties have agreed that the slip should be superseded by the subsequent policy. In this situation, the slip should still be considered to stress the intention of the parties to have different terms from the slip on the policy. Allowing reference to the slip in case of rectification but not construction of the policy does not make much sense since the allegation or defences based upon construction of the policy can be easily changed to rectification of the policy. For example, in *Youell* the reinsurers who raised the construction of the policy issue did not try to argue that the policy should be rectified in accordance with the terms of the slip and even conceded that the policy constituted

[231] Sometimes counter-offer can be made by the insurer. In other words, there might be a conditional acceptance which can not be regarded as final acceptance by the insurer *Assicurazioni Generali Spa v Arab Insurance Group* (BSC) [2003] Lloyd's Rep IR 131.

the contract between the parties. In this case, had the argument been for a rectification of the policy that the terms of the slip had not been placed in the policy; a different approach would have been adopted.

It is therefore clear that the slip has its own autonomy as a contract. The next stage is to consider the application of the duty of utmost good faith to the slip.

4 The duty of utmost good faith and the placing process

Under the duty of utmost good faith, during the negotiations of the contract, before the contract is concluded, the assured has the duty to disclose and represent all material facts, which a prudent underwriter would take into account in deciding whether or not to accept the risk and if to accept, at what premium. If the assured has failed to comply with these obligations, the insurer may avoid the contract, *ab initio.*[232]

These obligations are illustrated in the MIA 1906, which can be regarded as the codification of the law of marine insurance reflecting also the general law of insurance. These general rules of law generate from the belief that insurance contracts are based on the utmost good faith. In order to ensure a fair dealing the assured who has all the material information concerning the insured risks must disclose, and not misrepresent, all material facts to the insurer. In other words, the insurer relies upon the material information provided to him by the assured.

However, this is not the position in the commercial insurance market placing process. According to market practice, the following underwriters subscribe to the slip simply or largely on the basis of trusting the skill and judgment of the leading underwriter. They assume that the leading underwriter has subscribed to the risk after having considered full and accurate information of the risk given by the assured. In other words, the following underwriters usually decide whether or not to accept the risk by considering who is the leading underwriter and what the terms are on the slip agreed between the assured and the leading underwriter.

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[232] Section 18 and 20 of the MIA 1906.

It may be said that there is a kind of waiver on the part of the following market.[233] However, it is hard to understand why the following markets would have waived that a fair presentation of the risks have been made to them merely because the risks were firstly presented to the leading underwriter. As a result, it has been suggested that there should be a rule of insurance law, called the 'deemed communication' rule,[234] whereby following underwriters can take advantage of non-disclosures or misrepresentations established in the case of the leading underwriter.

4.1 The deemed communication rule and the placing process

The deemed communication rule is suggested in paragraph 623 of *Arnould's on the Law of Marine Insurance and Average* as follows:[235]

"Where there are several underwriters to the Slip or Policy, a representation of a material fact to the Underwriter whose name stands first extends to all the rest, so that each, when it proves false, may avail himself of the defence. The ground of this rule is the reasonable assumption that the others subscribe from the competence reposed by them in the skill and judgment in him whose name stood first, and their belief that he duly ascertained and weighed all the circumstances material to the risk. The underwriter is now no longer an individual but a syndicate: the rule would appear to apply to syndicates in the same way as it formerly did to individual underwriters. The members of this syndicate conduct their business through a single underwriting agent and may avail themselves of any defences open to him. Of course, if the representation to the first underwriter be not of material fact it cannot avail a subsequent one; and if it were of such a nature that it ought to have put the first underwriter on further inquiry, it will be equally imputed to the negligence of the subsequent underwriter that no such inquiry was made..."

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[233] Clarke, 348 para.11-3B.
[234] H. Bennett, "The role of the slip in marine insurance law," *Lloyd's Maritime and Commercial Law Quarterly* (1994): 116.
[235] Mustill M.J. and Gilman J.C.B. eds., *Arnould's Law of Marine Insurance and Average*, 16th ed. (London: Stevens), 1981.

Arnould cited authorities, which are quite old, to support this comment about the rule. They concerned marine insurance and the eighteenth and early nineteenth century practices at Lloyd's.[236]

4.1.1 Doubts about *Arnould*'s justification for application of the deemed communication rule

Several flaws can be noted from the rule suggested by *Arnould*:

First, the suggestion made by *Arnould* that the underwriter is at that stage no longer an individual but a syndicate is inconsistent with the existing law that each of the following underwriters enters into the contract on his own behalf and has a separate contract with the assured. Therefore, it is difficult to see why the relationship between the leading underwriter and the following underwriters should become a syndicate relationship basis.

Secondly, it is not coherent with the general rules of insurance law as appear in the MIA 1906. Whereas under s.18 and 20 of the MIA, the insurer is allowed to avoid the contract only on proof that there was a failure to disclose or a misrepresentation of material facts to the insurer seeking avoidance, the deemed communication rule permits avoidance by an insurer who has not established any such failure or misrepresentation in his own case.[237]

Thirdly, the courts have adopted this rule with dissatisfaction. Reservations made by the judges can be seen in the authorities. In an old authority *Bell v Carstairs*[238] Lord Ellenborough observed that: " it is difficult to see on what principle of law a representation to the first underwriter is considered as made to all those who afterwards underwrite the policy". Consider also the recent authority *General*

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[236] *Pawson v Watson* (1778) 2 Cowp 785, 789; Barber *v Fletcher* (1779) 1 Dougl 305 (*obiter*, as the representation was not material); *Marsden v Reid* (1803) 3 East 572; *Feise v Parkinson* (1812) 4 Taunt 640 (simple application of the rule with no discussion).
[237] *Bank Leumi Le Israel BM v. British National Insurance Co* [1988] 1 Lloyd's Rep 71.
[238] (1810) w Camp 543, 544.

Accident Fire & Life Assurance Corp v Tanter (The Zephyr)[239] where the judge expressed his doubt about the deemed communication rule introduced by *Arnould.*

This case did not directly concern the issue. It dealt, *inter alia*, with a signing down indication that had been presented to the first and fourth reinsurers but not to the second and third. The latter contended that they could rely upon that signing down indication and the broker was in breach of his duty of care as he was not able to acquire the indicated subscription.

At first instance,[240] Hobhouse J. held that the broker was liable to the first and fourth reinsurers in the tort of negligence but not to the second and third reinsurers.

The Court of Appeal, however, disapproved of the finding of tortious liability based on the signing indication. There was no evidence that the broker's optimism about the percentage of signing indication was not founded upon honest and reasonable belief. It was stated that liability might lie in contract for failure to pursue the percentage indicated with reasonable endeavours. There was, however, no appeal against the finding at first instance of tortious liability to the first and fourth reinsurers, and the Court of Appeal had to proceed on the assumption that there was such tortious liability.

The appeal was by the second and third reinsurers on the basis that the broker owed them a duty derived from the signing down indication given to the first reinsurer. Mustill L.J., who gave the main decision, dismissed this argument. In his reasoning he mentioned the deemed communication rule saying that:[241]

"...that there is an analogy with the suppose rule (the deemed communication rule) that a misrepresentation by the broker to the leading underwriter of such a character as to entitle the latter to avoid his contract with the assured, is effective to give a similar right to the other subscribers: see Arnould on Marine Insurance, 16th Edn, par. 623. I doubt whether this rule is still good law, if indeed it ever was..."

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[239] [1985] 2 Lloyd's Rep 529.
[240] [1984] 1 Lloyd's Rep 58.
[241] [1985] 2 Lloyd's Rep 529, 532.

Consequently, the answer to the question whether some special feature of the London market established a link between the signing down indication and the second and third reinsurers was addressed by Mustill L.J. as an analogy to the supposed rule of deemed communication. Having doubted its existence as stated above, he continued that no analogy can be made[242] and held that the broker was not liable to the second and third reinsurers.

The latest authority that shares the doubts of this deemed communication rule is *Bank Leumi Le Israel BM v British National Insurance Co (Bank Leumi).* [243]

The case was about contingency insurance effected by a bank. This insurance was a security for a loan given by the bank to finance the cost of production of a feature film. The loan was not repaid and the bank claimed under the policy. The insurers contended that there were non-disclosures and misrepresentations of material facts. The insurers argued several points: one that the bank ought to have disclosed that the film was no longer going to be produced in accordance with the terms of a certain agreement (the Mueller agreement) because the film was going to be produced by someone else not the borrower (Sagittarius); two that Sagittarius ceased to be the owner of various rights referred to in the Mueller agreement; and three that one of the prime sources of revenue in respect of the film was not available to Sagittarius anymore. The insurers argued that what was represented to them was that the film would be produced by Sagittarius, that Sagittarius would remain the owner of the rights in the Mueller agreement, that there was no limitation on any revenue in respect of the film being available to Sagittarius and that they entered into the insurance contract in reliance upon such representations, which were untrue.

The judgments dealt mostly with these contentions and it was held that there were no non-disclosures or misrepresentations by the assured. However, there was a point advanced by the 10th defendants, who were brokers sued by the bank on the basis that they bore the responsibility for any non-disclosures, misrepresentations or breaches of duty that might be established by the first nine defendants. The brokers argued on this

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[242] Ibid.
[243] [1998] 1 Lloyd's Rep 71.

point that the non-disclosures or misrepresentations were made only to the first three insurers and there was no evidence that they were made to the following underwriters (the fourth to ninth defendants). Therefore, the following underwriters could not rely upon such a defence. Saville J., who gave judgment in this case, said it was not necessary to consider this point and gave his view about the deemed communication rule by saying that:[244]

"For the reasons given earlier in the judgment, it is not necessary for me to decide this point in this case. Suffice to say that I share the doubts expressed by Lord Justice Mustill about the validity of this supposed rule (see The Zephyr, (1985) 2 Lloyd's Rep. 529 at p. 532) ..... in any case where this [the market practice whereby following underwriters subscribe to the risk by relying upon the judgment of the leading underwriter: this sentence is not mentioned in the case] is established, the supposed rule could perhaps be supported by proving a custom or usage in the particular market, or by importing an implied term into the contracts of the following underwriters, or even perhaps by treating the rule as resting upon some implied representation made to following underwriters that all material circumstances have been accurately provided to the leading underwriter. Even then the supposed rule could cause difficulties: for example, would it apply when the following underwriters (but not the leading underwriter) have been given full and accurate details of the risk? It must always be remembered that each subscribing underwriter makes a separate contract for himself (or for those he represents) so that it is difficult to accept the proposition that the mere fact that the leading underwriter may be able to avoid his contract should allow the others, contracting separately with the assured, also to do so".

For these reasons, even though the rule has become well established and can be regarded as one way to harmonise the general rules of law and the market practice, the rule still has flaws and is subject to many dissatisfactions by the authorities.

Until this stage the existing authorities have not provided any reasonable justification for the application of this rule except the one given in *Bank Leumi* by Saville J. as

[244] [1988] 1 Lloyd's Rep 71, 78.

stated above. However, he doubted the rule and had reservations upon its usage. In addition, it was merely an *obiter dictum* and has not been adopted by following authorities.

Therefore the status of law until now leads to a dilemma in answering the question: how should the duty of utmost good faith be applied to the placing process?

On the one hand, applying the general law as stated in the MIA 1906 would be inconsistent with the way the market operates. The following underwriters indeed often rely upon the judgment of the leading underwriter in deciding whether or not to accept the risk instead of going into detail of the risks with the broker. On the other hand, applying the deemed communication rule to the placing process, even though that would be consistent with market practice, would amount to a violation of the principle of law that the slip constitutes a bundle of contracts between the assured and the insurers.

Recently, alternative solutions have been made in a succession of cases that support the deemed communication rule but are based upon different justifications.

4.1.2 Other solutions in case law

Two solutions are suggested by the judgments in recent cases.

1) The fact that a false statement or non-disclosure of material fact has been made to the leading underwriter is itself a material fact and should be disclosed to the following underwriters. Non-disclosure entitles the following underwriters to avoid the insurance policy.

Five first instance cases illustrate this solution.

Aneco Reinsurance Underwriting Ltd v Johnson & Higgins Ltd (Aneco). [245]

[245] [1998] 1 Lloyd's Rep 565 (Comm);[2000] Lloyd's Rep IR 12 (CA); [2002] 1 Lloyd's Rep 157 (HL).

Cresswell J. dealt with this issue at first instance.[246] In this case, the claimants, the retrocedants, had instructed the defendants as their brokers to place retrocession cover for them. There was a misrepresentation to the leading retrocessionaire underwriter that the liability faced by the retrocedant was under an obligatory treaty. The treaty was in fact a facultative obligatory treaty,[247] under which the retrocedant was required to accept such risks as its policy holders chose to cede. The retrocessionaire underwriters sought to avoid the reinsurance. There was an arbitration between the claimants and the retrocessionaires. The arbitrators held that the retrocessionaires were entitled to avoid the retrocession cover by reason of non-disclosure or misrepresentation made to the leading retrocessionaire underwriter only. They also held that the following market could avoid on the ground that the brokers should have disclosed this failure to make a full and fair presentation to the leader and/or there was an implied representation that they had done so in the course of brokering to the following market.

After being unable to claim for the retrocession cover, the claimants commenced an action against their brokers seeking damages for loss of the benefit of the retrocession by reason of the broker's negligence. The defendant brokers argued that they were not bound by the decisions of the arbitrators and they were also not liable for the loss of retrocession cover written by the following market in these circumstances as a matter of law. The brokers relied on *dicta* doubting the availability of such a remedy by Mustill L.J. in *The Zephyr* and Saville J. in *Bank Leumi.*

After considering the above authorities and the findings and reasoning of the arbitrators, Cresswell J. decided that the evidence in the case adduced before him did support a finding of fact that the following market had accepted the risk on the basis that a full and fair presentation had been made to the leading retrocessionaire underwriter. From the case, the presentation to the leader was not complete and correct. Therefore, this failure should have been disclosed to the following underwriters in order to ensure a fair presentation to them. Failing to disclose this by the broker, he is thus liable to the assured. Cresswell J. emphasised that his decision was based on the facts of the case and not on some general legal principle.

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[246] [1998] 1 Lloyd's Rep 565 (Comm).
[247] See chapter four for declaration policies.

International Lottery Management Ltd v Dumas and Others.[248]

In this case, the claimant effected a political risk insurance with the defendants to cover loss of the claimant's investment and also consequential loss of operating profits in a lottery project in Azerbaijan. The claim arose by reason of alleged expropriation of the lottery by the government of Azerbaijan within the period of cover. The insurers rejected the claim on the grounds of alleged non-disclosure, misrepresentation and breach of warranty concerning a local law.

The judge held that there was a non-disclosure and misrepresentation to the underwriters. After the judge had held the leading underwriter was entitled to avoid the policy, he gave the judgment as to whether the following underwriter was also entitled to avoid the policy. He held that the cover was a specialised one and that the following underwriters had placed considerable reliance on the underwriting judgment of the leading underwriter on the basis that the leading underwriter had been given a full and fair presentation and was thus in a position to make a proper evaluation of the risk. Therefore, in order to give a full and fair presentation to the following underwriters, the failure to represent or disclose material facts to the leading underwriter must be disclosed to the following underwriters. In other words, the failure to disclose material facts itself is regarded by the court as a material fact that has to be disclosed to the following underwriters.

The judge regarded the decision made by Cresswell J. in the *Aneco* case as deriving basically from facts establishing the particular way of doing business in the case and not depending upon any rule of law or proof of a strict custom.

International Management Group (UK) Ltd v Simmonds.[249]

The case concerned a cancellation policy of a bilateral cricket tournament between India and Pakistan, which would be held in Toronto, Canada in the year 2000. Apart from ordinary risk, the claimant sought cover for political risk but did not disclose

[248] [2002] Lloyd's Rep IR 237.
[249] [2004] Lloyd's Rep IR 247.

certain material facts, namely, that the Indian government had refused to allow the Indian team to participate in a similar bilateral tournament in 1999 but gave permission to a trilateral tournament. The Indian government later refused to allow the Indian team to participate. The claimant claimed against the defendant under the policy in respect of losses suffered as a result of the cancellation. The defendant underwriters denied liability, *inter alia*, for breach of the duty of utmost good faith in misrepresenting or failing to disclose material facts to induce the underwriters to cover the political risk under the policy.

It was held that an unfair presentation was made to the two leading underwriters. With respect to the following underwriters, Cooke J. said that:

" In the context of a Lloyd's placement of this kind in a small contingency market, where the risk included a political element, with which the lead underwriters were more familiar than the followers and where one of the lead underwriters had access to greater sources of information, the reliance upon the leaders' subscription is self evident....the misrepresentations and non-disclosures which prevented a fair presentation of the risks to the leaders represented a material circumstance which was required to be disclosed to the followers, in order to make a fair presentation to them".

Brotherton and Others v Aseguradora Colseguros SA and another(No. 3).[250]

The claimants were primary and excess layer underwriters at Lloyd's and insurance companies carrying on business in the UK as reinsurers. The defendants were insurance companies in Colombia, who were the insurers of a Colombian bank. The reinsurance was Bankers Blanket Bond and Professional Indemnity reinsurances. The primary layer reinsurance covered loss up to a maximum of 5 billion Colombian Pesos each and every loss and in the aggregate, in excess of a deductible of 125 million Columbian Pesos each and every loss. Under the primary layer reinsurance, the risk was presented to the leading underwriter by the slip in accordance with market practice. Some of the following underwriters, however, had separate presentations before taking a line. Some accepted a line without a separate

[250] [2003] Lloyd's Rep IR 762

presentation. On the excess layer the brokers made separate presentations to each underwriter. The reinsurers contended that the reinsured's failure to disclose allegations of serious impropriety and fraud against the bank's president and four other senior officials amounted to a failure to disclose material facts that entitled the reinsurers to avoid the contracts.

On the issue of whether the following reinsurance underwriters would be able to avoid the policy, especially those before whom separate presentations were not made, it was held that the leading underwriter's participation was an important feature of the background leading the following market to the decision to accept the risk, as this type of business is relatively specialised. The following market therefore wrote the risk partly on the basis that there had been a fair presentation to the leading underwriter. The non-disclosure of material facts was itself a material fact.[251] However, Morison J. made some reservations that this judgment, which followed three previous cases as mentioned above, had not received the approbation of the Court of Appeal. Moreover, there was a case[252] which seemed to divert from this solution and that the correctness of the judgment in *Aneco* was made in a text-book.

Morison J. focused on the expectation of the market that a fair presentation had been made to the leading underwriter, and that if the leading underwriter is entitled to avoid the policy, so must the following market be entitled. It can thus be said that he was convinced that the following markets relied upon the leading underwriter but that he still doubted the justification of the judgments made in earlier cases.

The latest case, *Forrest & Sons Ltd v CGU Insurance plc,*[253] should also be mentioned at this stage. Even though it does not deal with the use of the slip at the placing process as such but it can be regarded as supporting the view that the previous breaches of the duty of utmost good faith are themselves material facts going to the moral hazard of the assured which should be disclosed to the insurers at the formation of contract.

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[251] Ibid., para. 44.
[252] *Sirius International Insurance Corp v Oriental Assurance Corp* [1999] Lloyd's Rep IR 343.
[253] 23 September 2005, unreported (forthcoming in [2006] Lloyd's Rep IR).

The case concerned a fire insurance of the assured's two pet food factories. The policy was meant to be renewed in April of the consecutive year since it was effected in 1997. The manufacturing process was carried out in an annexe to the factory. There bones were deep fried in open tanks heated by gas burners. There was a fire in the annexe which was probably caused by someone stumbling into a valve on a gas supply pipe and caused gas to escape and to be ignited by the heat. The insurers paid the loss although they insisted upon various risk improvements including full-time attendance while frying was taking place. Following the fire, the assured changed its process. The assured obtained from a company called Airflow an enclosed oven which was designed to bake the bones rather than to fry them. This implementation of the oven was unsuccessful and resulted in several events described as "almost a fire" event. The assured stopped using the oven and reverted to the old frying method, which it carried out subject to the obligations imposed by the insurers after the fire. Later the assured needed extra capacity and reconnected the oven. The oven caused a serious fire at the assured's premises. The assured then made a claim against the insurers. The insurers rejected the claim both on the terms of the policy and by reason of non-disclosure.

HHJ Kershaw QC held that the increase of risk clause operated to discharge the insurers from liability as stated in the insurance once the oven had been re-commissioned. The important point regarding the current considered issue concerned the judgment regarding non-disclosure. The judge held that, independently of the defence based on breach of condition, the insurers were entitled to avoid the renewal by reason of the assured's failure to disclose that the oven had been brought back into use. The judge accepted market evidence which indicated that this was a fact which would have been material to a prudent underwriter, and he was also satisfied that the insurers' underwriter would have refused to renew had he been aware of the changed circumstances. The judge went on to hold that if it was the case that the oven had been reconnected at the time of previous renewal (the year 2000 renewal) the assured would have been guilty of non-disclosure at that point, so that failure to reveal the earlier non-disclosure at the time the renewal in this case (the year 2001) was entered into would itself have been a breach of the duty of utmost good faith.

Applying this holding to the placing process where a non-disclosure or misrepresentation was made to the leading underwriter but not the following underwriters, this case supports the view that the non-disclosure or misrepresentation by the assured to the leading underwriter amounts to a previous breach of the duty of utmost good faith which should be disclosed to the following underwriters.

2) Because of the specialised cover, it is to be assumed that the following market has relied upon the presentation to the leading underwriter, and the underwriting judgment made by him, in the consideration of the risk

The case that best illustrates this solution is *Toomey v Banco Vitalicio De Espana Sa De Seguros Y Reaseguros (Toomey).*[254]

The claimant reinsurers refused their liability under facultative reinsurance relying upon, *inter alia*, misrepresentation of the terms of the underlying policy which was material and had induced the reinsurers to subscribe to the reinsurance policy.

The claimants reinsured a risk accepted by the defendant reinsured who had insured a Spanish football club in respect of loss resulting from relegation. It was alleged by the reinsurers that the underlying insurance had not been properly described by the reinsured in the reinsurance policy as not providing an indemnity for ascertained loss but rather for an agreed value.

Andrew Smith J. held that each of the underwriters, the leading and the following underwriters, was induced by the misrepresentation. From the underwriters' evidence, one of the underwriters clearly stipulated that he had limited experience of this class of business and was relying heavily upon the leading underwriter. Moreover, he would not have subscribed to the risk unless it was led by the leading underwriter.[255] Hence, from the judgment it can be said that if there was a misrepresentation made to the leading underwriter and he was entitled to avoid the contract, the following underwriter who relied upon the judgment of the leading underwriter should also be allowed to avoid the contract.

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[254] [2004] Lloyd's Rep IR 354 (Comm); [2005] Lloyd's Rep IR 423 (CA).
[255] [2004] Lloyd's Rep IR 354 (Comm), 71 (iv) and 77.

4.1.2.1 Implementation of the solutions suggested by case law: which one should be the best solution?

There are doubts regarding the first solution that a failure to disclose or represent material facts to the leading underwriter is itself a material fact which has to be disclosed to the following underwriters in order to achieve a fair and full presentation of risk to the following underwriter.

Academic[256] remarks that the reasoning of Cresswell J. in *Aneco*,[257] with respect to this issue, is inconsistent with *CTI v Oceanus*. [258] In *CTI* the proposition was that previous non-fraudulent breaches of the duty of utmost good faith are not material facts for the purpose of later applications. It is quite clear that the judgment of *CTI* is reasonable, since in a fraudulent breach of the duty of utmost good faith, the assured or the broker presenting the risk realises that those facts are material facts but fraudulently fails to disclose or misrepresents them. From the facts in *Aneco*, it can be seen that there was no fraud. The judge held that the failure to disclose or represent material facts is itself a material fact which has to be disclosed to the following underwriters and does not involve any fraud. In consequence, it seems that the judges held that even a non-fraudulent breach of the duty of utmost good faith is a material fact, which has to be disclosed to the insurer.

Non-fraudulent breach of the duty of utmost good faith can be innocent or negligent non-disclosure or misrepresentation. The difference between the two is that in an innocent or negligent non-disclosure the assured must possess or be aware of the existing material facts but innocently or negligently does not disclose those facts to the insurer. In an innocent or negligent misrepresentation, the assured might not possess or know of material facts but would believe in his statement without having

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[256] Merkin, *Colinvaux and Merkin's Insurance Contract Law*, 10265 para. A 0286 fn.3.
[257] This includes also the reasoning in subsequent cases which followed this view, namely, the reasoning in *International Management Group (UK) Ltd v Simmonds* [2003] Lloyd's Rep IR 247, in *Brotherton and Others v Aseguradora Colseguros SA and another(No.3)* [2003] Lloyd's Rep IR 762 (Comm), and in *Forrest & Sons Ltd v CGU Insurance plc* 23 September 2005, unreported (forthcoming in [2006] Lloyd's Rep IR).
[258] [1982] 2 Lloyd's Rep 178, 193, 198-200.

reasonable ground for doing so in the case of negligent misrepresentation, or having reasonable ground for doing so in the case of innocent misrepresentation.[259]

The material fact required for disclosure in *Aneco* was the failure of the assured or the broker to disclose or represent material facts to the leading underwriter. Therefore, if the assured and/or the broker were innocent and did not know that they failed to disclose or represent material facts to the leading underwriter, it is hard to imagine that at the time they approached the following underwriters, they would possess the knowledge of this material fact amounting to innocent non-disclosure. According to the law, there is no duty to disclose material facts which the proposer does not know. This issue was raised in *Economides v Commercial Union Assurance plc,*[260] a non-commercial case.

In this case, the assured effected a household contents insurance policy with the defendant insurers. He stated that the contents of his flat were worth £12,000 and that the total value of the valuables in the flat did not exceed one-third of this. Later in 1990, the assured's parents took up residence in the flat. They brought with them some jewellery and silverware, worth approximately £30,000. The assured, who was at this time 21 years old, showed little interest in the goods, but accepted his father's advice that he ought to increase the sum insured under his policy. His father suggested that an increase of approximately £ 3,000 should suffice. The assured asked the insurers to increase the sum insured to £16,000. The flat was then burgled and property worth £31,000 was stolen, the bulk of which were the valuables belonging to the assured's parents. The assured claimed under the policy, and it was only then that it became clear that the value of the parents' valuables was £30,970, much more than one third of the total sum insured or even the total sum insured itself. The insurers denied liability, alleging both misrepresentation and non-disclosure of material facts. Considering the non-disclosure issue, the Court of Appeal accepted the view of Moulton L. J. given in *Joel v Law Union and Crown Insurance Co* that "The duty is a duty to disclose, therefore, necessarily depends on the knowledge you possess."[261] Moreover, they also stated that the view he expressed was actually the position at

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[259] Elizabeth A. Martin, *A Dictionary of Law* (Oxford: Oxford University Press, 2002) 317
[260] [1998] QB 587.
[259] [1908] 2 KB 863, 884.

common law before codification. Consequently, they held that the insured was required to be honest, which he was, and, provided that he did not wilfully close his eyes to knowledge, he was under no obligation to make further inquiries of any sort in order to discharge his obligation as to the disclosure of material facts.[262]

Hence, it can not be said that the assured in *Aneco* was in breach of the duty of disclosure as he did not possess the facts. However, the defence by the insurers often includes the allegation that there was non-fraudulent misrepresentation by the assured. It could be said that this aspect of the defence would be inconsistent with the *CTI* judgments, which proposed that previous non-fraudulent breach of the duty of utmost good faith is not a material fact for the purpose of later applications. As the decision given in *CTI* was given by the Court of Appeal, it may be said that the decision of the higher court should be applied.

According to section 18(1) of the MIA 1906: "...the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him." One might therefore argue that the failure to disclose or represent material facts to the leading underwriter is something that ought to be disclosed to the insurers by the assured.

From the facts of those cases, the breach of the duty of utmost good faith was the result of the placing process. According to section 18 (1) the material fact which ought to be disclosed must be a circumstance that occurs in the ordinary course of business of the assured. The placing process is not in the assured's ordinary course of business. In this case the non-disclosure was the result of the way the insurance contract was placed not the result of the course of the assured's business.

In addition to this, even though it can be said that the judges came to this solution as a result of market practice, the courts pay attention only to the insurers' position in market practice. On the other side of the coin, market practice also illustrates that the assured usually agrees to the terms of the slip with the leading underwriter only. Therefore, if the assured does not act fraudulently, he normally discloses all relevant

[262] [1998] QB 587 per Simon Brown and Peter Gibson L. J.J.

material facts to the leading underwriter. Hence, these types of material facts clearly put an extra burden under the duty of utmost good faith on the assured. This distorts the objective of the duty of utmost good faith at the negotiation process in deriving fair dealing between the assured and the insurers.

For all these reasons, even though the judgments entitle the following underwriters to rely upon the non-disclosure or misrepresentation made to the leading underwriter, the reasons given by the judges, with due respect, might not be convincing.

However, the second solution suggested by Andrew Smith J. in *Toomey* is more convincing. It was held in this case that if the cover is specialised, the following underwriters rely upon the judgment exercised by the leading underwriter. Therefore, misrepresentation made to the leading underwriter should also be made to the following underwriters. This judgment is different from the former solution in that in the former solution, even though the judgments in the cases involved as stated above pay attention to the fact that the cover is specialised, the judges went on to hold that the failure to disclose or misrepresent material facts is itself a material fact. In *Toomey*, the case was decided upon the evidence given by the underwriters. In other words, the following insurers have to prove that they rely upon the judgment of the leading underwriter in accepting the risk. Therefore, the availability of a defence depends upon the facts of the case whereby the insurers have the burden of proof. Nevertheless, this solution is subject to doubt. It is noted that it could not be said that the only reason that these underwriters had written the risk was the presence of that particular leading underwriter, as there was no reason to believe that some other leading underwriter would not have been found and the underwriters would have followed his lead. [263]

It should be noted that another solution can be extracted from the suggestions made by Saville J. in *Bank Leumi*. He treated the rule as resting upon the implied representation made to the following underwriters that all material circumstances have been accurately provided to the leading underwriter. According to this view, if the leading underwriter can prove that there has been a non-disclosure or

[263] Robert Merkin, "Reinsurance, Warranties and the full reinsurance clause," *Insurance Law monthly* 16(1) January 2004: 1, 3.

misrepresentation of material facts, the following underwriters would be entitled to avoid the contract without the need to prove that they have relied upon the judgment of the leading underwriter and would not have accepted the risk were not it for the acceptance of the risk by the leading underwriter.

The last two solutions would solve the problem existing under the first solution. The following underwriters would be able to rely upon non-disclosure of material facts made to the leading underwriter, whose decisions they rely upon, without falling under the circumstances whereby the assured failed to disclose or represent the material facts to the leading underwriters without knowing that such material facts exist. This would create a fair dealing between the parties.
Nonetheless, it is said that this problem rarely arises in practice. According to the usual practice in the market, in the event of a dispute, the insured sues a representative underwriter in return for an agreement from the others to be bound by the result of such action.[264] This is done by using leading underwriter clauses.

4.1.3 Solution by using the leading underwriter clause

It is very common in the London market for insurance slips to include "leading underwriter clauses", which authorise the broker to approach the nominated leading underwriter on behalf of the market as a whole. Such clauses are not in standard form, and may cover matters such as amendments or extensions to the insured peril, receiving notice from the assured where this is required by the policy and, in some cases, settlements. They are typically included in the slip that is presented to the market for subscription. The clause takes effect as a contract between the assured and each of the insurers who sign the slip that the insurers will be bound by the decisions of the leading underwriter in the circumstances provided for by the clause. Thus, if the clause requires the following market to follow the settlements of the leading underwriter, the assured has the right to insist that all insurers do just that, as long as the settlement falls within the scope of the leading underwriter's authority.[265] In this situation, the assured only sues the leading underwriter as representative underwriter

[264] *Bank Leumi Le Israel BM v British National Insurance Co* [1998] 1 Lloyd's Rep 71, 77.
[265] *Barlee Marine Corporation v Mountain, The Leegas* [1987] 1 Lloyd's Rep 471.

for all the following underwriters, if there is a non-disclosure to the leading underwriter by the assured, the leading underwriter can use that defence against the assured and the settlements between the leading underwriters with the assured will bind the following underwriters.

If the leading underwriter acts outside the scope of his authority, that act between the leading underwriter and the assured might not bind the following underwriters. This depends on whether or not the leading underwriter is regarded as the agent of the following underwriters. If the leading underwriter is the agent of the following underwriters, there might be an apparent authority, whereby the following underwriters would be bound by the leading underwriter's act.[266] However, the later case illustrates that the leading underwriter may not be regarded as the agent of the following market and is therefore not in breach of warranty of authority. [267]

Suffice it here to say that the problem in relation to the deemed communication rule can be avoided by having a representative underwriter settling the claim on behalf of the following underwriters.[268]

As there is no standard use of leading underwriter clauses, some insurance contracts therefore may not contain a leading underwriter clause which authorises the leading underwriter to settle disputes on behalf of the following underwriters. The solution is therefore uncertain and merely a short term solution. In addition, it cannot solve the situation where non-disclosure or misrepresentation is made to the following underwriters but not the leading underwriter

4.2 Non-disclosure to the following underwriters but not the leading underwriter

It should be noted that breach of the duty of utmost good faith can be towards the following market and not the leading underwriter because, according to the law, the slip contains a bundle of contracts between each insurer who signs the slip and the

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[266] *Roadworks (1952) Ltd v Charman* [1994] 2 Lloyd's Rep 99.
[267] *Mander v commercial Union Assurance Co plc* [1998] Lloyd's Rep IR 93.
[268] The status of the leading underwriter clause is scrutinised in the chapter four. The result of the study is that t the leading underwriter should be regarded as the following underwriters' agent.

assured. Using a leading underwriter clause would not be of assistance as the leading underwriter clause binds the following underwriter only when he signs the slip. If one following underwriter avoids his contract with the assured for a breach of duty of utmost good faith or misrepresentation his contract would be avoided and the leading underwriter clause would also be revoked as there is no basis upon which such authority can exist.

This situation was illustrated in *Unum Life Co of America v Israel Phoenix Assurance Co Ltd.*[269]

The claimants were the reinsurers of the defendants under quota share reinsurance treaties[270] in respect of personal accident insurance business. The cover had been placed by slip in 1995, the slip stating that the wording was to be agreed upon by the leading underwriter only. In July 2000 the claimants, the following underwriter, avoided the reinsurance treaties, alleging that material facts relating to the scope of the cover provided by the underlying policies had not been disclosed and that there had been misstatements about previous losses. In December 2000, the leading underwriter agreed with the defendants that the matter should go to arbitration. The claimants in the present action sought a declaration that they had validly avoided the treaties and that the agreement for arbitration had been made by the leading underwriter without the authorisation of the following market and thus was void.

It was held, *inter alia*, that once the treaties had been avoided, the leading underwriter no longer possessed any authority to act on behalf of the following market, and accordingly, the arbitration agreement had been reached without authorisation.

It can thus be said that even though the leading underwriter clauses would give some assistance. This is a solution at a later stage and would not help those situations where non-disclosure has been made to the following underwriter but not to the leading underwriter.

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[269] [2002] Lloyd's Rep IR 374.

[270] Quota share treaty is an obligatory declaration policy which would attract the duty of utmost good faith. This is explained in the chapter four.

5 Conclusion

The placing process of commercial insurance in the London Market is unique and complicated. It can be said that the general rules about the duty of utmost good faith cannot be applied straightforwardly when the slip is used at the placing process. There are doubts whether the following underwriters could rely upon non-disclosures or misrepresentations made by the assured to the leading underwriter - usually referred to as the "deemed communication rule".

The most recent authorities have been trying to reach the same solution, as if the deemed communication rule were applied, without applying the rule but instead relying upon and trying to interpret the facts of the case. In doing so, any confusion between the deemed communication rule and the existing law will not occur. The existing law then would enable the market to operate and no change would be needed.

Nevertheless, the market solves this issue by way of its practice by the use of leading underwriter clauses. In the event of dispute, the assured would sue a representative underwriter, in return for an agreement from the others to be bound by the result of such action. However, this is subject to the fact that the scope of the leading underwriter clauses includes dispute settlements on behalf of the following underwriters. Therefore, it is not always the case that the leading underwriter clauses can solve the problem. It is only a method to avoid the problems at the later stage. In addition, it would not solve the problem where non-disclosure was made to the following underwriter instead of the leading underwriter.

It can thus be said that this problem therefore cannot be solved by the common law and the old market practice. Recent recommendations on the market practice are in the London Market Principles 2001. This thesis considers the efficiency of the Principles in chapter seven and how it affects the problem regarding the duty of utmost good faith at the placing process.

Chapter 4

Declaration policies and the duty of utmost good faith

1 Introduction

There are facilities created by the insurance market to fasten the insurance placing process. These facilities enable the insurers to underwrite large numbers of similar risks without the need for individual presentations and also to give access to the overseas market to the insurers at a relatively low cost, or *vice versa,* to pull foreign insurers into the London market. The insurers can authorise other intermediaries in other countries to accept risks on their behalf.

These facilities can be effected through different types of declaration policies. They can be made between insurers and the assured, between insurers and brokers or between insurers and other intermediaries and can be obligatory, facultative obligatory or non-obligatory in nature. The important function of declaration policies is that they provide the framework and scope for declarations made thereunder.

This chapter focuses first on problems arising from the nature of declaration policies themselves. It is not easy to apply the duty of utmost good faith in the same manner to the different nature of different policies, but it is also not easy to decide the nature of declaration policies themselves. The same declaration policy might be different in nature.

The next problem that this chapter ponders is where the declaration policy is effected between the broker and the underwriters before the existence of the actual assured. When should insurance contracts come into effect? When does the duty of utmost good faith apply in this situation? Another important issue is conflict of interests between the broker's duties towards the insurers and the assured, what are the broker's liabilities towards the assured or the insurers when there is a conflict of interest? How would this affect the duty of disclosure of the assured? This issue is

considered in depth in chapter five: Agency and the duty of utmost good faith. Suffice it here to say that the insurers bear the burden of non-disclosure by the broker.

After that this chapter examines the case where insurers under declaration policies empower an intermediary to accept risk for them. Would the duty of utmost good faith or something similar to the duty of disclosure apply to that type of declaration policy?

Lastly, where the leading underwriter is authorised to accept a risk on behalf of the other insurers under a line slip or open cover, the question, that must be examined, is rather different, as in this situation the leading underwriter can exercise his discretion as to whether or not to accept the insurance. Hence, there is no obligatory nature between the assured and the underwriters. The question that should be considered is the scope of the leading underwriter's power to bind the other underwriters who have signed the facility. Would the leading underwriter become the agent of the other underwriters as a result of this facility? If it is not an agency contract, what should it be? How would the result of this affect the assured?

In order to derive answers to these issues, this chapter shall consider the types and nature of declaration policies to illustrate the various implementations of declaration policies. After that the controversial issues as mentioned above are analysed by considering common law cases, with the hope of entailing feasible and suitable answers to the problems.

2 Type of declaration policies

There are different types of declaration policies in name and in function. However, under declaration policies, there must always be declarations made under the provided framework. This chapter divides declaration policies by the parties effecting those policies.

2.1 Declaration policies made between the assured and the insurers: open cover or treaty

The differences between these two types of declaration policies lie in the markets where they are found. The treaty[271] is used in the reinsurance market while open cover is used in the insurance market, commonly in the marine market. Their mechanism is, however, more or less the same. Open cover or treaty defines the type of risk which may be insured under a policy and sets out the terms that will be applied in the event open cover or treaty is used. The assured or reinsured can declare under the policy a risk that falls within the scope of the open cover. Open cover and treaty are often made by using the slip and through the broker, like when a normal insurance contract is effected by using the slip.

2.2 Declaration policies made between the assured and the brokers: binding authorities

From market practice, it is possible for the open cover to be agreed initially between a broker and the insurer, by which the broker may declare any risk produced by any of their clients. Such covers are occasionally referred to as broker's "master cover".[272] This facility can also be called as binding authority. The broker is considered as holding the pen of the insurers in this situation, especially in the case where insurers are obliged to accept declarations made by the broker. It is settled that in applying for insurance, the broker is acting as the assured's agent.[273] Thus, there is no one who exercises the judgment on behalf of the insurer under this type of declaration policy as soon as this type of declaration policy is made.

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[271] Lowry and Rawlings, 392. "Treaties come in various proportional and non-proportional forms. Quota share and surplus treaties are both proportional, the reinsured retaining an agreed proportion of each risk and the reinsurers taking the remainder. The most important form of non-proportional treaty is excess of loss, under which the reinsurers accept liability for sums in excess of reinsured's 'ultimate net loss,' a figure defined as the total aggregate liabilities, excluding fixed costs, arising out of an event or occurrence. Stop loss reinsurance is a quarantee of solvency, and comes into play when the reinsured's loss reach an agreed figure..."

[272] Eggers and Foss, 16 fn.127.

[273] *Empress Assurance Corp Ltd v CT Bowring & Co Ltd* (1905) 11 Com Cas 107.

2.3 Declaration policies made between insurers and other intermediaries or leading underwriter: binding authorities, line slips, leading underwriter clauses under open cover or treaty

2.3.1 Binding authorities given to other intermediaries apart from the broker

Binding authority is normally given to other intermediaries, who are also known as "coverholders". They are the agents of the insurer. The insurers grant authority to them to enable them to accept insurance business on behalf of the insurer within the specified limit. The coverholder collects premiums, issues certificates of insurance, and services claims. The coverholder could be an insurance company, an underwriter or reinsurer etc. any intermediary other than the placing broker. Binding authorities have long been used by insurers, particularly by Lloyd's in the non-marine market.[274] They provide access to markets, above all overseas, at a relatively low cost. They are especially attractive to Lloyd's syndicates that do not have their own branch network. Under binding authorities, classes of business and limits to what the other intermediaries can underwrite are stated. It is said that this type of contract is a contract for insurance.[275] The other intermediaries will exercise their judgment in accepting the risks on behalf of the insurers. Even though the agent is not to be treated as carrying on insurance business in his own right but conducting business on behalf of the insurer, he is definitely not the assured's agent. The assured or his broker must present the risks to the coverholder who then will exercise judgment on the insurer's behalf.

2.3.2 Line slip; leading underwriter clause used in line slip, open cover or treaty

"A line slip is an authority (known in the London market as a facility) given in writing by a number of underwriters which enables the leading underwriter (or writers) to agree to proposals for the insurance of risks within a prescribed class on behalf of all underwriters subscribing to the line slip, provided that the proposed insurance is

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[274] C. Bennett, *Dictionary of Insurance* (London: Pitman Publishing, 1992), 39.
[275] *Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep 602.

within the scope of the terms of authority".[276] The broker still has to broke individual risks with the leading underwriter(s) for acceptance and rating, which is done through documents called "off-slips". The off-slip will be scratched by the leading underwriter(s). The other members of the slip will be advised of the risks through regular "bordereaux", which are documents giving brief details of the individual risk. In other words, line slips do not have obligatory effect in a strict sense towards the insurers as the insurers' discretion in accepting the risk is still exercised through the leading underwriter(s). By this way, brokers do not have to visit all the underwriters to get the risk agreed, which means that risks requiring large capacity can be placed quickly.

This can also be done by the use of leading underwriter clauses typically included in the slip, which vary in scope. With respect to a declaration policy, the leading underwriter clause should be taken into consideration when it allows the leading underwriter to accept declarations for the following underwriters who signed the open cover slip. The function of such a leading underwriter clause is analogous to the line slip.

3 The nature of declaration policies

3.1 The nature of open cover or treaty[277]

1) Obligatory open cover or treaty
   The assured is obliged to declare the risk and the insurer is bound to accept it.

2) Facultative obligatory open cover or treaty
   The assured is not bound to declare all risks to the open cover and can choose the risk he wants to declare but the insurer is obliged to accept those risks which are declared.

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[276] *Balfour v Beaumont* [1982] 2 Lloyd's Rep 493, 494.
[277] Merkin, *Colinvaux & Merkin's Insurance Contract Law*, 10710 para. A- 0734.

3) Non-obligatory open covers or treaty

The assured can choose the risk he wants to declare and the insurer is not obliged to accept any risk which is declared.

3.2 The nature of binding authority and line slip

1) Facultative obligatory binding authority

The insurer is obliged to accept the risk declared by the broker under the binding authority.

2) Non-obligatory binding authority

The insurers merely have to consider the proposals made by the broker.

It can thus be said that each type of declaration policy has its own characteristics. The application of the duty of utmost good faith to declaration policies is not straightforward, as sometimes both parties are bound as soon as they agree to declaration policies whereas at other times the insurers are bound to accept declarations made under the policy while the assured can choose which risk to declare. The latter type affects the application of the duty of utmost good faith, as by the time a declaration is made there is no need for the duty of utmost good faith, i.e. the assured's duty of disclosure since the insurers are bound to accept the risks declared. This issue thus merits a closer consideration.

4 The application of the duty of utmost good faith to declaration policies

In order to understand how the duty of utmost good faith applies to declaration policies, not only must the nature of declaration policies be considered but also the parties to them, as it is obvious that the assured and the broker do not have the same position in law when approaching the insurers. This chapter focuses on the assured's or the broker's duty of disclosure as this is often the arising dispute at the formation of contract stage.

4.1 Non-obligatory declaration policies

With respect to non-obligatory declaration policies, the authorities consider them as being either a contract for insurance, *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank and Others*[278] or merely a framework for future insurance contracts which do not have contractual effect, *SAIL v Farex Gie.* [279]

The different analysis of the status of the policies in these two judgments is because of the parties involved under the policies and the type and characteristics of the policies in each case.

HIH v Chase Manhattan Bank and Others (Chase)[280]said that non-obligatory declaration policies are contracts for insurance.

This case concerned line slips whereby the insurers authorised the leading underwriter to accept risks on behalf of the insurers who subscribed to the line slip. The court held that insurers who sign their names in the slip are bound by the leading underwriter's acceptance of the risk. The nature of the line slip is that it is a contract of authority whereby insurers delegate to another insurer the power to underwrite on their behalf.[281] It is clear that an individual declaration has to be agreed by the leading underwriters and can be rejected by the leading underwriters when presented. Aikens J. said, *obiter*, that the line slip facility in this case is a contract granting authority to the leading underwriter to effect insurance contracts and does not have the necessary qualities to make it a contract of the utmost good faith.[282] He regarded the line slip in the case as a contract for insurance. The risk is written when the leading underwriter signs the relevant off slips.[283]

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[278] [2001] Lloyd's Rep IR 191. The point did not arise in the Court of Appeal [2001] Lloyd's Rep IR 702 or in the House of Lords [2003] 2 Lloyd's Rep 61.
[279] [1994] CLC 1094, 1098 referred to Gatehouse J's first instance judgment.
[280] [2001] Lloyd's Rep IR 191. The point did not arise in the Court of Appeal [2001] Lloyd's Rep IR 702 or in the House of Lords [2003] 2 Lloyd's Rep 61.
[281] *Touche Ross & Co v Baker* [1992] Lloyd's Rep 207, 210.
[282] [2001] Lloyd's Rep IR 191 para. 49.
[283] He cited *Denby & Others v English & Scottish Maritime Insurance Company Limited & Others* [1999] Lloyd's Rep IR 343.

Thus it is quite correct to say that there was a contract for insurance in this case that was not a contract of utmost good faith.

SAIL v Farex Gie (SAIL)[284] said that non-obligatory declaration policies do not have contractual effect.

In this case, the broker effected a facultative reinsurance facility by using a line slip. The claimant, the reassured, was not obliged to make declarations to the reinsurer and the reinsurer had a similar option a to whether to accept such declarations. Several issues arose from this case but it is sufficient here to say that in relation to the status of the non-obligatory declaration policy, the line slip was not regarded as a contract of insurance. Hence the duty of utmost good faith does not apply to the case.

The line slip in this case was not the normal type of line slip that one would normally expect it to be. From the facts, the only insurer subscribing to the line slip was Farex, the defendant. Thus this was not a line slip subscribed to by a number of insurers enabling the leading underwriter to agree to a proposal of insurance within the described class. In addition, Farex were bound to nothing. Hence, it is correct that it should not be regarded as a contract of insurance but merely a mechanism for risks to be declared and accepted or declined. The contract of insurance arises when each declaration is made under the arrangement and the duty of disclosure is applied at that time. Non- disclosures or misrepresentations should be considered when each negotiation is made. Insurers might or might not be affected by that declaration when accepting declarations made by the assured. The issue is one of fact in relation to each risk.[285]

To sum up, no matter whether non-obligatory declaration policies should be regarded as contracts for insurance or merely a framework for future contracts, the application of the assured's duty of disclosure under both analyses would be the same. A contract of insurance is entered into when each declaration is made; hence the assured has to disclose material facts every time each declaration is made, either to the insurer or the leading underwriter in the case of a line slip.

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[284] [1994] CLC 1094, 1098 referred to Gatehouse J.'s first instance judgment.
[285] Ibid., 1108.

The only difference is that while the common law rules of misrepresentation apply to each declaration, if the non-obligatory declaration policy is regarded as merely providing a framework as can be seen in *SAIL*, they are applied to contracts for insurance. Hence, if the assured is induced to enter into a contract for insurance, the contract becomes voidable. If it is avoided, all declarations- contracts of insurance- made thereunder are undermined and are to be treated as never having come into existence. The insurers have the usual right to claim damages for negligent or fraudulent misrepresentation, and also damages under s. 2 of the Misrepresentation Act 1967.[286]

4.2 Obligatory and facultative obligatory declaration policies

The application of the duty of utmost good faith to these types of policies is more complicated than to non-obligatory declaration policies. The complication arises from their obligatory nature. Under these types of declaration policies, the insurers are obliged to accept every declaration made by the assured under the policies.

With respect to the application of the assured's duty of disclosure, on the one hand since the insurers are obliged to accept risks declared, it seems that the duty of disclosure should apply at the time declaration policies are made. On the other hand since they do not themselves operate as insurance covers but provide merely a framework, it is said that the duty of disclosure should apply when declarations are made.

What should therefore be the application of the duty of disclosure? At this stage, this chapter shall first focus on declaration policies made between the insurers and the assured or between the insurers and the broker under open over or treaty where the broker is acting on the assured's behalf when effecting the insurance.

4.2.1 Obligatory open cover or treaty

[286] Merkin, *Colinvaux & Merkin's Insurance Contract Law*, 10712/2 para. A- 0736.

It is easier to explain the application of the duty of disclosure to obligatory open cover or treaty. Under this type of cover the assured agrees in advance to declare business which falls within the scope of the policies and the insurers agree in advance to accept every declaration which falls within the scope of the policies. Hence, contractual obligations arise as soon as declaration policies are agreed. The insurers are bound to accept the declared risks. The assured's duty of disclosure should therefore be exercised when obligatory open cover or treaty is entered into.

As a result of this characteristic, it is said that failures to make declarations have not prevented the risk from attaching to the policy. Declarations simply provide the insurer with information about the risks that have already attached to the cover in accordance with its terms. This view was made in *Glencore International AG v Ryan (The Beursgracht).*[287]

The case concerned charterer's liability insurance. The claimants were insured by the defendant underwriters under an (obligatory) open cover in respect of their liabilities to the ship owners by way of reimbursement for claims brought against them by third parties. An accident allegedly occurred on the vessel. It was said that a stevedore was killed in circumstances which gave rise to the claimants becoming legally liable to the ship owners of *Beursgracht.* The claimant assured sought to recover from the defendants insurers for the money paid to the ship owners. The insurers alleged three contentions:

- No insurance contract in relation to the vessel had ever come into existence since no declaration was made to or accepted by the insurers.
- There was an implied term in the open cover that declarations had to be made within a reasonable time, namely, within one month of the making of any charter and in the order in which the charters were concluded by the claimant. Omissions to make declarations might only be rectified if such omissions occurred in good faith.
- By reason of an express term, a contract of charterer's liability insurance in relation to the vessel only came into existence on the claimant's confirmation

[287] [2002] Lloyd's Rep 574.

> to the underwriters that the charter in question conformed with wording previously approved, or after submission to and approved by the leading underwriter.

It was held in the Court of Appeal by Tuckey L.J. that the contract was an obligatory open cover requiring the assured to declare all charters to the cover. The making of the declaration was an essential part of the contract but did not link the making of declarations to the attachment of risks.[288]

There was an implied term that the contract had to be made within a reasonable time but this was an innominate term not a condition precedent or a warranty as the insurers themselves had not sought to create such a term by express wording. If the insurers wanted to treat the policy as repudiated, they had to prove that the breach was of a serious nature or had serious consequences to the insurers. Since failure to make a declaration did not affect the liability of the insurers in respect of a risk under this policy, the breach was therefore not repudiatory.

The judgment is good in relation to the application of the assured's duty of disclosure as it would mean that the duty applies when obligatory open cover is made at the time both parties become bound.

With respect to facultative obligatory open cover or treaty, the matter is not easy to justify. While the insurers are obliged to accept declarations made thereunder, the assured can choose the risk he wants to declare. Hence, by the time those policies are made, there are no contractual obligations between the parties. Contractual obligations arise when a declaration is made by the assured. It is therefore said that a contract of insurance arises when each declaration is made. When therefore should the assured's duty of disclosure apply?

4.2.2 Facultative obligatory open cover or treaty

[288] Ibid., 579.

From the authorities, facultative obligatory open covers or treaties are regarded as being a standing offer, and contractual obligations arise when a declaration is made no matter whether they are agreed between the assured and the insurers or between the broker and the insurers.

Citadel Insurance Co v Atlantic Union Insurance (Citadel).[289]

From the case, the US broker wanted to have a 'Hull open over' by way of a reinsurance facility and therefore approached the London reinsurance broker for this purpose. The London broker placed the open cover (facultative obligatory open cover) with the Greek defendants and a 'slip' was prepared by the London broker in London and initialled by C. on behalf of the defendants. A year after the slip was initialled; the claimants became clients of the US broker. The claimant's agent asked for reinsurance of some proportion of the risks insured by the claimants through the US broker. The US broker then declared these risks to the London broker under the open cover with the defendants. The claimants then claimed under the reinsurance. The defendants denied liability contending that these losses did not fall within the terms of the reinsurance cover. The issue for decision was whether the claimants could sue the defendants in the English Courts.

In considering where the contracts were concluded the status of the open cover was examined. Kerr L.J. pondered that: [290] "the open cover under which the defendants accepted liability as reinsurers was a standing offer whereby they agreed to accept liability for any declarations made to the London broker in London within the terms of the cover..."

BP Plc v GE Frankona Reinsurance Ltd.[291]

This case concerned a facultative obligatory open cover in favour of the claimant and other co-assureds. The open cover slip was subscribed by a number of insurance companies and underwriters. The dispute concerned declarations made thereunder.

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[289] [1982] 2 Lloyd's Rep 543, 547.
[290] Ibid., 547-548.
[291] [2003] 1 Lloyd's Rep 537.

This case dealt with preliminary issues relating to the meaning of the open cover and the effect of declarations made under it. In considering one of the preliminary issues Cresswell J. had to consider the nature of facultative obligatory open cover. From his analysis, the open cover was a standing offer whereby the defendants agreed to accept liability in respect of any declarations made within the terms of the cover. When a declaration was made by the claimant under the open cover within the terms of the cover to a particular defendant, a contractually binding obligation was created.[292] He reached this conclusion by citing past authorities.[293]

Another case that supported this view, even though not cited by Cresswell J., was *Sedgwick Tomenson Inc v PT Reasuransi Umum Indonesia.*[294]

From the case, the second defendant held binding authorities from the first defendant, limited to territory outside the USA and Canada and to a limited sum for each class of risk and issued open covers in the first defendant's name to the brokers, the claimants, carrying on business in the USA. Under these open covers the claimants declared 70 fishing vessels, the owners of which in due course made claims asserting that either the first defendant was liable to them as bound by the second defendant or the second defendant was liable to them for breach of warranty of authority.

One of the defendants' contentions regarding the limited sum under the binding authorities was that the undertaking to accept declarations (the open covers) was itself unauthorised as it permitted declarations up to a higher limit than specified under the binding authorities. The acceptances are likewise unauthorised. Evans J. gave his view that this contention overlooked the undoubted fact that a new contract comes into existence when a declaration is made and, if the open cover requires acceptance of the declaration, when it is accepted. He relied on Kerr L.J.'s judgment in *Citadel.*[295] He then held that the agreed limit applied separately to each insurance contract which the second defendants accepted on the first defendants' behalf.

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[292] Ibid., para. 117.
[293] *Citadel Insurance Co v Atlantic Union Insurance*[1982] 2 Lloyd's Rep 543 ; *Phoenix General Insurance Co of Greece S. A. v Halvanon Insurance Co Ltd*, [1985] 2 Lloyd's Rep 599, 612; *The Beursgracht* [2002] 1 Lloyd's Rep 574, 579.
[294] [1990] 2 Lloyd's Rep 334.
[295] [1982] 2 Lloyd's Rep 543, 547.

Hence, from the authorities it is settled that each declaration creates a contract of insurance. The standing offer is accepted when each declaration is made. There must be a declaration for the insurers to be bound but there is no need for any specific acceptance by an underwriter of a declaration.[296]

As a result of this settled law, it might be said that the assured's duty of disclosure should apply when each declaration is made as this is the time when the insurance contract is entered into. However, this would not be consistent with market practice. The aim of the use of declaration policies is to provide flexibility and continuity of cover. The obvious benefit that the insurers get from the policies is that they can underwrite large numbers of similar risks without the need for individual presentations.[297] In other words, after facultative obligatory open covers or treaties are agreed, in practice, what the assured does is only making a declaration; the insurers are bound to accept those declarations provided they fall within the scope of the policy. For this reason, it seems that the better position would be that the assured's duty of disclosure should apply when facultative obligatory open cover or treaties are made.

There are different views as to how this application should be justified.

First view: it is said that the duty of utmost good faith is applied when facultative obligatory and obligatory open cover or treaty is made, even though with respect to facultative obligatory policies, the insurer is binding himself merely to offer insurance and there is no contractually binding obligation under the insurance contract at the time when declaration policies are made.

This view can be seen in *MacGillivray*. While accepting that facultative obligatory treaties are not themselves contracts of insurance but agreements that create individual contracts of insurance when the reinsured, or intermediary, makes use of the facility available to him for reinsurance, and when declarations are made and individual policies issued,[298] in considering the duty of disclosure in treaty

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[296] *BP Plc v G.E. Frankona Reinsurance Ltd* [2003] 1 Lloyd's Rep 537 para. 128.
[297] *Glencore International AG v Alpina Insurance* [2004] Lloyd's Rep 111 para. 10.
[298] MacGillivray, 960 para. 33-20.

reinsurance it is said that the reinsurer subscribing to a treaty is binding himself to offer an indemnity in the future in respect of such risks of the particular kind covered by the treaty as may or must be ceded to him thereunder. *MacGillivray* was of the view that this is a contract for insurance. The contract is an insurance contract in a broad sense and the duty of disclosure should apply to this type of contract.[299] *MacGillivray* cited two cases to support this view, namely, *Glasgow v Sydmonson*[300] and *Berger v Pollock.*[301]

Considering these cases, neither provides a good explanation to the issue. The first case was *Glasgow v Sydmonson.*[302]

In this case, the reinsurers entered into an agreement with the brokers under which the reinsurers agreed to accept all risks of a certain class and at a fixed percentage premium. The reinsurers sought to avoid the agreement on the basis that they had not been informed that the brokers were not acting as intermediaries but were reinsureds in their own right, and had ceded their own liabilities to the reinsurers under the agreement. Scrutton J. held that the facts withheld were not material to the risk so there was no basis for avoidance. He rejected the submission that the agreement was not a contract of utmost good faith, without giving reasons.[303]

Hence, the case did not provide a good explanation as to why the assured's duty of disclosure should be applied when facultative obligatory open cover or treaty is entered into.

The second case was *Berger v Pollock.*[304]

In this case, open cover was issued by the insurers to the brokers. The assured approached the broker for insurance for the sum of £20,000 on a cargo of steel injection moulds, and a provisional cross-slip was issued by them. Thereafter, details of the risk were provided to the underwriters, who subsequently issued a binding

[299] Ibid., 967 para. 33-32.
[300] [1911] 16 Com Cas 109.
[301] [1973] 2 Lloyd's Rep 442.
[302] [1911] 16 Com Cas 109.
[303] Ibid., 120-121.
[304] [1973] 2 Lloyd's Rep 442.

singing slip to replace the provisional cross-slip. Following damage to the cargo in transit, the insurers sought to avoid liability on the basis that the true value of the moulds was only £ 5,000, a material fact which had not been disclosed. Kerr J. held that the duty of utmost good faith had been infringed by the withholding of a material fact and that the insurers were entitled to avoid the policy.

This case should not be regarded as authority as the learned judge preferred the construction of the document to be non-obligatory. The application of the duty of utmost good faith in this case would be better justified by saying that the open cover in this case was a non-obligatory open cover, which attracts the assured's duty of disclosure when each declaration was made.

Hence, even though *MacGillivray*'s view is consistent with the authority that a facultative obligatory open cover or treaty merely provides a standing offer and seems to be correct in applying the duty of disclosure to the open cover, the justification for the application is not clear.

Second view: obligatory or facultative obligatory open cover is regarded as an insurance contract. [305] Howard Bennett stated in his text book, *The Law of Marine Insurance*, under the heading of obligatory and facultative insurance contracts that "by virtue of the insurer's immediate commitment, the agreement pursuant to which declarations may be made constitutes an immediate contract of insurance, albeit latent pending the making of a declaration to which it can attach. Consequently, the duty of utmost good faith does not attach to individual declarations".[306]

The result of this view is the same as the first view regarding the application of the duty of utmost good faith. However, the difference is that the insurers are considered as being bound to the insurance contract as soon as the declaration policies are agreed, not merely bound to the offer they made, as analysed by *MacGillivray*. The second view is therefore inconsistent with the authorities that the insurers are bound only

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[305] *Ionides v Pacific Fire & Marine Insurance Co* [1871] QB 674 supported this view.
[306] Howard Bennett, *The Law of Marine Insurance*,(Oxford: Clarendon, 1996), 37 (hereinafter in this thesis referred to as "Bennett").

when the declaration is made under the policy by the assured. This view is therefore also not a good explanation.

Third view: In *Colinvaux and Merkin's Insurance contract law*,[307] it is said that declaration policies operate as contracts for insurance as opposed to contracts of insurance. In particular, it is said that: "Contracts for insurance do not themselves operate as insurance covers, but rather provide a framework under which contracts of insurance can be made by the used of the agreed machinery, consisting of the declaration of individual risks to the framework policy".[308] The duty of utmost good faith applies to contracts for insurance separately from the application of the duty of utmost good faith to declarations to contracts for insurance. Under the third view, without distinguishing facultative and obligatory declaration policies, the obligatory policy is regarded as a contract for insurance but one that ought to attract the duty of utmost good faith, as the insurer has no discretion to reject risks subsequently declared by the assured under this type of contract as long as the declarations fall within the financial, geographical and other risk criteria set out in the open cover. [309] With respect to declarations made to a contract for insurance, if a contract for insurance is obligatory, the declarations made thereunder are subject to the doctrine of waiver: that the insurers have agreed to accept any risk that falls within the ambit of the open cover without regard to any special circumstances surrounding the risk.[310]

This explanation is consistent with the authorities, that under facultative obligatory open cover or treaty the insurers are not bound until receiving a declaration made thereunder. The assured's duty of disclosure attaches to the time each declaration is made but is subject to the doctrine of waiver. Indeed, in *Citadel* even though Kerr L.J. said that each declaration gives rise to a new contract, he said that what he meant is not a new contract for the purpose of the duty of disclosure but merely a new obligation of the insurers under the umbrella of the open cover. [311] Nevertheless, Kerr L.J. did not mention in that case whether the duty of disclosure should be applied to the open cover itself.

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[307] Merkin, *Colinvaux & Merkin's Insurance Contract Law*, 10710-10718.
[308] Ibid., 10710 para. A- 0734.
[309] Ibid., 10712/1 para. A- 0735.
[310] Ibid., 10713 para. A- 0737.
[311] [1982] 2 Lloyd's Rep 543, 547-548.

Therefore the next question that needs further contemplation is on what basis the duty of disclosure should be applied to facultative obligatory open cover or treaty.

In *Colinvaux and Merkin's Insurance contract law* again without distinguishing obligatory from facultative obligatory declaration policies, it is said that an obligatory declaration policy is a contract for insurance but one that ought to attract the duty of utmost good faith, as the insurer has no discretion to reject risks subsequently declared by the assured under this type of contract as long as the declarations fall within the financial, geographical and other risk criteria set out in the open cover.[312]

This seems to be a good solution to the problem. A contract for insurance does not transform into a contract of insurance but should be regarded as a contract which attracts the duty of utmost good faith. *Glasgow v Sydmonson*[313] was cited to support this view. However, it was doubted whether this proposition should represent the law. Two cases were mentioned which were regarded as inconsistent with the suggestion that the duty of disclosure should be applied to obligatory declaration policies.

Pryke v Gibbs Hartley Cooper Ltd (Pryke).[314]

In this case Lloyd's underwriters and Excess (a London insurance company) authorised Atlas Underwriters Ltd. (Atlas) in the USA to accept risks on their behalf under binding authorities that had been negotiated by a Lloyd's broker, Gibbs Hartley Cooper Ltd. (GHC). Later on, Atlas effected a financial guarantee insurance policy with Landbank Equity Corporation (Landbank). This type of insurance was outside the scope of the binding authorities. Landbank became insolvent and claims were made against Excess and the Lloyd's underwriters under the insurance policy. These claims were settled. The Lloyd's underwriters and Excess sought to recover their losses from GHC. One of the allegations was that when GHC invited Excess and the Lloyds' underwriters for renewal, it should have disclosed to the insurers all material information that it knew or ought to have known concerning the binding authority.

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[312] Merkin, *Colinvaux & Merkin's Insurance Contract Law*, 10712/1 A- 0735.
[313] [1911] 16 Com Cas 109.
[314] [1991] 1 Lloyd's Rep 602.

Waller J. was of the view that binding authorities are not insurance contracts, nor are they contracts *uberrimae fidei* strictly so called. Thus the obligation to disclose all material facts either at the negotiation or re-negotiation stage does not arise.[315] What does arise is a duty similar to an obligation of disclosure.

The case dealt with a binding authority made between other intermediaries and the insurers, not an open cover made between the assured and the insurers. The function of the binding authority in this case can be said to be analogous to a line slip as the insurers relied upon another insurer, here Atlas, to exercise its discretion in accepting the risk declared. Thus, the binding authority in this case is closer to a contract that authorised another intermediary to accept risks on behalf of the insurers. The coverholder is the one who exercises judgment in accepting the risk on behalf of the insurers. The contract should be regarded as an agency contract.

HIH Casualty and General Insurance Ltd v Chase Manhattan Bank (Chase).[316]

The details of this case have already been mentioned under the heading of the non-obligatory declaration policy above. But this case is relevant to this issue in that Aikens J. said, *obiter*, that the line slip facility in this case was a contract only to grant the authority to contract for insurance and did not have the necessary qualities to make it a contract of the utmost good faith.[317]

Again, this does not seem to say that the duty of utmost good faith should not apply to an open cover or a treaty. A line slip in this case does not have the same characteristics as open cover or treaty, as the insurers still have the leading underwriter to make a judgment as to whether or not to accept the risk when each declaration is made.

The difference between *Glasgow v Sydmonson (Glasgow)* and the two cases is that in *Glasgow* the open cover was effected with the broker. As soon as the insurers agree to facultative open cover, they can no longer exercise their judgment whether or not to

[315] Ibid., 615.
[316] [2001] Lloyd's Rep IR 191. The point did not arise in the Court of Appeal [2001] Lloyd's Rep IR 702 and the House of Lords [2003] 2 Lloyd's Rep 61.
[317] [2001] Lloyd's Rep IR 191 para. 49.

accept the risk. In declaring each risk under the treaty the broker should be regarded as acting on behalf of the assured's principal as the broker must have the assured's order for insurance before making a declaration under the open cover agreed. In addition, there is no obligation upon the assured to disclose material facts to the broker. On the contrary, according to the law, the broker has the duty to disclose all material facts to the insurers under s. 19 of MIA 1906.

Hence, with respect to the application of the duty of utmost good faith, in particular the assured's duty of disclosure, the position of the insurers is as if they have agreed to open cover with the assured from the beginning. Even though this agreement can also be seen as a contract for insurance, as the agreement made between the insurers and the assured or between the insurers and the broker on behalf of the assured are for future insurance contract, the insurers must accept all declarations made thereunder. A contract for insurance in this situation should therefore attract the assured's duty of disclosure.

In *Pryke* and *Chase,* after the insurers agreed to those agreements the judgment whether or not to exercise the risks would be done for them by other intermediaries or the leading underwriters. Thus, even though there is a contract for insurance, the insurers still exercise their discretions in considering whether or not to accept the risk through the leading insurers or other intermediaries. The assured has the duty to disclose material facts when approaching the coverholder under a binding authority or the lead underwriter under a line slip for insurance. Therefore, the duty of disclosure should not attach when such a contract is entered into.

To sum up, when a facultative obligatory open cover or treaty is agreed, there is a contract for insurance that attracts the duty of disclosure by the assured. In other words, there is no difference in the application of the assured's duty of disclosure to an obligatory or facultative obligatory open cover or treaty. The assured is subject to the duty of disclosure when an open cover or treaty is agreed as it is at this time that the insurers exercise their judgment as to whether to accept the risk.

Hence, the difference between an obligatory and facultative obligatory open cover or treaty is the moment when the insurers become bound. The insurers would become

bound under the latter when the declaration is made. Thus, it would be better to focus on declarations made under the open cover or treaty. In particular, these questions must be answered: when can the declaration be made?; can it be made after the loss has occurred?; if it is allowed, would an obligatory open cover or treaty then provide the assured with the option to declare the risk as in a facultative obligatory open cover or treaty or even more than in a facultative obligatory open cover or treaty, as the option is made for a risk which is already incurred through a loss? This would make it difficult to decide whether open cover or treaty is obligatory or facultative obligatory in nature. Thus, this issue merits a closer consideration.

4.2 Obligatory or facultative obligatory open cover or treaty?

In *The Beursgracht,*[318] where an obligatory open cover was made, it was held that the declaration made under obligatory open cover was contractual machinery but did not link the making of the declaration to the attachment of risks. The risk attached automatically when the assured chartered a vessel to carry goods that fell under the cover. The failure to make the declaration was merely a breach of an innominate term that did not affect the insurers' liabilities towards the assured.

From the case the loss had already occurred before the assured made the subsequent declaration after learning about the existence of the loss. Hence, it seems from practice that the assured declared the risk knowing that the loss had already occurred.

This judgment was subject to comments. As a result of this case, open cover would become little more than a facultative obligatory policy that requires the assured to make declarations but that does not penalise the assured if he fails to do so, thereby depriving underwriters of the premium recoverable from a 'balanced' portfolio of good and bad risks.[319] The insurers may find this decision hard to accept.[320] In other words, even though the open cover is obligatory in nature, allowing a declaration to be made after the loss would render it similar to the facultative obligatory policy in

[318] [2002] 1 Lloyd's Rep 574 details of the fact can be seen earlier under obligatory open cover heading.
[319] R. Merkin, "Formation of a contract of insurance," *Insurance Law Monthly* March (2002) : 9, 11.
[320] Ibid., 9.

character, as it would mean that the assured can choose which risk to declare. The assured would not declare at all if the loss had not occurred. Thus, this seems to be unfair towards the insurers. In addition, considering the nature of an insurance contract itself, that it is a contract of indemnity of an uncertain event,[321] would this be considered as an insurance contract at all, since this practice would amount to the insurer insuring a loss that has already occurred?

The answer to these arguments can be extracted from the characteristics and the objective of having the open cover itself and from the good faith of the assured's conduct. Indeed, it is said that the result of this case might be because the claimant acted in good faith.[322]

It is clear that open cover is now widely accepted in the market and it is not possible to reject its existence. In *The Beursgracht,* Tuckey L.J. vividly explained the difference between types of open cover or treaty. He mentioned the obligatory and facultative obligatory open cover. Therefore, it could not be argued that there is no such thing as obligatory open cover or that there is only facultative obligatory open cover.

Tuckey L.J. said that it is not always the case that declarations have to be made to insurers before they are bound.[323] He raised floating policies as an example. He was of the view that an obligatory open cover in this case is more like a floating policy.[324] The similarity between them is that the assured, after agreeing to the policy, does not have any choice in selecting which risk to declare.

The difference between a floating policy and open cover is that a floating policy has a fixed sum that is deducted at each declaration, finally becoming exhausted, and that the premium is payable in advance rather than when declarations are made. In a floating policy, it is possible for the assured to rectify declarations made thereunder,

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[321] Except in the case of life and accident insurance, when an agreed sum is payable.
[322] Merkin, "Formation of a contract of insurance", 11.
[323] [2002] 1 Lloyd's Rep 574, 579 para. 26.
[324] Ibid., para. 34.

according to s. 29 (3) of the MIA 1906.[325] This section recognises the making of a declaration in arrears, provided it was made in good faith.

Thus, it can be said that the common law seems to regard this type of policy as having the special characteristic of flexibility that allows the assured to make a declaration after the loss has already occurred.

With respect to the uncertainty element of the insurance contract argument, it can be explained that since under obligatory open cover, risk attaches to the cover at the time each vessel is chartered, uncertainty is still an element of the insurance contract. At the time the risk attaches, the loss has not occurred.

Hence, unless the assured is fraudulent in making a declaration, the assured's good faith allows this type of circumstance to exist. Good faith here, however, does not subsume the duty of utmost good faith, especially the assured's duty of disclosure at the formation of contract stage. This is correct as the contract has already been entered into under obligatory insurance.

One might think that since the making of declarations is a requirement under the terms of the contract, the failing to make a declaration might amount to a breach of the post-contractual duty of utmost good faith. However, considering the criteria set up by Longmore L.J. in *The Mercandian Continent,*[326] that there must be fraudulent conduct by the assured; that for the remedy of avoidance to be available, the breach of that contractual term must have an effect upon the insurers' ultimate liabilities and must be so grave that it would entitle the insurers to repudiate the contract, this argument would not be sound. There was no fraudulent conduct by the assured, or even if the term to make monthly declarations was regarded as an innominate term, breach of the terms would not have any effect upon the insurers' liabilities as the risks attach automatically when each charter is made. Anyway, avoidance *ab initio* would

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[325] "Unless the policy otherwise provides, the declarations must be made in the order of dispatch or shipment. They must, in the case of goods, comprise all consignments within the terms of the policy, and the value of the goods or other property must be honestly stated, but an omission or erroneous declaration may be rectified even after loss or arrival, provided the omission or declaration was made in good faith".

[326] [2001] 2 Lloyd's Rep 563.

not be an ideal solution as it would affect other perfectly good declarations made under the cover.

As a result, it seems that the insurers must bear this risk when they enter into obligatory declaration policies. In *Glencore International AG v Alpina Insurance, (Alpina)*[327] it was said that the insurers agreeing to an obligatory declaration policy were expected to be aware of the whole range of circumstances that may have arisen in the course of carrying on a business of that kind.[328] Moore – Bick J. thought that the insurers must therefore be aware of the assured's business, in particular, the possibility that a declaration might be made after the loss had already occurred.

Hence, it seems that not only should the assured's duty of disclosure apply when open covers or treaties are agreed upon and not when declarations are made but its scope is also more limited as the insurers must be aware of the assured's business. Thus, the insurers are the party that has to bear the risk when they agree to an obligatory open cover or treaty.

This burden upon the insurers might be relieved. The insurers have the option to choose the nature and type of declaration policy. The latest case examined at the next stage illustrates that it is possible for an open cover to be both obligatory and facultative obligatory in nature. It is now clear that in an obligatory open cover or treaty there might be a condition that makes the open cover or treaty become a facultative obligatory one in relation to that condition. As soon as it is regarded as being facultative obligatory in nature, the declaration would determine when the insurers are bound under the cover. The insurer and the assured must therefore be careful in entering into an open cover or treaty policy.

This idea can be seen in *The Beursgracht*. In this case, even though Tuckey L.J. held that the open cover under the case was an obligatory open cover, he said this classification was not determinative. The insurers can still provide that they will not

[327] [2004] 1 Lloyd's Rep 111.
[328] Ibid., para. 41.

be bound unless and until they have received a declaration, and then this intention of the parties will prevail.[329]

The case that best illustrates this position is *Glencore International AG v Alpina Insurance (Alpina).*[330]

The claimant was an oil trading company. For many years the claimant had made use of open covers in connection with commodity trading activities for the purposes of insuring goods in transit. From the facts, the policy was an obligatory open cover as goods in transit falling within the terms of the cover are automatically insured as soon as the policyholder acquires an interest in them. The intention in making the open cover was to procure a broad and flexible contract providing cover against all risks of loss and damage to oil in which the claimant acquired an interest wherever it was situated.

Under this open cover there were two conditions dealing with transit and storage risks respectively. One of these two conditions provided that: "... if required... the cover shall include storage blending prior to shipment or after final discharge etc. and additional premium shall be paid".

The claimants claimed under the cover. One of the contentions by the defendants was that this condition rendered the cover as a facultative obligatory cover. The insurers would not take on the risk without declarations made by the assured. From the case, declarations were made under the monthly bordereaux but after the loss had occurred. The issues in the case were whether it was possible for a declaration to be made with retrospective effect; if so, whether it could be made after a loss had occurred and after the assured had known about the loss.

Moore- Bick J. held that a declaration under a facultative open cover can have retrospective effect and can be made after the loss has occurred but not if the loss is already known to the assured. Considering the condition in the open cover that allowed the assured to choose whether or not to declare a storage risk by using the

[329] [2002] 1 Lloyd's Rep 574 para. 34.
[330] [2004] 1 Lloyd's Rep 111.

word "if required", Moore-Bick J. agreed with the insurers' argument that the insurance was facultative on the part of the assured, but obligatory on the part of the insurers and therefore was different in function compared to the obligatory open cover in *The Beursgracht*.

Even though Moore – Bick J. accepted that the assured in this case did in fact believe that the storage risks were obligatory on both sides and that in practice the assured did declare all storage risks to the cover, he found that this would not have any effect upon the nature of the policy as there was no evidence that the insurer was aware of it. Thus, if there is no common agreement between the parties, if there is a controversy regarding the nature of the open cover or treaty, the wording of the terms and conditions under the cover come into play, and the same open cover might be obligatory or facultative obligatory in nature.

Since an insurance contract under a facultative obligatory open cover is regarded as coming into effect when each declaration is made, the argument that the risk has already attached to the cover when each vessel was chartered cannot be used. Moore – Bick J. relied on the 'lost or not lost' principle available in marine insurance for making the declaration with retrospective effect.[331]

According to s. 6 of the MIA 1906, the subject-matter may be insured 'lost or not lost', and the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss and the insurer was not. The rationale behind the 'lost or not lost' principle is the way business is carried out. In insuring a ship, it is very common that insurance is effected when the ship is at sea. The assured might therefore be unaware of the loss of the ship when effecting insurance. In other words, the nature of the business insured allows this kind of practice to exist. This was confirmed by Moore – Bick J. himself in *Alpina*.[332] In considering whether or not a declaration can be made after the loss has occurred, he admitted that under a facultative obligatory open cover it seems to be a good starting point to say that the assured must communicate his intention to attach the risk to the cover before the insurers can come

[331] [2004] 1 Lloyd's Rep 111.
[332] Ibid., para. 264.

on the risk. However, he continued to say that the nature of the business insured and any established course of dealing between the parties must also be taken into consideration. He then considered that because of the nature of the assured's business in this case, it would seem difficult for the assured to declare the risk, storage risk, in advance.

Once the party is allowed to make a declaration in arrears, the rest of the judgment is easy to understand. Since it is allowed to declare a risk in arrears, it would be more sensible to allow the assured to make declarations after a loss has occurred. Otherwise it would mean that the insurer would enjoy charging the premiums on a retrospective basis in respect of risk that had not suffered a loss while being in no danger of incurring liability in respect of any that had already occurred.[333]

However, as soon as the assured knows about the loss, the element of uncertainty disappears. Allowing the assured to declare a known loss would distort the fundamental basis of insurance contracts and it would allow the assured to enjoy declaring loss risks only.

Hence, the same situation would have a different outcome. If it happens under an obligatory open cover, the assured would not be prevented from making a declaration after the loss has occurred and after it is known to him. However, if it happens under facultative obligatory open cover, the assured may make a declaration after the loss has occurred but not if he knows about the loss. The court acknowledges this distinguished outcome based upon the nature of the business insured. Giving a different judgment would hinder the way business is carried out. As a result, both the assured and the insurer should be aware of this flexibility of open cover. In order to avoid this conflict, the parties should have a common agreement regarding the nature of the open cover or treaty.

5 Declaration policies agreed between the insurers and the broker in advance

[333] Ibid., para. 266.

5.1 The status of the policy and the justification of the application of the duty of utmost good faith

There has been an argument that since the insurers agreed with the broker under open cover, prior to the existence of a contract of insurance, the insurers should not be considered as bound to give insurance cover to the assured.[334] This view is correct. As aforementioned, the insurers are bound only when the declaration is made. However, with respect to the assured's duty of disclosure, it might be said that when the assured agrees to the insurers' offer brought to his attention by the broker, the broker is offering to act on his behalf in relation to that insurance cover. He thereby constitutes the broker as his agent to obtain the cover offered. Thus, if the broker fails to disclose material facts when he agrees to the open cover with the insurers, the assured is affected when he later accepts the offer of the insurers.

This analysis can be extracted from *General Accident Fire and Life Assurance Corp v Tanter (The Zephyr).*[335]

In this case, a broker having been instructed to place insurance on a vessel, sought to obtain the subscription of reinsurers first. In obtaining the subscription of the leading reinsurance underwriter, the broker gave a signing indication of one–third, leaving the leading underwriter with the belief that his agreed subscription would be reduced to one-third of the stated sum. However, the broker failed to obtain the relevant level of oversubscription, and the leading underwriter was instead signed down to 88.48 per cent of the sum agreed. The leading underwriter sought to avoid the reinsurance agreement against the insurers who had subsequently subscribed to the direct risk or, in the alternative, to claim damages from the broker. The leading underwriter was held to be entitled to claim damages from the broker. The avoidance issue went to the Court of Appeal.

The Court of Appeal upheld the first instance judgment that there was no right to avoid the reinsurance agreement. The broker was the agent of the person who appointed him to obtain reinsurance. Therefore, the broker was not the agent of the

[334] *Berger v Pollock* [1973] 2 Lloyd's Rep 442.
[335] [1985] 2 Lloyd's Rep 529.

reinsurers and accordingly it could not be argued that the signing indication was a limitation on the broker's authority to act for the reinsurers, restricting the broker to binding them to one-third of the risk.

In presenting the risk to the reinsurers under the reinsurance contract, the broker was regarded as the agent of the reinsureds even though at the time the broker approached the reinsurers the reassured had not yet come into existence. On the agency issue Hobhouse J. noted that: [336]

"A broker who approaches an insurer with an offer of reinsurance is offering to act as the agent of the insurer. If the insurer accepts the reinsurance offered he thereby constitutes the broker as his agent to obtain the cover offered. The insurer is affected by any act or omission of the broker in bringing the contract about. For example if there had been any misrepresentation by the broker to the reinsurer then the insurer's/reassured's contract with the reinsurer is affected by that misrepresentation".

In other words, the broker's conduct can be ratified by the later existing assured. Applying this analysis to the open cover, as soon as the declaration is made, the broker's act prior to the declaration will be ratified. The obligatory nature of the open cover effected between the broker and the insurer would render the insurers bound to the assured. As a result of this, the declaration policy itself should become a contract of utmost good faith. A declaration made thereunder should be subject to the doctrine of waiver so that the assured is not under the duty of disclosure.[337]

5.2 Dual capacities of a broker under binding authorities leading to conflict of interests

When there is an open cover or binding authority between the insurers and the broker prior to the existence of the insurance contract, the broker when drawing the assured's

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[336] Hobhouse J. referred to *Glasgow Assurance Co v Symondson* [1911] 16 Com Cas 109 as analogy to this case. Approved by later cases *Youell v Bland Welch & Co (No.2)* [1990] 2 Lloyd's Rep 431; *Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd* (No.2) [1999] Lloyd's Rep IR 603.

[337] This view can be seen in Merkin, *Colinvaux & Merkin's Insurance Contract Law*, 10714.

attention to the standing offer made by the insurers should be regarded as being authorised by the insurers to do so.[338] In addition, in a situation where binding authority is given to the broker, not only is the broker acting on behalf of the assured, or prospective assured, but also on behalf of the insurers, syndicate or insurance company, who has made the standing offer or granted the binding authority. These dual capacities give rise to conflicts of duties which the broker on the one hand owes the assured and on the other hand owes the insurer. If there is no authority given to the broker by the insurers in effecting the insurance contract, the broker is acting on behalf of the assured only and owes no duty of care or skill to the underwriter.[339] Under binding authorities, the broker may be authorised to accept the risks on insurers' behalf, but would the broker's knowledge be imputed to the insurers as his agent? Would the insurers be able to deny liability for breach of the duty of disclosure at the time of formation of contract, if the broker is informed of the material fact by the assured? This issue of dual agency is considered in depth in the next chapter. What can be briefly said at this point is that the authorities are in favour of the assured, the original principal.[340] The insurer has to bear the risk of non-disclosure if the broker failed to disclose material facts to him.[341]

The next stage of this chapter shall consider those contracts for insurance that are more similar to an agency contract in character. These contracts are made by using binding authorities or a line slip. They are contracts for insurance in the sense that insurance is coming into effect based upon these contracts. Hence, it is worth looking at their functions and the need for the application of the duty of utmost good faith under these contracts. It is said that a party may be obliged not to suppress unusual features of the transaction, by reason of the general principle of misrepresentation.[342]

6 The application of the duty of utmost good faith to binding authorities given to other intermediaries

[338] *Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd* (No. 2) [1999] Lloyd's Rep IR 603.
[339] *Empress Assurance Corp Ltd v Bowring* (1905) 16 Com Cas 107.
[340] *Anglo African Merchants v Bayley* [1969] 1 Lloyd's Rep 268; *Eagle Star Insurance Co v Spratt* [1971] 2 Lloyd's Rep 116.
[341] *Woolcott v Excess Insurance and Others* [1979] 1 Lloyd's Rep 210.
[342] MacGillivray, 967 fn.15 referred to *GMA v Storebrand & Kansa* [1995] LRLR 333, 349 and *HIH Casualty and General Insurance Co Ltd v Chase Manhattan Bank* [2001] Lloyd's Rep IR 702.

It is clear that other intermediaries are acting on behalf of the insurers in accepting the risks proposed by the assured. A binding authority is an agency contract. However, under facultative obligatory binding authority the insurers are also bound to accept all the risks accepted by the other intermediaries. It is therefore argued that the duty of utmost good faith should be applied to this type of contract.

6.1 The broker's duty when effecting binding authority on behalf of a coverholder who is the other intermediary

In *Pryke v Gibbs Hartley Cooper Ltd (Pryke),*[343] Waller J. held that a binding authority is not an insurance contract nor was it a contract *uberrimae fidei.* The obligation to disclose all material facts did not arise.[344] From the case, the binding authority was given to another intermediary. Because of this holding, the other intermediary does not have to comply with the obligations under the duty of utmost good faith.

However, the interesting aspect of the case lies in what the judge did consider, *obiter*, the broker's duty that:

"What is more, if the broker were aware of the unusual features, it seems to me that the broker would have a personal responsibility. It seems to me that s. 19 of the Marine Insurance Act certainly supports the view that the broker has a personal responsibility in the insurance market. Furthermore, there is no reason why on the principles of Hedley Byrne v Heller (1963) 1 Lloyd's Rep. 485; (1964) A.C. 465 and Esso Petroleum Co. Ltd v. Mardon (1976) 2 Lloyd's Rep. 305; (1706) Q.B. 801 why the broker should not be personally liable in relation to any negligent mis-representation....Thus the practice in the market (about which evidence was adduced) for brokers to disclose material facts in relation to coverholders, would seem to me to be one that almost certainly would follow naturally and properly from the way in

[343] [1991] 1 Lloyd's Rep 602, 616.
[344] *Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep 602, 616.

which negotiations take place; and furthermore, brokers might themselves be personally liable in damages for any failure in that regard..."[345]

In short, Waller J. was of the view that brokers might have a personal responsibility to disclose unexpected features of the coverholder when negotiating the binding authority or its renewal with underwriters not because there was no contract between the insurers and the brokers but rather because of the character of the binding authority itself. He analysed the position of the broker, parallel to the position of the parties in a contract of suretyship.

This analysis was followed in subsequent cases.[346] These subsequent cases, however, consider the broker's duty of disclosure here as the duty to disclose in order to avoid misrepresentation as a result of partial non-disclosure - not a breach of the duty of disclosure under the duty of utmost good faith as such. In other words, the common law rules of misrepresentation are applied to the broker personally and separately from the assured.

Hence, it can be said that as a result of market practice, a broker who acts in the market owes a personal responsibility to the insurers. This responsibility is not limited to the duty of disclosure under an insurance contract but can also be used with other instruments in the insurance market as in this case. However, the personal responsibility that the broker has in this case is not the same as the duty of disclosure in an insurance contract. Rather, it is a kind of misrepresentation resulting from partial non-disclosure.

6.2 The duty of the coverholder who is the other intermediary, the other insurer or insurance company towards the insurer

Sphere Drake Insurance v Euro International Underwriting.[347]

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[345] Ibid.
[346] *L'Alsacienne Premiere Societe Alsacienne et Lorraine D'Assurances Centre L'Incendie Les Accidents et Les Risques Divers v Unistorebrand International Insurance A.S and Kansa Reinsurance Co Ltd* [1995] LRLR 335; *HIH Casualty and General Ins. Co Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep IR 191 (Comm).
[347] [2003] Lloyd's Rep IR 525.

It was held that there were fiduciary duties owed to the insurers by the coverholder. The case was a case of a binding authority issued to a person who is not a broker, which is the same as in *Pryke*, only that *Pryke* involved a broker who effected a binding authority between the coverholder and the insurer while this case involved the coverholder directly.

From the case, SD, the insurer, employed EIU (the coverholder) as its underwriting agent under a binding authority. EIU agreed to accept reinsurance of a US workers' compensation 'carveout' business, which was being offered by the brokers SCB. Under the scheme devised by SCB and EIU, the premium which was paid to SD was far less than the likely amounts of claims, and accordingly the reinsurance was deliberately written at a loss. This was disguised by outwards retrocession: most of the business accepted by SD was then retroceded to other insurers in the market, and there were further levels of reinsurance and retrocession cover leading to the creation of a spiral. It was anticipated by EIU and SCB that SD would make a small profit on the difference between losses that had to be paid plus outward retrocession premiums, and the sums received from retrocessionaires. SD did not know that the reinsurance was intended to be effected in this way. The scheme was devised to profit EIU and SCB. There were substantial claims faced by SD from the US and in the present proceedings SD sought to recover those sums from EIU.

It was held, *inter alia*, that EIU owed fiduciary duties to SD. Thomas J. said that the coverholder had been given the insurer's pen to write contracts of insurance and reinsurance. Given the extent of that authority and the circumstances of the appointment, the relationship was one of the highest degrees of trust.[348] Under this duty EIU must act in good faith and in the interests of SD, and not have regard to the interests of any person other than SD and must disclose and report to SD all material information in relation to the binder and the business written under it.[349]

To sum up, the coverholder who is the other intermediary owes a fiduciary duty to the insurer who granted binding authority. There is a duty of disclosure under this duty but it is not the same as that under the duty of utmost good faith in insurance law.

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[348] Ibid., paras. 42-46.
[349] Ibid., paras. 48-49.

The duty of disclosure in this case does not include the innocent failure to pass information. The broker who effects binding authority on behalf of the coverholder also owes a duty similar to the duty of disclosure to the insurers - his personal responsibility towards the insurers. This obligation arises as a result of the insurance market practice whereby it is accepted that a broker owes a separate duty of disclosure to the insurers.

This analysis should at first sight be applied to the relationship between the leading underwriter and the insurers under the line slip or open cover under which the leading underwriter is empowered to agree to proposals for the insurance of risks. However, this might not be so as it is not universally accepted that the leading underwriter acts as the agent of the following underwriters. This affects the relationship between the leading underwriter and the insurers themselves and between the assured and the leading underwriter. It is therefore important to look at this issue separately.

7 Leading underwriter clauses in line slip, open cover or treaty

The issue to be considered here is whether there is an agency relationship between the leading underwriter and the following underwriters.

Leading underwriter clauses have been created to relieve the problems arising as a result of the composite nature of insurance policies effected by using the slip.[350] Leading underwriter clauses entitle the leading underwriter to agree to amendments to the cover granted by the slip at a later stage or at some time, to settle the claim. It was held that this type of leading underwriter clause establishes an agency relationship between the underwriters. This can be seen in *Roadworks (1952) Ltd v Charman (Roadworks).*[351]

In this case, the claimants were the charterers of a barge that was to be used to transport granite. The barge was to be beached, and the assured obtained a survey of the proposed beaching area. The assured instructed the broker to obtain insurance

[350] Merkin, *Caulinvaux's Law of insurance*, 26 para. 1-39.
[351] [1994] 2 Lloyd's Rep 99.

against the possible liability of the assured to the owners of the barge in the event of damage caused by the beaching. The slip stated that towing arrangements were subject to London Salvage Association approval. The slip contained a leading underwriter clause that provided that "all alterations, additions, deletions, extensions, agreements, rates and changes in conditions to be agreed by the leading Lloyd's underwriter", and in due course the slip became fully subscribed. The broker then sought to arrange a survey by the LSA, but that was refused. The broker then took the slip back to the leading underwriter and secured his scratching on an endorsement that removed the requirement for LSA approval. Thereafter the barge was damaged in the course of the beaching operation. Members of the following market argued that they were not bound by the second slip. It was held by HHJ Kershaw Q.C. that the new agreement bound both the leading underwriter and the following market. The leading underwriter was the agent of the following market, and was authorised by the leading underwriter clause to waive the inspection condition. By taking a leading line he knew that there would be following underwriters and he saw the terms of any leading underwriter clause on the slip. He may have required the leading underwriter clause to be altered if he was to take a line. The following underwriters saw from the slip the identity of the leader or leaders. They saw the terms of the leading underwriter clause. By taking a line they did not only make a contract with the insured but also made the leader or leaders, their agent or agents for the purpose shown in the leading underwriter clause.[352]

Problems arise when leading underwriter clauses are used in a declaration policy e.g. a line slip, an open cover or treaty. In this situation the leading underwriter is the one who accepts declarations made under the declaration policy. The assured has to present all the risks he wishes to declare to the leading underwriter and the leading underwriter is not bound to accept that declaration. As soon as he accepts the declaration the following underwriters become bound.[353] In other words, the contract of insurance between the assured and each underwriter occurs when the leading underwriter accepts the risk presented by the assured or the broker. The facility, effected between the leading underwriter and the insurers in this situation, is probably merely a contract for insurance.

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[352] Ibid.,105.
[353] *Denby v English & Scottish Maritime Insurance Co Ltd* [1998] Lloyd's Rep IR 343.

In this case, there are cases saying that a leading underwriter's act merely triggers an event by which the following underwriters become bound.

Mander v Commercial Union Assurance (Mander).[354]

The case concerned an open cover subscribed by a number of underwriters with the broker in relation to retrocession. Under that open cover, the condition provided that declarations be "t.b.a (L/U) only" (to be agreed with leading underwriter only). That meant the broker had to declare the risk to the leading underwriter before the contract of insurance was entered into. The claimant was a representative of a Lloyd's syndicate and a reinsurer in respect of marine liability policies. The following underwriters who subscribed to the open cover in relation to the retrocession agreement refused to indemnify the claimant, asserting that the leading underwriter had not been authorised to be bound to accept the risk presented by the claimant or, alternatively, that the declaration to the open cover could be avoided. The present action was against the brokers who had purported to the placing of the cover, and also against the leading underwriter on the basis that he was in breach of his warranty of authority in indicating that he was authorised by the other underwriters to write the risk on their behalf.

Rix J. tentatively suggested that the acceptance of a risk by the leading underwriter under the open cover was not done as an agent of the following market but merely provided the trigger event by which the following market themselves came to be bound by the declaration.[355]

Another recent case seems to follow this view even though it was not said that there was a trigger event but clearly said that there was no duty of care, which means the relationship between the leading underwriters and the insurers was not based on an agency relationship.

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[354] [1998] Lloyd's Rep IR 93.
[355] He cited *dicta* to similar effect by Steyn J. in *Seavision Investment SA v Evennett (The Tiburon)* [1990] 2 Lloyd's Rep 418 (Comm), 422.

Bonner v Cox Dedicated Corporate Member Ltd (Bonner).[356]

This case involved reinsurance of a non-obligatory open cover. The open cover was a standing offer for the cover underwriters to be bound to risks accepted by the leader within the terms of the cover. The broker facilitated its broking by seeking reinsurance for the cover that could then be offered to those underwriters who were prepared to subscribe to the open cover. The reinsurance slip had been scratched by some reinsurers before the cover underwriters accepted the cover slip. The reinsurers denied liability by alleging that: (1) there was a non-disclosure of a substantial loss to the previous year of the cover which should have been disclosed when the reinsurance was being broked; (2) there was a misrepresentation and non-disclosure since the reinsurers had been misled as to the nature of the business that had been or would be accepted to the cover; (3) the broker had falsely represented to one of the reinsurer that he would obtain stop loss reinsurance for that particular reinsurer; (4) there was a breach of an implied term in the reinsurance contract to accept risks on the same or substantially the same terms and conditions as would otherwise have been if underwriting without the benefit of the reinsurance cover; (5) the reinsurances as a matter of construction were limited in scope and duration.

Morison J. gave the judgment for the reassured that non-disclosure had not had a causative effect because, on the evidence, the reinsurance and fronting arrangements would still have been made had disclosure been made.[357] It was also held that there was no misrepresentation by the assured of the history of the cover. The important judgment relating to this issue was that there was no duty of care owed by the cover underwriters to the reinsurers. In particular, there was no breach of any duty by the lead underwriter in relation to the individual declarations on which the reinsurers relied. This seemed to support the view of Rix J. in *Mander* that the relationship between the leading underwriter and the insurers is based on other factors which are not agency. It was then held that there was an implied term that the policies to be accepted to the cover would be those which in the ordinary course of business the lead underwriter would write, taking account of reinsurance. If the business written was

[356] [2004] Lloyd's Rep IR 589.
[357] In other words, the reinsurers were not induced to enter into the contract.

written in the normal course of the business, then that was what the reinsurers had agreed to cover and no question of non-disclosure arose.

7.1 Criticisms

The relationships between leading underwriters and following underwriters are similar to those between the coverholder and the insurers under binding authorities as in both cases the underwriters give their pen in underwriting the risks to someone else. Hence, the basis of the relationship between the leading underwriter and following underwriters should be the same. As it is settled in the binding authority cases that the relationship is based upon agency, this view should be applied to the relationship between the leading underwriters and following underwriters also.

In addition, the basis of the relationship of the leading underwriter and following underwriters should be consistent. It is hard to say how trigger analysis could be applied to the fact of *Roadworks*. From the case, each underwriter was bound as soon as he signed the slip creating a separate contract between each of them and the assured. The leading underwriter clause on the slip empowered the leading underwriter to the amendment of cover. It is difficult to see how the trigger analysis could apply here as the contract of insurance had already been entered into. If the leading underwriters merely triggered an amendment, it would mean that the broker must seek acceptance of each following underwriter to that amendment triggered by the leading underwriter as separate contracts between the assured and each underwriter already exist.

This is unlike what happened in *Mander*, there was no contract of insurance between the assured and each underwriter when the open cover was entered into. Hence, it is possible for the leading underwriter clause to be the trigger of a contract of insurance. It is not unusual for a contract to have an event triggering the existence of the contract itself.

In addition, if the leading underwriter clause empowers the leading underwriter to settle claims, it is difficult to see how the trigger analysis can be applied. The problem would not occur under agency analysis.[358]

As there is no standard wording for leading underwriter clauses, it is said that leading underwriter clauses have led to abuse. It might be for this reason that the court was reluctant to base its judgments on agency in relation to leading underwriter clauses. If it is an agency agreement, appointing an agent to a particular position confers on him apparent authority to bind his principal in respect of the usual acts that someone in that position would have authority to do. It is irrelevant that the agent is actually not authorised to do some of the usual acts, unless the third party is aware of this. Indeed, Rix J. mentioned in *Mander* that the trigger analysis would avoid the danger of imposing upon a leading underwriter the unrealistic fiduciary obligations of an agent,[359] namely, that while he must exercise his judgment in accepting the risks carefully, he might still face liability to the assured for breach of warranty[360] of authority like the underwriter in *Mander*. With due respect, this argument is not totally convincing. When following markets confer upon the leading underwriter the power to accept the risk they trust the leading underwriter's judgments and rely on them. Therefore there should be a fiduciary obligation upon the leading underwriter. Before they sign the declaration policy in which the leading underwriter clause is stated, they have the ability to go through the terms of the policy before they accept that cover and they can also change the terms if they see them unfit. In *Mander*, Rix J. used this argument to reject the apparent authority of the leading underwriter. He said that the scope of an open cover is there for the assured to see; therefore there is no reason to think that a leading underwriter makes any further representation about the

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[358] *Roar Marine Ltd v Bimeh Iran Insurance Co* [1998] 1 Lloyd's Rep 423. In this case, it was held that the leading underwriter's decisions on settlements of claim are to be followed by other underwriters, such provision is binding on them, and there is no basis for implying any provision that leading underwriter's settlement decisions are to be taken in a *bona fide* and businesslike fashion. The following market can claim the leading underwriter for negligence or breach of agency agreement.

[359] [1998] Lloyd's Rep IR 93,144.

[360] Clarke, 270 para. 8-5. Requirements for liability for breach of warranty are: "first, the agent must represent by words or by conduct that he has authority to act in the way in question on behalf of the insurer. If he purports to act as agent he is taken to have represented that he has authority to act. Second, the insured must have been induced by the agent's representation to act in a way in which he would not otherwise have acted if this representation had not been made. There will be no liability for breach of the warranty if the insured knows all the material facts from which the agent's or its extent may be inferred, or if the agent expressly disclaims present authority..."

scope of his authority merely by acting as leading underwriter.[361] The slip, however, does not normally contain detailed wording of the scope of cover and the leading underwriter clause seems to give the leading underwriter carte blanche[362] which would make it difficult for the assured to know the scope of the leading underwriter clause. Even though this problem might be mitigated by the London Market Principles 2001 which creates clarity of contract from the outset,[363] it would be more reasonable if the underwriters are the people who should be cautious of the authority they give to the leading underwriter, as the following underwriters see the terms of the slip which they may alter before they sign the slip. If the leading underwriter acted outside his scope of authority and the following underwriters become bound by the leading underwriter's apparent authority, they can claim damages from the leading underwriter for breach of his duty as agent of the following underwriters.

The judgment in *Bonner* was also not totally convincing. The case concerned reinsurance effected prior to the existence of the direct insurance.[364] There was merely an open cover. Under the open cover the leading underwriter had the right to accept risks on behalf of the following underwriters. One might understand that the reinsurers exercised their judgments through the leading cover underwriter. However, this is not true. The reinsurance is actually a reinsurance of the risks accepted under the open cover. In other words, the cover underwriters were the reassured who chose the risks to reinsure with the reinsurers. The reinsurers were bound to accept those declared risks under the reinsurance. Hence, it was right to hold that there was no duty of care owed to the reinsurers by the cover underwriters in accepting each declared risk in this case. The relationship between the reinsurers and the leading cover underwriter under the direct cover should not be regarded as an analogy to the relationship between the leading underwriter and the following underwriters in an insurance contract. The reinsurers merely agreed to cover those risks which had been written in the normal course of the business. Hence, if the accepted risks fell outside the scope of the open cover, the reinsurers could reject their liabilities.

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[361] *Mander v Commercial Union Assurance* [1998] Lloyd's Rep IR 93.
[362] *Roadworks (1952) Ltd v Charman* [1994] 2 Lloyd's Rep 99, 104.
[363] Detail of the London Market Principles 2001 can be seen in chapter seven
[364] *General Accident Fire and Life Assurance Coproation v Tanter (The Zephyr)* [1985] 2 Lloyd's Rep 529.

That the leading underwriter clause does not have anything to do with the reinsurance and that the risks must be written in the normal course of business, taking account of reinsurance has been confirmed in *American International Marine Agency of New York Inc and another v Dandridge.*[365]

This case concerned a reinsurance of a total loss only of a hull and machinery insurance in respect of a vessel and was expressed to be "a reinsurance and subject to the same clauses and conditions and against the same perils as in the original policy or policies". The sum reassured was stated to be a percentage of the entire risk insurance insured. The reassured had a 15% participation evidenced by a binder which contained the same terms as a document which evidenced the remaining 85% of the participation. Only the binder included a widely worded "follow the leader" clause. During the period of insurance, the class of vessel was changed and this change, with an accompanying reduction in the value of the vessel, was accepted by the lead insurers and was followed by the reassured without any involvement from the reinsurers. The vessel ran aground and was declared a total loss. The reassured sought to recover his payment from the reinsurers. The issue was therefore whether the clause in the reinsurance slip incorporated the "follow the leader" clause in the binder.

Mr. Richard Sibbery QC. sitting as a deputy judge of the High Court gave his judgment on the basis that "the original policy or policies" in the general incorporation provision in the reinsurance contract referred to the insurance as a whole and not the binder. Since the "follow the leader" clause appeared only in the binder, it had therefore not been incorporated into the reinsurance.[366]

The important view concerning the current discussed issue was when the court went on to consider whether and in what form the leading underwriter clause might have been incorporated into the reinsurance in the event that the binder had fallen within the incorporation wording.[367] It was held that a leading underwriter clause in the

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[365] [2005] 2 All ER 496 (Comm).

[366] The "follow the leader" clause can be incorporated if the reassured obtains a specific agreement to be bound. [2005] All ER 496 para. 46.

[367] The court considered the conditions for incorporation laid down by David J in *HIH Casualty and General Insurance v New Hampshire insurance* [2001] Lloyd's Rep IR 224 (Comm) as follows: 1) the

direct policy is to be regarded as ancillary to the reinsurance and thus will not be incorporated. Here, Mr. Richard Sibbery QC. recognised, *inter alia,* the different legal analysis of the effect of the leading underwriter clause in a contract of insurance in *Roadworks* and *Mander* and the difference in the facts of these cases was that the former dealt with a facultative slip and the latter with an open cover, but he did not analyse any further.[368] He was clearly of the view that the leading underwriter clause concerns the relationship between the leading underwriter and the following market, as well as that between the leading underwriter and the insured. According to him, the leading underwriter and the following underwriter generally have mutual interests. This might not always be so in the relationship between the leading underwriter and the reinsurers. He mentioned the facts of this case as an example, the reduction in the insured value agreed by the leading underwriter would, if it had bound reinsurers who had insured on total loss only terms, have been potentially very prejudicial to their interest. [369] Hence, had the reinsurance incorporated the "follow the leader" clause, the acceptance of a new class may not be regarded as something which was acted out in the normal course of business, taking account of the reinsurance. Apart from this, the leading underwriter in this case was clearly not the leading underwriter in the reinsurance. It was not the intention of the parties to the reinsurance that reinsurers should follow the leading underwriter of the original insurance.[370]

In conclusion, it might be said that the trigger analysis might be plausible in a situation where the leading underwriter is empowered to accept declarations under an open cover. However, it is doubtful whether it can be used in situations where it is provided under a contract of insurance. The supporting cases do not seem to be convincing. The better view seems to be that agency analysis should be used in every

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term must be germane to the reinsurance; 2) the term must make sense, subject to permissible 'manipulation' of the words used, in the reinsurance agreement; 3) the term must be consistent with the express terms of the reinsurance; and 4) the term must apposite for inclusion in the reinsurance.

[368] Another case where the conflict between agency and trigger theories was referred to, but not resolved, was the Court of Appeal case *Unum Life Insurance Co of America v Israel Phoenix Assurance Co Ltd* [2002] Lloyd's Rep IR 374.

[369] [2005] All ER 496 para. 48.

[370] Ibid., para. 49.

situation.[371]The insurers must be cautious, as they have the opportunity to see or alter the terms before they commit themselves. Further judgments are awaited to be seen.

8 Conclusion

When declaration policies are formed, the assured's duty of disclosure which is one of the obligations under the duty of utmost good faith should be applied if the insurers are bound to future insurance contracts. At this time the insurers exercise their judgment as to whether or not to accept the risks, which is the rationale behind the application of the duty of utmost good faith even though the real insurance contract had not been entered into at that time. The doctrine of waiver comes to play in justifying why the duty of disclosure does not apply to each declaration made under the declaration policy. In short, a declaration policy that has an obligatory effect towards the insurers, and that is effected between the insurers and the assured or between the insurers and the broker acting on behalf of the assured, including the case where the broker agrees with the insurers in advance prior to the existence of the assured but later ratified by the assured when a declaration is made on the assured's behalf by the broker, should be regarded as a contract of utmost good faith attracting the duty of disclosure even though not a contract of insurance itself. Declarations made thereunder should be subject to the doctrine of waiver by the insurers.

What should be regarded with caution is the nature of declaration policies when they are agreed. It is now clear that one declaration policy might be various in nature. Conditions under an obligatory declaration policy might allow the assured to have the option in making a declaration. The same declaration policy would be regarded as being facultative obligatory in nature to that extent. The nature of a declaration policy affects the time at which the insurers become bound. The insurers would become bound under a facultative obligatory insurance only when declarations have been made in good faith, namely, without knowing that the loss has occurred even though

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[371] Clarke, 256-257 para. 8-2A3 seems to support this view. He said, under the heading agents: authority to bind the insurer, that: "In the case of "lineslips". Which are arranged by a Lloyd's broker, and "consortia", a leading (active) underwriter has authority to contract for other (active) underwriters in respect of certain kinds of business...persons, such as coverholders under binding authorities, outside Lloyd's may have been given delegated authority to make contracts on behalf of Lloyd's underwriters..."

the declaration was made after the loss has occurred. Under an obligatory declaration policy the insurers are bound when declaration policies are made. Declarations can be made in arrears with the assured's knowledge of the loss, provided the assured must not be fraudulent in making a declaration. Hence, to avoid this problem, the contract should be clear from the start as to whether it should be facultative or obligatory in nature or in the case where the contract is a mixture of both natures, which terms of the contract should be considered as facultative or obligatory in nature.

When insurers authorise another intermediary to accept risks on their behalf, even though there is an immediate commitment of the insurers as soon as the agency contract is agreed i.e. binding authority, the duty of utmost good faith should not be applied as the third party still exercises judgment on the insurers' behalf. The rationale for the use of the duty of utmost good faith does not exist in this type of contract. However, something similar to the duty of disclosure is applied under this contract for insurance. It is said to be a kind of misrepresentation as a result of partial non-disclosure. This obligation applies to both the broker who effects the declaration policies and to the other intermediary. The broker's duty at this point is analysed in parallel to contract of suretyship. The other intermediary owes this duty as he has a fiduciary duty towards the insurers. The insurers trust the third party's judgment in accepting the risks

If the broker is the one who is authorised to accept the risk on the insurers' behalf, there is an obvious conflict of interest. The law gives priority to the broker's duty owed to the assured, who is the original principal. The insurers can claim damages from the broker who was is breach of his duty towards them.[372]

In the case of a line slip or a leading underwriter clause used in a line slip or an open cover either to allow the leading underwriter to amend the cover, settle the claims or accept declarations, the better view would be that there is an agency relationship between the leading underwriter and the other insurers. If the leading underwriter acts outside the scope of the leading underwriter clause, the following underwriters should

[372] Clarke, 271 para. 9-1. "The agent may be liable concurrently in contract and tort and, in most cases, the extent of the liability will be the same." In the case where broker is acting for the insurers without a contract only tort will come into play.

be liable towards the assured as a result of apparent authority. The following underwriters, however, can claim damages from the leading underwriter. This would be consistent with the status of binding authorities where the broker is authorised to accept the risks on the insurers' behalf; where the other intermediary is authorised to accept the risk in such cases the courts have held that the binding authority is an agency contract. The function of a binding authority given to the broker or the other intermediary and the leading underwriter clause, whereby following underwriters agree to follow the leading underwriter's decision in making a judgment in accepting each declaration, are very similar. In both situations, the insurers authorised a third party to accept risks on their behalf. Hence it would be more correct to analyse the relationship of the insurers and the brokers; and of the insurers and other intermediary; and of the insurers and the leading underwriter in the same way.

Chapter 5

Agency and the duty of utmost good faith

1 Introduction

This chapter focuses on s.19 of the Marine Insurance Act (MIA) 1906. This section imposes a separate duty of disclosure upon the agent. Two main questions are considered in this chapter: what is the scope of this section and; is the section able to accommodate the practice in the London commercial insurance market? In particular, the chapter considers the following issues:

1) The corpus of s.19 of the MIA 1906

At this stage, the settled and the seemingly settled issues are mentioned briefly and the unsettled issue is closely examined. The unsettled issue concerns the scope of the duty of disclosure of the agent under s.19 of the MIA 1906. Since the wording used in section 19 is very broad that the agent to insure has to disclose "every material circumstance which is known to himself...", it is doubtful whether every material fact must be disclosed by him and whether there is a fraud exception or a broader exception - facts which have come to the agent's possession while he was not acting as the agent of the assured need not be disclosed.

2) The application of s.19 in the commercial insurance market

The section uses the word "agent to insure". On its general meaning, "agent to insure" means an agent who is authorised by the assured to place insurance with the insurers. There are some agents, whom even though are authorised to insure the risks may not directly fall under the definition of the agent to insure under s.19. This is because on the balance of authorities only the agent who places insurance with the insurers falls

under this section.[373] It is therefore important to consider the question as to whether the law can accommodate non-disclosure of this type of agent.

Another issue needing to be considered is the conflicts of interests in dual agency situation. The insurance market practice allows an agent to act for more than one principal. Sometimes a broker also acts on behalf of the insurer to perform a particular task or to accept the risks. The underwriting agent that manages an insurance pool has to reinsure the risk accepted by the fronting company on behalf of the pool members. The underwriting agent in these situations therefore acts for both the assured and the insurer. How does the duty of utmost good faith apply to this situation?

2 The current position of the law regarding agency and the duty of utmost good faith

Section 19 of the MIA 1906 provides that:

"Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer – (a) every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and (b) every material circumstance which the assured is bound to disclose, unless it comes to his knowledge too late to communicate it to the agent".

There have been various contentions in the past regarding the legal basis of the duty whether the knowledge of an agent to insure should be imputed to the assured and whether the intermediate agent should fall under this section. These issues have been considered by common law judges. The issue regarding the imputed knowledge of the agent to insure is now settled. The issue regarding the intermediate agent is not quite settled but on the balance of authorities, the position of law may be assumed.

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[373] *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241; *Group Josi Re v Walbrook insurance Co Ltd* [1996] 1 All ER 791; *ERC Frankona Reinsurance v American National Insurance Company* [2005] EWHC 1381(Comm).

The next stage considers these issues briefly to derive a clearer picture of the duty of utmost good faith resting upon an agent to insure.

2.1 The settled issues of law: section 19 of the MIA 1906 imposes upon the agent to insure a separate duty of disclosure

The law is settled that the knowledge of the agent who is employed to effect insurance is not to be imputed to the principal and that this type of agent is bound as the principal is bound to communicate to the underwriters all material facts within his knowledge. This was the holding of Lord Macnaghten in *Blackburn Low & Co v Vigors*[374] even though in this case the majority, Lord Halsbury L.C., Lord Watson and Lord Fitzgerald came to the same solution by adopting an imputation of knowledge analysis whereby it was to be assumed that the broker would communicate facts known to him to the assured and thus the assured was under a personal obligation to disclose facts known to his agent by reason of the imputation of that knowledge to him.

Lord Magnaghten's holding has finally been confirmed by the House of Lords in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank.*[375] This should be the correct position of law. If s.19 is based on the imputation of knowledge analysis, the section would not have been necessary.[376] The knowledge of the broker will always fall under the question whether it is the deemed knowledge of the assured which would be the same question when one deals with s.18. In addition, the agent to insure is employed to place the insurance contract. The insurer is entitled to contract on the basis that the person with whom he is dealing, being someone authorised by the assured so to act, discloses all facts within that person's knowledge.[377] It would be unfair for the insurer to be deprived of facts material to the risk based upon the fact that the assured does not have a close relationship with his agent or does not know of the existence of the agent to insure who actually is placing the risk on his behalf.

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[374] [1887] LR 12 App Cas 531, 542-543.
[375] [2003] Lloyd's Rep IR 230.
[376] *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685; *SAIL v Farex Gie* [1994] CLC 1904 both cases per Hoffman L.J.
[377] *Blackburn Low v Vigors* [1887] LR 12 App Cas 531, 541 per Lord Watson; *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241, 259 per Saville L.J.

Moreover, this is consistent with market practice that sometimes the assured does not know the existence of the agent to insure at all, for example, in the situation where the agent whom is authorised by the assured to insure the risk passes the risk onto the Lloyd's broker to insure it with the Lloyd's underwriters. Material facts known to the placing broker should be disclosed to the insurers. It would be a harsh burden put upon the assured to be deemed to know facts possessed by the placing broker of whom he does not know the existence. Creating a separate independent duty of the agent to insure balances the scale as the agent to insure himself is now under the duty to disclose material facts to the insurers.

2.2 The seemingly settled law: the agent to insure under s.19 means only agent who actually places the risk with the insurers

The broad classification of the types of agents can be seen in *Simner v New India Assurance Company Limited*[378] as follows:

1) Agent to know

The assured relies on the *agent to know* for information concerning the subject matter for the proposed insurance. It has been said that this type of agent is an agent for the management of a shipping business. The assured is deemed to know circumstances which such agents ought to have communicated to the assured in the ordinary course of business on the basis that all material facts connected with the vessel insured, known to the agent employed for that purpose have been communicated by him, in due course to his principal.[379] The test of what ought to be known by the assured is not an objective test of what ought to be known by a reasonable, prudent assured but a subjective test of what ought to be known by the assured in the ordinary course of carrying on his business in his usual manner.[380]

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[378] [1995] LRLR 240.
[379] *Proudfoot v Montefiore* [1867] LR 2 QB 511; Approved by *Blackburn Low v Vigors* [1887] 12 App Cas 531.
[380] Michael J. Mustill, Jonathan C. B. Gilman, eds., *Arnould's Law of Marine Insurance and Average,* 16th ed. (London : Stevens, 1981), 488 para. 640.

2) Predominant agent

The predominant agent is an agent who is in such a predominant position with respect to the assured that his knowledge can be regarded as the knowledge of the assured. The most common example of such a relationship is that between the controller of a company and the company itself. Such a relationship is not lightly established to prove deemed knowledge of the assured.[381]

3) Agent to insure

An agent to insure is an agent who is authorised by the assured to place a risk on his behalf.

Even though it can not be said that the law is settled on this issue, but on the balance of authorities, it seems that s.19 applies to an agent to insure who is the last person who places the risk with the insurer. [382] This can be extracted from the judges' judgments given in the authorities. The case that illustrated this issue was *PCW Syndicates v PCW Reinsurers (PCW).*[383]

In this case, underwriting agents acting for the reassureds had defrauded the reassureds, a fact which the reinsurers alleged to be material and to be known to the underwriting agents amounting to a non-disclosure of material facts by the agent to insure under s.19 (a) of the MIA 1906.

The important judgment regarding this issue was given by Saville L.J. He gave judgment on the basis that an agent to insure "...is the agent who actually deals with the insurers who, as a matter of practical politics, is going to provide the insurers with the information relating to the proposed insurance."[384] Rose L.J. agreed. It can thus be said that two members of the Court of Appeal held that the only person who can be an agent to insure is a placing broker.

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[381] Merkin, *Colinvaux's Law of Insurance,* 121 para. 5-07.
[382] *Blackburn Low v Haslam* [1888] 21 QBD 144, 152-153 per Pollock B.; *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241, 257 per Rose L.J and at pp. 258-259 per Saville L.J.
[383] [1996] 1 Lloyd's Rep 241.
[384] Ibid., 259 per Saville L.J.

The issue is also analysed in *Group Josi Re v Walbrook Insurance(Group Josi).*[385]

In this case, Weavers was the underwriting agent of the defendant English companies, one of them was Walbrook who arranged reinsurance with a Belgian company, Group Josi, the claimant through a broker. Group Josi alleged that three individuals in Weavers, the underwriting agency, were party to a fraud to divert from Weavers and the reassured companies commissions which should have been paid or credited to them. With respect to the duty of utmost good faith, it was alleged that this fraudulent conduct should have been disclosed according to s.18 and s.19 of the MIA 1906.

The disputing issue was the same as that of *PCW* and the judgments were consistent. The Court of Appeal held that the fraudulent conduct of Weavers was not something which had to be disclosed as it offended common sense for the fraudster to disclose his fraudulent conduct to his principal or the insurers. The judges, in particular Saville L.J. as Rose L.J. again merely agreed to the judgment, and also considered the issue of the duty of disclosure of the underwriting agent. It was held that even though Weavers arranged the reinsurance, they had not placed it. The insurance was placed by an innocent broker. Weavers were therefore not the agent to insure under s.19.[386] The House of Lords subsequently refused to give leave to appeal in either of these cases so they must be taken to be correctly decided.

The latest case to follow this view was *ERC Frankona Reinsurance v American National Insurance Company.*[387]

In this case, the reinsurers denied their liabilities and based their defences on misrepresentation, non-disclosure or breach of warranty. The reinsurers were quota share reinsurers of the reassured who reassured the risks in respect to its participation in a certain insurance pool in the US. The pool was managed by an underwriting agent called National Accident Insurance Underwriters Inc. (NAIU). The reinsurance started in 1997. At that time the reinsurers reinsured another company P. The reinsurance in 1997 was presented to the reinsurers by the placing brokers B. Later in

[385] [1996] 1 Lloyd's Rep 345.
[386] Ibid., 367 per Saville L.J.
[387] [2005] EWHC 1381 (Comm).

1998, the reassured took over from P. The reinsurance was effected through placing brokers K. One of the allegations regarding non-disclosure concerned two charges of fraud of NAIU's chief executives, which was the material fact and had an inducing effect. The defence raised by the reassured was that neither it nor any of its relevant agents were aware of these facts and therefore could not have disclosed them.

Andrew Smith J. considered whether the NAIU fell under any of the three types of agents mentioned in the *Simner* case- 1) the agent to know; 2) the predominant agent; 3) the agent to insure- or whether the knowledge of NAIU should be regarded as ought to have been known by any of the three types of agents. Here in answering who was the agent to insure, he followed the *PCW* case's judgment. The agents to insure are those who actually deal with the insurers and directly make the contract of insurance. In this case it was K. K did not have any connection with the NAIU as the NAIU- the underwriting agent- did not authorise K to place the reinsurance. It was held that K did not posses NAIU's knowledge. However, it turned out that the reassured themselves possessed the knowledge as the reassured's senior employee either knew the facts or had deliberately shut his eyes to them.

Hence, it can be said that on the balance of the authorities, the agent to insure should be the agent who places the risk with the insurer. This position of law is consistent with the relationship between the agent to insure and the insurers. When the insurers deal with the agent to insure, they expect him to disclose material facts within his knowledge to them.[388] As a result, it is logical that only the agent who really deals with the insurer should be regarded as an agent to insure. To expect the insurer to rely on material facts known only to the intermediate agent would be impractical. Sometimes the insurer does not know the existence of the intermediate agent. The insurers may know the assured by name without having met the assured in person and receive all the information from the agent to insure. Frequently the intermediate agents are not mentioned to the insurers. The insurers expect all the facts to be

[388] This can be extracted from Lord Watson's passage in *Blackburn Low v Vigors:* "...When an agent to insure is brought into contract with an insurer, the latter transacts on the footing that the agent has disclosed every material circumstance within his personal knowledge, whether it be known to his principal or not; but it cannot be reasonably suggested that the insurer relies, to any extent, upon the private information possessed by persons of whose existence he presumably knows nothing".

disclosed from the agent they are dealing with. Limiting the meaning of agent to insure to placing agent solves this problem.

2.3 The unsettled issue of law: what should be the scope of s.19 of the MIA 1906?

This problem arises when one looks at the rationale behind s.19 that the insurer is entitled to contract on the basis that the person with whom he is dealing, being someone authorised by the assured so to act, has disclosed all facts within that person's knowledge. S.19 indeed provides very broad wordings consistent with the rationale that the agent to insure has to disclose "...every material circumstance which is known to himself..."On the one hand, the agent to insure is the assured's agent. Hence, there are authorities saying that the material facts that have to be disclosed are confined to facts that the broker has acquired in his capacity as the agent of the assured. On the other hand, as the wording of s.19 is so broad and the duty is regarded as an independent duty, the material facts should have a broad meaning and include:

1) Material facts known to the agent to insure for reasons entirely unconnected with his functions as a broker or;

2) Material facts known to the agent to insure by reason of his role as a broker for others but not for the assured in question or;

3) Material facts known to the agent to insure by reason of the agent to insure's own fraudulent conduct against the assured.

The best way to answer these questions is to contemplate what are the exceptions and the limitations under the duty. The exceptions render material facts immaterial and unnecessary to be disclosed. They are provided in s.18 (3) of the MIA 1906 as follows:

"...In the absence of inquiry the following circumstances need not be disclosed, namely: (a) any circumstance which diminishes the risk; (b) any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to be

known matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know; (c) any circumstance as to which information is waived by the insurer; (d) any circumstance which it is superfluous to disclose by reason of any express or implied warranty..."

Even though s.18 imposed the duty of disclosure upon the assured and not the agent, it does not mean that the agent is not subject to these exceptions. S.19 clearly provides that "...subject to the provisions of the preceding section as to circumstances which need not be disclosed...". Hence, in considering whether the agent is under the duty of disclosure, these exceptions must also be taken into account.

The cases are not reconciled as to whether there are other exceptions apart from those provided in s.18(3). The question considered at this stage is whether the other exceptions are necessary for a fair and effective operation of s.19.

2.3.1 Is there a fraud exception?

There are two principles regarding fraud of the assured's agent. The first one appeared in *Fitzherbert v Mather*[389] where it was said that where a loss must fall on one of two innocent parties through the fraud or negligence of a third, it ought to be borne by the party who has trusted or employed that other fraudulent or negligent party. The second one appeared in *In Re Hampshire Land*[390] where it was said that the imputation of knowledge of the agent to the assured does not apply to the situations where the agent has been fraudulent or has been "guilty of irregularity". With respect to the rule in *In Re Hampshire Land,* later in *Kingscroft and Others v Nissan Fire and Marine*[391] Colman J., even though he followed the rule, exemplified the rule to a more general principle that applies wherever, because of the nature of the information in question, it cannot be inferred that the agent will reveal it in the ordinary course of business. [392] Because of this judgement, in *ERC Frankona Reinsurance v American*

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[389] (1785) 14 East 494.
[390] [1896] 2 Ch 743.
[391] Lloyd's List, May 16, 1996 (I.D.) (QBD (Comm)). Affirmed by [1999] Lloyd's Rep IR 371 (CA (Civ Div)).
[392] The type of agent in this case was the agent to know not the agent to insure.

National Insurance Company[393] it has been argued by the assured that the non-disclosure of the losses by the agent because they would have revealed incompetence on the agent's part should not be attributed to the assured. Andrew Smith J. rejected this argument and held that the losses incurred were embarrassing and might show incompetence but the information was not of a type which an agent could not be expect to disclose.[394]

The next stage considers how these two principles apply to the agent to insure.

The first case considering the fraud exception was *Deutsche Ruck v Walbrook Insurance Co Ltd.*[395]

In this case, three directors of the reassured companies who had underwritten the original business on behalf of the reassured and arranged the reinsurance of that business with the reinsurers had improperly diverted overriding commissions from the reassured to the other companies controlled by them. The reinsurers alleged that this fraudulent conduct was a material fact which had to be disclosed. The knowledge of this conduct had to be imputed to each of the reassured companies because the directors were the directing mind of those companies in relation to the reinsurance. Accordingly, those companies were obliged to disclose such conduct to the reinsures. The directors themselves, as the agents that placed the reinsurance on behalf of the reassured, were obliged to disclose all material facts within their knowledge, including the fact of their own fraudulent conduct.

Phillips J. resorted to the common law cases to resolve the issue. He could either apply the rule in *Fitzherbert v Mather (Fitzherbert)*[396] that where an agent's fraud, default or wrongdoing caused loss or prejudice to two parties, the loss or prejudice should fall on the party by whom the agent was trusted or employed or who took the

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[393] [2005] EWHC 1381 (Comm).
[394] Ibid., para.200.
[395] [1994] 4 All ER 181.
[396] (1785) 14 East 494 per Lord Mansfield followed by *Proudfoot v Montefiore* [1867] LR 2 QB 511, 522 per Cockburn C.J.

risk of the agent's wrongdoing or apply rule in *In Re Hampshire Land*[397] whereby the knowledge of any fraud of an agent upon his principal will not be imputed to the principal. He considered that any fraud having a direct impact on the assured risk should be subject to the rule in *Fitzherbert*. This case, however, involved the agent's own fraud against the assured and was merely indicative of moral hazard. He based his decision upon the *In Re Hampshire Land* principle, where it was held that to require the assured to disclose this type of fact is an affront to common sense. He then held that the underwriter could not avoid the policy where the information withheld from them by the broker related to the broker's own fraudulent conduct against the assured.

Even though the result of the case is fair and just, the reasoning is discredited as Phillips J. based it on the imputation of knowledge principle for every type of agent even in the case of an agent to insure. The law is now settled that an agent to insure has an independent duty of utmost good faith. Since the fraud exception in *In Re Hampshire Land* is an exception of the imputation knowledge principle, it cannot be said for certain that it should be applied to s.19.

Two subsequent appeal cases the hearing of which overlapped for three days considered this issue in depth. The first case was *PCW Syndicates v PCW Reinsurers (PCW)*[398] where the reinsurers alleged that the fact that the reinsured's underwriting agent had defrauded the reassured were material and had to be disclosed to them.

Waller J., the judge at first instance, held that a broker who had defrauded his assured was not obliged to disclose that fact to the underwriters, as he acquired that knowledge in a capacity other than a capacity as an agent of the assured. His ruling was upheld by the Court of Appeal. However, there were inconsistencies in the Court of Appeal judges' arguments. Saville L.J. reached his judgment on the ground that an underwriting agent was not an agent to insure within s.19 (a) without concentrating on the fraud exception. In contrast, Staughton L.J. considered the fraud exception and its

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[397] [1896] 2 Ch. 743. The modern formulation of the rule is to be found in *Belmont Finance Corporation Ltd V Williams Furniture Ltd* [1979] Ch 250, 261 per Buckley L.J.; See also *Kwei Tek Chao v British Traders and Shippers Ltd,* [1954] 2 QB 459, 471 per Devlin J.; *Newsholme Bros v Road Transport & General Insurance Co* [1929] KB 356.

[398] [1996] 1 Lloyd's Rep 241.

application under s.18 and 19. He mentioned that one might resort to the imputation of knowledge rule exception under the common law whereby the imputation of knowledge is negatived by fraud directed against the assured on the part of the agent. The rule was laid down in *In Re Hampshire Land.* He then applied this exception to the situation where the knowledge of the agent to know is imputed to the assured under s.18. However, he preferred to reach a conclusion based on the wording provided in s.18 that "...the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by, or to have been communicated to, him". Staughton L.J. applied this wording to the facts of the case and held that the dishonesty of the underwriting agent of the reassured is not something the reassured ought to have known in the ordinary course of business.[399]

This consideration illustrated that the wording of s.18 is sufficient to exclude the agent's fraudulent conduct from the assured's deemed knowledge without the need to refer to the exception of imputation of knowledge principle. However, the fraud exception is not completely rejected. He then continued to consider the issue as to whether the reinsurers' allegations that the agent to insure has to disclose his fraudulent act to the insurers under s.19 can be successful.

With respect to the issue of s.19, Staughton L.J. was of the view that it would be absurd to suppose that the agent would disclose his dishonesty, whether to the principal assured or to the third party the proposed reinsurer. He based his judgement on the fraud exception and that it should be extended to any case where the principal's rights are affected if the agent does not make disclosure to a third party. In other words, the fraud exception should also be applied to a situation where the agent's fraudulent conduct against the assured has not been disclosed by the agent to the insurer which would affect the assured's rights. Alternatively, he said that the doctrine in s.18 and s. 19 are an allied doctrine.[400] Hence, it would be strange that under s.18 the assured is not affected by knowledge of fraud of his servants or ordinary agents which has not actually reached him, and yet his rights are impaired if fraud by an agent to insure is not disclosed under s.19. In addition, the agent did not possess those

[399] [1996] 1 Lloyd's Rep 241, 255.
[400] Ibid., 256.

material facts in his capacity as the assured's agent.[401] Rose L.J. agreed with both judgments. Hence, it seems that the majority of the judges recognised this exception.

A similar dispute was proceeded between other parties at the same time in *Group Josi v Walbrook Insurance (Group Josi).*[402] The difference of this case from *PCW* was that in this case the assured was a corporate body, while in *PCW* the reassured were natural persons acting through an underwriting agent.

In this case, H.S. Weavers (Underwriting) Agencies Ltd. was a company that underwrote original risks on behalf of a number of other companies and also arranged and managed reinsurance for them. Weavers made a number of reinsurance treaties for these companies. Group Josi was one of the reinsurers who made an arrangement whereby Weavers paid over to them certain loss reserves held in respect of reinsurances under these treaties, in return for which Group Josi arranged for the opening of letters of credit for those loss reserves. It was alleged by Group Josi that three individual in Weavers were party to a fraud to divert from Weavers and the reassured companies commissions which should have been paid or credited to them and this was a material fact which had to be disclosed.

The same judges gave parallel decisions. Staughton L.J. again stated that s.19 (a) of the MIA 1906 had no application to fraud and referred also to the principle in *In Re Hampshire Land.* Saville L.J. dismissed the claim for the same reason that underwriting agents are not agents to insure hence s.19 (a) did not apply. He was of the view that to suggest that the underwriting agent's fraud should be the deemed knowledge of the assured under s.18 offended common sense as well as to suggest that the fraudster should commute it to the insurers.[403]Rose L.J. again agreed with both judgments.

From the two cases, it seems that the fraud exception was recognised by the judges.[404] Nevertheless, it should be noted that Staughton L.J. preferred to reach the judgment

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[401] Ibid.
[402] [1996] 1 Lloyd's Rep 345.
[403] Ibid., 367.
[404] Academics also agree to the existence of the fraud exception in insurance law: Merkin, *Colinvaux & Merkin's Insurance Contract Law,* 10773; Eggers and Foss, 299 para. 13.51.

by construing the wording of s.18 or via the route that the information was in the agent's possession other than in his capacity as agent for the assured. Rose L.J. merely agreed to both judgments without expressing any reason. Saville L.J. reached his judgment by emphasising that the underwriting agent is not the agent to insure and therefore the case did not fall under s.19. However, he did mention that he was not persuaded that a fraud being practised on the assured was a circumstance "known" to the agent. He was of the view that this offended common sense. It could therefore not really be said that he was totally supportive of the fraud exception.

In any event, it does not really matter whether the fraud exception is applicable or not as the outcome is the same, namely, that fraudulent conduct of the agent against the assured or in some cases against both the assured and the insurers[405] need not be disclosed to the insurers.

What is more interesting is the question of whether there is a wider exception than a fraud exception. Does the agent to insure have to disclose facts coming into his knowledge while he was not acting for the assured? This broader exception can be implied from Staughton L.J.'s judgment in *PCW* where he agreed with Waller J., the judge at first instance, that an agent to insure is not required by s.19 to disclose information which he has received otherwise than in the character of agent for the assured.[406] However, the authorities have been inconsistent on the issue.[407] The next stage therefore examines this issue in depth.

2.3.2 Is there a further exception that information known to the agent to insure in some other capacities does not need to be disclosed?

[405] *Arab Bank Plc v Zurich Insurance Co* [1999] 1 Lloyd's Rep 262.
[406] [1996] 1 Lloyd's Rep 241, 257.
[407] *SAIL v Farex Gie* [1994] CLC 1094; *El Ajou v Dollar Land Holdings Plc* [1994] 2 All ER 685.

The agent to insure apart from acquiring information within his capacity may acquire information 1) for reasons entirely unconnected with his functions as a broker or 2) by reason of his role as an agent for others but not for the assured in question. Should the agent to insure disclose these types of facts? There have been two different views as to the necessity to disclose these types of facts.

The first view is that the agent to insure should disclose them. This view can be extracted from the wording of Lord Magnachten given in *Blackburn Low v Vigors*[408] that "but that is not because the knowledge of the agent is to be imputed to the principal but because the agent of the assured is bound as the principal is bound to communicate to the underwriters all material facts within his knowledge".[409] Because of this judgment, s.19 is regarded as putting an independent duty upon the agent to insure. The wording of s.19 itself states clearly that the agent must disclose to the insurer "every material circumstance, which is known to himself". These wordings are broad enough to subsume the two types of information in question.

The second view is that the agent to insure is not required to disclose information that has come to him in some capacity other than that as the agent of the assured.

As s.19 provides the wording which clearly supports the first view, the authorities considered at this stage are those relevant to the second view as they limit the wording of s.19. If these judgments are justifiable, this would mean this exception exists.

The second view was supported by Staughton L.J. and Rose L.J. in *PCW*. The reasoning given by Staughton L.J. was that he could not find in the authorities any decision that an agent to insure is required by s.19 to disclose information which he has received otherwise than in the character of agent for the assured.[410] Rose L.J. also confirmed this view by holding that there is nothing in s.19 which requires an agent to insure to disclose to a proposed reinsurer information, as to his own fraud on his principal or of any other kind, received otherwise than as agent for the assured.[411]

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[408] [1887] LR 12 App Cas 531.
[409] Ibid., 542.
[410] [1996] 1 Lloyd's Rep 241, 257.
[411] Ibid.

In *Group Josi,* Staughton L.J. restated his judgment and held that the material facts were not held in the capacity of agents for the assured, the stamp companies.[412]

Even though the judgments of these two cases support this view, the facts of these cases involved the non-disclosure of the agent's fraudulent act against the assured which was special and limited. This type of fact is not the type of fact the assured is supposed to know in the ordinary course of business as stated in s.18 and even under s.19, where the agent to insure has a separate duty of disclosure. This fraudulent conduct of the agent to insure is not the case where the agent to insure fraudulently failed to disclose facts material to the risks. In such a case, it would be held that of the two innocents-the assured and the insurer- it is the assured who should bear the loss flowing from the breach of duty, as the agent to insure represents the assureds' interests, not those of the insurers.[413] Hence, it is correct that the agent's fraudulent conduct against the assured should relate to facts which are not required to be disclosed by the assured or the agent to insure. The judgments were correct because of the special characteristics of the facts themselves. In any event, basing the judgments upon the fraud exception or the construction of the s.18 and 19 should be sufficient.

There is another case which can be regarded as the leading authority on this issue, namely, *SAIL v Farex Gie (SAIL).*[414] The facts of the case involved non-disclosure of facts which were known to the agent while he was acting for another person who was not the assured.

In this case, the reassured instructed the London brokers to arrange a facultative reinsurance facility. The broker approached a US insurance company. However, the US company was not prepared to accept the reinsurance business offered but would be willing to share the retrocession cover of the reinsurers if a suitable facultative reinsurer could be found. The London brokers then approached Farex, the defendant. Farex agreed to reinsure only if retrocession and security were provided. The London brokers thus confirmed the retrocession arrangements, purportedly with the US company and also with two other retrocessionaires. The US retrocessionaire avoided

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[412] [1996] 1 Lloyd's Rep 345, 361.
[413] *Fitzherbert v Mather* [1785] 14 East 494; *Barwick v English Joint Stock Bank* [1867] LR 2 EX 259, 266.
[414] [1994] CLC 1094.

the retrocession on the grounds that its own agent had exceeded the given authority in agreeing to its participation. Farex alleged that the fact was known by the London brokers and in turn purported to avoid the reinsurance of the claimant reassured, arguing that the London brokers ought to have disclosed to them the fact that its retrocession was unlikely to be enforceable.

The reinsurers were held liable. The Court of Appeal judges reached the same judgments based upon different reasons. Dillon L.J. was of the view that had the allegation been true, the non-disclosed facts would have been material facts. However, the assured and his agent did not have to disclose as the matter was covered by the fraud exception based upon the *In Re Hampshire Land* principle. Dillon L.J's judgment seems to support the broad exception when he said he cannot see that s.19 can be invoked by the defendant to the detriment of the claimant reassured so as to require disclosure from the broker in his capacity of agent for the reassured of information which the broker in his capacity as agent for the defendant was already under a direct obligation to disclose to the defendant and which was not the reassured's concern.[415] Hoffmann L.J. felt that the fact was immaterial irrespective of the London brokers' own knowledge as the information related to an entirely separate contract, the retrocession.[416] He was of the view that for the assured or the agent to have this knowledge was a pure coincidence. Saville L.J. considered the issue in a more systematic manner. He stated that s.18 and 19 are made subject to the provisions of s.18 'as to circumstances which need not be disclosed'. He held that in the ordinary course of business a reinsurer ought to know the state of his retrocession, if any and the argument therefore failed at the outset since the alleged circumstance is not a material circumstance requiring disclosure, even assuming that the knowledge of it is to be imputed to SAIL.[417]

It can be seen that only Dillon L.J's judgment was relevant to the broad exception discussed at this stage. The reasons given by him should therefore be scrutinised.

With due respect, both reasons seemed to be unjustifiable. The fraud exception should not be applied to this situation because the undisclosed facts were regarded by him as

[415] Ibid., 1102 per Dillon L.J.
[416] Ibid., 1111 per Hoffman L.J.
[417] Ibid., 1120 per Saville L.J.

material in relation to the placing of the reinsurance with the defendant. It was obvious that the defendants were only willing to accept the reinsurance subject to arranging satisfactory retrocession – 'subject to reinsurance and security'. The fraudulent conduct, therefore, was related to the insured risk and should be subject to the rule laid down in *Fitzherbert v Mather* where it has been said that if the agent acts fraudulently, of the two innocent parties, the assured who has employed the agent, must bear the loss not the *In Re Hampshire Land* principle, which is a more specific rule applying to facts where the agent acts fraudulently against the assured directly or is guilty of irregularity. The assured should therefore be held liable applying *Fitzherbert*'s judgments provided that the non-disclosed facts were material. This rule applied however to the situation where the agent's knowledge is imputed to the assured. In this case, the insurance was placed by the London brokers who were the agents to insure and had a separate duty to disclose under s.19. Dillon L.J. limited the scope of the agent's duty of disclosure to those facts he acquired in his capacity as the reassured's agent. However, he continued to say that the broker in his capacity as agent for the reinsurers was already under the duty to disclose the facts to the reinsurer. Hence, it can be implied that the facts were circumstances which were known or presumed to be known to the insurer which is one of the exclusions provided under s.18 (3) (b). It would be easier to consider the case in the way Saville L.J. did as indeed the limitations of s.19 as provided in the MIA 1906 are the exclusions provided under s. 18 (3) and the test of materiality which is the same test as provided in s. 18(2). To start with the capacity of the agent creates confusion and unclear issues.

From these considerations it can be said that the supportive authorities, with due respect, are not quite convincing. The matter can be resolved based upon construction and s.18 and 19 without the need to create further exceptions. What should then be the real scope of s.19?

2.4 The real scope of s.19 and its limitations

It is obvious that s.19 is intended to place a separate duty of disclosure upon the agent. This section would be unnecessary if the assured is bound to disclose those facts

which are in his mind and his insurance agents' mind as s.18 would be sufficient to cover these facts.[418] It is clear that s.19 (b) provides that the agent must disclose what under s.18 the assured must disclose in addition to material circumstances known to the agent or which in the ordinary course of business the agent ought to know or have communicated to him as provided in s.19 (a). Such circumstances thus could include matters which the assured neither knew nor ought to have known.

As considered previously, the fraud exception is not necessary and the reasons for having a broader exception that the agent to insure merely has to disclose facts he has acquired in his capacity as the assured's agent are not convincing. The facts needed to be disclosed by the agent to insure should therefore be those as provided by s.19 of the MIA 1906 namely those which are not subject to exclusions provided in s. 18 (3) and those which are material. This is consistent with market practice itself as there are certain circumstances that come to the agent to insure's knowledge, which are material and need to be disclosed, for reasons which are unconnected with his functions as the assured's agent to insure. Such facts might include peculiarly actuarial matter, such as prior refusals by other insurers, although such matters are not always material, particularly in the marine insurance market or losses reported to the market or the market practices or customs which should be the agent to insure's professional knowledge and sometimes a mystery to the assured.[419]

In conclusion, the application of s. 19 is as follows:

1) This section comes to play only where there is a non-disclosure by the agent to insure. On the balance of authorities, the agent to insure is the agent who places the risk with the assured and is subject to a separate duty of utmost good faith.

2) Facts which must be disclosed must not be subject to the exclusions provided in s. 18 (3) that: "In the absence of inquiry the following circumstances need not be disclosed, namely: (a) any circumstance which diminishes the risk; (b) any circumstance which is known or presumed to be known to the insurer. The

[418] *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241, 258 per Saville L.J.
[419] Eggers and Foss, 311 para. 13.79.

insurer is presumed to know matters of common notoriety or knowledge, and matters which the insurer in the ordinary course of his business, as such, ought to know; (c) any circumstance as to which information is waived by the insurer; (d) any circumstance which it is superfluous to disclose by reason of any express or implied warranty."

3) The non-disclosed facts must be material. The test of materiality is the same as provided in s.18 (2) and at common law.[420]

3 The justification of s.19 of the MIA 1906 in the commercial insurance market

Even though there are different types of agents involved in an insurance contract, only the agent to insure is the focus of s.19. However, in practice it is not easy to identify the agent to insure. There are agents who are authorised to place the risk but do not directly deal with the insurers. Would this type of agent be regarded as an agent to insure? In addition, if the law is that only the agent who directly places the risk with the insurer has a separate duty of disclosure, there has been a warning that such analysis would allow the intermediate agent to conceal material facts easily by appointing a sub-agent to carry out the placement for him.[421] To answer this issue, the existence of an intermediate agent is illustrated and consideration is made as to the application of the duty of utmost good faith to this type of agent.

3.1 Intermediate agents

3.1.1 Producing broker

It is the practice of the market that much insurance business is transacted through brokers or independent intermediaries. In the past, prior to the use of the Financial Services and Markets Act 2000 (FSMA), there were various types of agents. In general terms, there are two types of insurance intermediary: independent

[420] Please see chapter one for materiality and inducement test.
[421] Merkin, *Colinvaux & Merkin's Insurance Contract Law*, 10771.

intermediaries and tied agents. Insurance intermediaries are categorised in three types as follows: [422]

1) Independent agents who were registered as "insurance brokers" pursuant to the Insurance Brokers (Registration) Act 1977;

2) Lloyd's brokers, who have exclusive access to the underwriting in Lloyd's. Other insurance intermediaries may place business at Lloyd's by acting through a Lloyd's broker;

3) Independent intermediaries who did not call themselves "insurance broker" and were outwith the Insurance Brokers (Registration) Act 1977. Such agents were subject to a self-regulatory scheme issued by the Association of British Insurers: *General Insurance Business – Code of Practice for all Intermediaries (Including Employees of Insurance Companies) other than Registered Insurance brokers.*

After the promulgation of the Financial Services Act 2000 this distinction was abolished.

In practice, a broker instructed to place insurance or reinsurance may find it necessary to pass the risk to another broker to effect insurance. This might be because the producing broker is not recognised by Lloyd's and has to act through a Lloyd's placing broker to obtain access to the Lloyd's market.[423] Or in some situations, the broker is located overseas, or does not have expertise in the type of cover sought, the use of a local placing broker is therefore essential.[424] In addition, commercial insurance involves high cover. In order to meet the cover, several insurers are required. It is the practice that the broker is the one who approaches the insurers for the assured. The brokers must use their expertise to place insurance with the insurers

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[422] Lowry and Rawlings, 58.
[423] With effect from the beginning of 2001, Lloyd's abolished most of the restrictions on access to the Lloyd's market by non-Lloyd's brokers..
[424] Merkin, *Caulinvaux & Merkin's Insurance Contract Law,* 40192.

and are regarded as acting on the assured's behalf when placing insurance.[425]

3.1.2 Underwriting agency

Underwriting agent means a firm managing and carrying out underwriting for an insurance company, group of companies, or Lloyd's names.[426]

With respect to Lloyd's names it should be noted that there are two types of agent: a managing agent, who manages one or more syndicates and a member's agent who acts for names in other capacities and may place them on syndicates run by managing agents. It is clear that an underwriting agent should be regarded as an insurer's agent. Sometimes an underwriting agent in managing and carrying out underwriting business for a group of companies has to act as an agent to insure. This situation can be seen when an underwriting agent has to manage an insurance pool.

An insurance pool is a combination of insurers who form a pool in order to enhance their capacity to accept risks. They agree to share the premiums and losses in agreed proportions. As commercial insurance is an international market, the pool may comprise insurers from all over the world. In the case where the insurer must be an authorised insurer to carry on business in a particular country, an underwriting agent accepts business on behalf of a single member of the pool, the fronting company, as opposed to accepting on behalf of each member of the pool, and that business is then reinsured to the remaining members of the pool by the fronting company.[427]In addition, an underwriting agent must also arrange further outwards reinsurance or retrocession to cover the operation of the pool. The outwards reinsurance might be placed by underwriting agents for the pool against liabilities arising to third parties to whom pool members have issued policies. This is the situation where an underwriting agent arranges external reinsurance for the pool itself.

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[425] *Empress Assurance Corp Ltd v CT Bowring & Co Ltd* (1905) 11 Com Cas 107, 112 per Kennedy J.
[426] C. Bennett, *Dictionary of Insurance* (London: Financial Times Pitman Publishing, 1992), 334.
[427] Lowry and Rawlings, 389.

3.2 How does the law accommodate the non-disclosure of intermediate agent?

As mentioned earlier in this chapter, on the balance of authorities, the placing agent only should fall under s.19 of the MIA 1906.[428]

The dubious issue here is whether such analysis would allow the intermediate agent to conceal material facts easily by appointing a sub-agent to carry out the placement for him. At first sight this seems to be true as prior to the judgments given in *PCW,* the law was that any concealment of any agent who is authorised to effect an insurance policy would amount to a breach of the duty of disclosure by the assured. This can be seen in *Blackburn Low v Haslam (Haslam).*[429]

In this case, underwriters in Glasgow employed a firm of insurance brokers in Glasgow to reinsure a ship which was overdue. The brokers later received information that the vessel was lost. Without communicating this information to the claimants, they telegraphed in the reassured's name to their own London agents. The reassured adopted the act himself and carried out what the broker had commenced. It was held that the policy was void on the grounds of concealment of material facts by the agents of the assured.

Hence, the agent who was in breach of the duty of utmost good faith in this case was the agent to insure who was directly employed by the reassured not the London placing broker. The reason was stated by Baron Pollock that:[430]

"It is the negotiation that is tainted, and the contract is void because it is founded upon the negotiation, and through however many hands the offer of insurance may pass, if there be a concealment by the assured or his agent, the policy is vitiated."

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[428] *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241; *Group Josi Re v Walbrook Insurance* [1996] Lloyd's Rep 345; *ERC Frankona Reinsurance v American National Insurance Company* [2005] EWHC 1381(Comm).

[429] [1888] LR 21 QBD 144 The first edition of Halsbury's Laws of England, for which Mr. Arthur Cohen, K.C. was responsible [and in all subsequent editions] seems also to supported this view:
" Sometimes an agent employed to effect an insurance, instead of dealing direct with the underwriter, acts through an intermediate agent or agents, and in such cases the concealment of a material fact within the knowledge of any agent through whose agency, whether mediately or directly, the insurance has been effected, vitiates the policy."

[430] [1888] LR 21 QBD 144, 153.

Because of this judgment it might be thought that every type of agent must bear the duty of utmost good faith.

Subsequent cases with similar facts were decided upon the basis that the intermediate agent must pass information to the agents who really deal with the insurers. This expectation can be seen in Saville L.J.'s judgment in *PCW*. He said that:[431]

"What an intermediate agent does and is expected to do is to pass information etc., not to the insured but either to further intermediaries or to those who actually deal with the insurers who, as a matter of practical politics, are going to provide the insurers with information relating to the proposed insurance."

This is consistent with the wording of s.19 of the MIA 1906 that "... an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him". Thus, it does not matter whether information was possessed by a producing broker or placing broker since if the producing broker possesses information which in the ordinary course of business ought to be communicated to the placing broker, or which the agent ought to know, and if those facts are material, the broker has to disclose them to the insurer as stated in s.19.

This position of law also applies to an underwriting agent who is not the agent to insure under s.19. Saville L.J. mentioned in his judgment given in *Group Josi* that:[432]

" ..The agents will either be agents to insure under that section, and thus will have to disclose material circumstances within their knowledge, or will be intermediaries, in which event the agent to insure will be deemed to know material circumstances which ought in the ordinary course of business to be communicated to them. Such material circumstances within the knowledge of intermediaries would be caught by this latter provision (s.19)."[433]

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[431] [1996] 1 Lloyd's Rep 241, 259 per Saville L.J.
[432] [1966] 1 Lloyd's Rep 345, 366.
[433] In *Baker v Lombard Continental Insurance plc* 1996, unreported, Colman J. expressed the view that a majority of the Court of Appeal in *Group Josi* had held that s.19 required an intermediate agent

Academic has been of the view that Saville L.J's approach in *PCW* has changed the law because s.19 (a) of the MIA 1906 is based on *Haslam*.[434] This seems at first sight to be true since as said above, it was held in *Haslam* that material facts known to the assured's Glasgow originating brokers, but which had not been communicated to London placing brokers, had not been disclosed and thus justified the insurer's avoidance of the contract. However, the justification given in *PCW* can be applied to the facts of *Haslam* very easily. It is obvious that the chain of agent's negotiating the insurance in the latter case had not been broken. The London placing brokers were deemed to know every circumstance which in the ordinary course of business ought to be communicated to them. There was no doubt that the Glasgow brokers who knew that the vessel was lost should have communicated that knowledge down the line to the London placing brokers who actually effected the cover.

As a result, the issue whether the original contract was given up and a new distinct negotiation entered upon, or whether it was a mere handing over by the agents to their principals of an existing negotiation, in order that the principals might take it up at the point where the agents left off, and continued it until it resulted in a contract, must also be considered. In insurance market practice, there can be a situation where a new contract has been entered into which breaks the chain of brokerage and the link of communication. This situation should not be confused with the issue of transferring of knowledge from the intermediate agents to the agent to insure. If the chain of agent has been broken, there cannot be breach of the duty of utmost good faith. This can be seen in *Blackburn Low v Vigors (Vigors).*[435]

In this case, reinsurance was procured on an overdue vessel through the agency of the assured's London brokers. A member of a Glasgow firm of brokers which had previously acted for the reinsured had been informed that the vessel had been lost, but they did not pass on this information to the reinsured prior to the placing of the insurance by the London brokers. The reinsurers pleaded non-disclosure of this material fact. The House of Lords held that the policy was not voidable and that the

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instructing an agent to insure to supply the agent to insure with all material facts actually known to the intermediate agent.

[434] Merkin, *Colinvaux & Merkin's Insurance Contract Law*,10771.

[435] [1887] LR 12 App Cas 531.

knowledge of the Glasgow brokers was not the knowledge of the reinsured. In this case the assured approached the insurers by himself under a separate policy. There was no connection between the broker who previously acted for the assured and the assured in this contract.

ERC Frankona Reinsurance v American National Insurance Company[436] illustrated a situation where the link between the previous placing broker and the current placing broker of material information had been lost.

The facts of the case have already been mentioned under the issue of who is the agent to insure. For a better understanding, the facts of the case are mentioned here again. The reinsurers were the quota share reinsurers of the reassured's interest in respect of the reassured's participation in an insurance pool in the US. In 1997 the reinsurers acted for one of the pool members, P. The risk was presented to the reinsurers and the underwriting agent of the reinsurers, IGI through the placing broker B. In 1998 the reassured took over P's business and reassured the risk with the reinsurers through a new placing broker K under the 1998/1999 reinsurance. The allegation concerned the misrepresentation of the placing broker, B, in the 1997 reinsurance that P would only underwrite direct insurance business and not reinsurance business under the pool. The reinsurers alleged that this misrepresentation affected the 1998/ 1999 reinsurance because when that was placed it was understood to be a renewal of the 1997 and 1998 quota shares. Therefore, it was or ought to have been apparent that the reinsurers agreed to take the 1998/1999 quota share reinsurance in reliance upon and induced by the representations that had been made when the 1997 quota share was agreed. Andrew Smith J. was satisfied that the pool indeed underwrote a reinsurance business and this fact was material on the basis that an insurer could control its underwriting but a reinsurer could not.

The alleged breach of the duty related to the 1998/1999 reinsurance and not to the 1997 year when the statement was made. The reassured should have disclosed this fact when renewing the 1998/1999 reinsurance. The problem was that by the time of renewal the placing broker and the reassured were not the same entity as those in the

[436] [2005] EWHC 1381 (Comm).

old reinsurance policy. It was no longer P acting as the reassured and B acting as the placing broker but it was the reassured in the present case and K acting as the placing broker. The question was therefore whether the reassured or the placing broker should have known the facts in the ordinary course of business.

The expert witness in the case did say that when the business is transferred between brokers, it is considered essential in the market that there should be full cooperation in handing the files from the old to the new broker so that the new broker can properly carry out his duties to the assured.[437] That was the most the new placing broker should have done. The judge agreed with the expert witness that there was no reason that the placing broker ought to have been aware, or would in the ordinary course of business have been aware of representations made by the previous placing broker who had not acted for the current reassured. In other words, in this case the reassured had no connection with the previous placing broker who possessed the information. It can therefore not be assumed that the reassured or the broker placing broker would have possessed the facts.

In this case even though the facts of the case related to an underwriting agent managing an insurance pool, it is not the case where an underwriting agent placed reinsurance for the pool members. The reinsurance in this case was arranged by another agent on behalf of the reassured who took over the participation of the previous reassured in the insurance pool. This agent then passed the risks to the placing broker. The chain of brokerage had been broken. There was a new reassured and a new placing broker. There was no handing over of existing insurance business like the situation in *Haslam*. The reassured took over the business and applied for a new reinsurance in his name.

It is clear that in both cases there were new contracts effected by the assured. In other words, this situation the knowledge of agents operating independently does not come together.[438] Hence, it would be harsh for the assured to be expected to know and disclose material facts that appeared in another contract.

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[437] [2005] EWHC 1381 (Comm) para. 169.
[438] Clarke, 722 para. 23-8A1.

To sum up, the law on the balance of the authorities is consistent with market practice and is more logical since insurers expect the agent to insure to disclose material facts and not from any other agents. In any event, if material facts were known to the producing broker, they must disclose these material facts to the placing broker and the placing broker must then disclose these facts to the insurers subject to the fact that those facts are material. Hence, it is not possible for producing brokers to avoid the duty of disclosure merely by employing a sub-agent to place insurance. This is, however, subject to the fact that the agents are acting under the same contract.

4 The application of the duty of utmost good faith in a dual agency situation

The law has long been settled that the broker is the assured's agent.[439] Hence, non-disclosure of material facts by the broker is regarded as breach of the duty of utmost good faith by the assured even though the assured has disclosed those facts to the broker. The operation of the general rule is therefore that information provided by the assured to his broker is not deemed to have been received by the insurers, as the assured is in effect making a disclosure to himself. The most recent case illustrating this position of the general rule is *Hazel (trading as KGM Motor Policies at Lloyd's) v Whitlam.*[440]

The case concerned a motor insurance. The assured provided the broker with a signed hand-written proposal form which contained all material facts, describing his occupation and nature of business as a shop assistant and identified his employer as "Neil Burke – Horsham Golf & Fitness Worthing Road." The printed version of the proposal form produced by the broker omitted any reference to the assured's employer. The assured signed the printed version and this form was then submitted to the defendant. Later, an accident occurred, and the insurers purported to avoid the policy on the grounds of non-disclosure that the assured was trainee golf professional

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[439] *Bancroft v Heath* [1900] 5 Com Cas 110; affirmed [1901] 6 Com Cas 137 (CA), *Empress Assurance Corp Ltd v CT Bowring & Co Ltd* [1905] 11 Com Cas 107,112 per Kennedy J.; *Re Great Western* [1999] Lloyd's Rep IR 377, 386 per Hobhouse L.J. regarded it is an important point of principle that: "an insurance broker is an agent for the insured or would-be insured. He is not, when acting as an insurance broker, acting as agent of the insurer in the relevant transaction. If he chooses to act for the insurer, he is ceasing, in at least that respect, to act as a broker and may be in breach of his duties to the insured, or would-be insured."

[440] [2005] Lloyd's Rep IR 168. Followed *McNealy v Penine Insurance Co Ltd* [1978] RTR 285.

and that the insurers' questions were directed to both full-time and part-time occupations. It was held that the fact that the assured was honest and had disclosed the relevant facts to the broker was irrelevant. The insurer was entitled to avoid the policy for non-disclosure of material facts.

The position is however different when it comes to dual agency. Dual agency at the formation of contract stage could arise only if the broker or an independent intermediary who is the assured's agent also acts on behalf of the insurer. It is very common in the market for the broker to underwrite the risk on behalf of the insurers.

This chapter mentioned earlier the role of the underwriting agent in managing an insurance pool one of the duties of which is to reinsure the pool's liability. In practice, the main task of the underwriting agent is to manage the underwriting business of the principal which is to underwrite the risk on behalf of the insurers. Authorising a broker or an independent intermediary to accept the risk can be done through a binding authority.[441] Hence, under the binding authority the broker here on the one hand is acting on behalf of the assured and on the other hand on behalf of the insurers. Conflicts of interest may occur as while the broker must provide the best cover for the assured, he also accepting risks on the insurer's behalf which might not be the best cover for the assured.

With respect to the duty of utmost good faith, the controversial issue is whether the assured has breached the duty of disclosure, had he disclosed material facts to the broker who was an underwriting agent of the insurer? Can the insurer avoid the contract by alleging non-disclosure of material facts by the assured or broker under s.18 or 19 even though the broker is authorised to accept risk on the insurer's behalf? Under the English common law, the assured is the prime principal of the broker. It is possible to think that broker's non-disclosure should entitle the insurer to avoid the contract as the broker is indeed the assured's agent and even though acting also for the insurer this should not supersede the prime relationship between the broker and the assured. This is however not the English common law that is in favour of the assured in total. The insurance agent is subject to the full rigour of fiduciary duties

[441] Please see chapter three for further consideration of binding authority.

towards the assured. As the assured's principle, the broker needs to have the assured's consent before he can act for another party. This can be seen from various situations:

1) When the broker is authorised by the insurers to perform a certain task for them. It was held that in performing that task the broker is in breach of his duty towards the assured.

In *Anglo African Merchants v Bayley,*[442] the broker was instructed by the insurer to obtain assessor's report and refused to make that report available to the assured on recovery. It was clear that the broker was instructed by the insurer to act on his behalf for that certain task. Megaw J. held on this point, that in all matters relating to the placing of insurance, the broker was the agent of the assured therefore in the absence of express consent by his client with full knowledge of the implications, it would be a breach of duty on the part of broker to act on instructions from the underwriters.[443]

2) Even in circumstances where there might be a common or habitual practice that the broker acts on behalf of the insurers without an express authorisation, the judge warned that the broker might still be in breach of his duty towards the assured if he did not have the consent of the assured.

In *Eagle Star Insurance Co v Spratt,*[444] the claimant concluded reinsurance treaties with the reinsurers who were members of Lloyd's. The risks covered were those incurred by contractors doing work on dry land. The reinsurers were dissatisfied with the way these treaties had turned out. They thought they had been misled into signing them. The underwriters appointed a steering committee to discuss with the claimant possible terms of compromise. Agreements had been reached when the defendant was absent from the meeting and the slips had been signed by all underwriters; the defendant's partner was the one who signed the slip. The slip was brought round the market by the broker. He was clearly acting on the underwriters' behalf. The disputes

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[442] [1969] 1 Lloyd's Rep 268. See also *North and South Trust v Berkeley* [1971] 1 WLR 470; *Callaghan v Thompson* [2000] Lloyd's Rep IR 125.
[443] Ibid., 279. In supporting his judgment he referred to F. M. B. Reynolds, *Bowstead on Agency*, 13th ed. (London: Sweet & Maxwell, 1968), 144 that: " He [the broker] may not act for both parties to a transaction unless he ensures that he fully discloses all the material facts to both parties and obtains their informed consent to his so acting. Any custom to the contrary will not be upheld".
[444] [1971] 2 Lloyd's Rep 116.

were whether the defendant was bound by those slips which were initialled by his partner and by further addendum to the treaties issued by Lloyd's Policy Signing Office. The defendant insurer claimed that both types of documents were issued without his authority and he did not hold out anyone as having his authority and that in any event the claimant cannot rely on the documents because the broker had presumed knowledge of want of authority. It was held that the defendant was bound by the initialling slip. The broker did not have presumed knowledge of want of authority. With respect to broker's dual capacity, Megaw L.J. said that the broker did not seek consent of his true and original principal, the assured, but according to him, it may be that such consent would in special circumstances readily have been given.[445] In other words, the consent might not have to be expressed by the assured. In general, an agent for one party should not act for the opposite party in connection with the same transaction without the former's informed consent. Hence, even though in this case the judge did not decide whether the broker was in breach of his duty, he warned the broker that by acting for both parties he may be in danger of breach of his duty owing to the original principal.

3) After December 2001, it is the practice of the Lloyd's market that the broker and the insurers subscribe to a Terms of Business Agreement (TOBA).Clauses provided in TOBA allow the insurers to have access to certain documents in the brokers' possession. However, these clauses are subject to the overriding clause in the agreement which requires the brokers to put their clients' interests first.

Goshawk Dedicated Ltd v Tyser & Co Ltd.[446]

The case concerned insurance provided by the insurers to "viatical" companies, which were in the business of purchasing the life policies of persons over 65 or suffering from terminal illnesses. The companies benefited from the insurance proceeds on the death of the life assured but at the cost of purchasing the policy and paying the premiums until the occurrence of the insured event. The insurance in the case protected the companies from the risks that the expenditure might exceed the proceeds of the policy. In the proceedings, the insurers sought to obtain three classes of

[445] Ibid.,133.
[446] [2005] Lloyd's Rep IR 379.

documents from the brokers: the placing, claim and premium accounting documents. The insurers alleged that the brokers must disclose these documents according to the requirement under the TOBA clause 8.1.1. and 8.1.2. which provided that:

"8.1.1. the accounting records pertinent to any Insurance Business including information relating to the receipt and payment of premiums and claims and documentation such as any insurance contract or slip endorsements, addenda or bordereaux in the possession of the broker relating to the Insurance business; and

8.1.2. documents as may be in the possession of the broker which were disclosed to the managing agent by the broker in respect of any insurance business including, but not limited to, documentation relating to the proposal for the insurance business, the placing thereof (including endorsements and reinstatements) and any claims thereunder."

However, there was also clause 2.2. which states that nothing in TOBA "overrides the Broker's duty to place the interests of its client before all other considerations."

Christopher Clarke J. held that clause 2.2. superseded clause 8.1.1.and 8.1.2. Hence, if the requirement of disclosure of the documentations prejudiced the assured, the broker can refuse to follow the requirements. With respect to placing and claims documentations it seemed that the judge had assumed that the mere fact that clause 2.2. overrode clause 8.1.2. was of itself preclusion of disclosure. He did not take into consideration whether disclosure by the broker of his placing and claims file actually prejudiced the assured. With respect to accounting information, even though it was held that clause 8.1.1. was subject to the overriding provision of clause 2.2., the learned judge could see very few situations in which a broker could have genuine grounds to fear that the production of accounting information would be harmful to the interests of the assureds. The insurers therefore achieved with respect to disclosure of accounting documentation.

Applying this position of the common law to the above questioned situation where the broker is an underwriting agent and received material facts from the assured but failed to disclose to the insurers those material facts: whether insurers can avoid the policy

for non-disclosure of material facts by the broker who received the facts from the assured under s.18 and 19? the answer is straightforward. The assured's interest must come first. The insurers are not allowed to avoid the contract for non-disclosure. The case that illustrates this situation is *Woolcott v Excess Insurance and Others.*[447]

In this case, the insurers authorised the brokers to accept certain risks on their behalf under a binding authority. The assured had a number of criminal convictions, including one of 12 years' imprisonment for armed robbery. He set up a business and several insurance policies were effected for the business through the brokers. The assured asked the brokers to arrange a household comprehensive policy for him. This was placed in accordance with the binding authority. When a subsequent loss occurred due to fire the insurers repudiated liability on the grounds of non-disclosure of the claimant's criminal record. The assured argued that the brokers were aware of his previous record and as agents of the insurers in effecting the policy the brokers' knowledge was imputed to the insurers.

The case involved much dispute as to the facts, being referred back by the Court of Appeal to the trial judge, it was clearly assumed beyond argument by the Court of Appeal that the knowledge of a material fact by the broker in question was imputed to the insurers, and that the latter's defence of non-disclosure of that fact failed. The important point in this case lay where the judge went on to say that the knowledge was imputed to the insurer even if the insured did not know that the insurer had the knowledge or was deemed to know. Therefore it is clear that the binding authority is an agency contract.[448] And if the broker acted outside the scope of the binding authority, he might be considered as acting under an ostensible or apparent authority on behalf of the insurers, which would therefore bind the insurers to that act and would be liable to the assured. The insurers cannot deny liability for the brokers lack of authority.

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[447] [1979] 1 Lloyd's Rep 210.
[448] Ibid., 211.

What an insurer can do is to claim for indemnification from the broker for breach of his duty towards them. There may also be a duty of care imposed in respect of a binding authority where no conflict of interest is involved.[449]

5 Conclusion

From the above analysis, it can be said that the existing law can accommodate every existing type of agent. Non-disclosure by the intermediate agent is covered under s.19 of the MIA 1906, as facts which the agent to insure ought to know in the ordinary course of business. However, they all must be acting under the same contract. If the chain of agents has been lost, the assured or the agent to insure of the current contract does not have the burden to disclose material facts known only to the agents in the previous contract. When there is a non-disclosure by the broker, it is always that either the assured or the insurer must bear the consequence. Under normal circumstances where the broker acts for the assured in placing the risk, if there was a non-disclosure of material facts by the broker, no matter how innocent the assured was, the insurers would be entitled to avoid the contract for breach the duty of disclosure under s.19. If however the broker also acted for the insurers, the insurer is then the party who bears the broker's fault. He would not be able to avoid the contract and must pay the assured's claim. What he can do is to claim indemnification from the brokers under the underwriting agency agreement between them.

[449] *Pryke v Gibbs Hartley Cooper* [1991] 1 Lloyd's Rep 602.

Chapter 6

Waiver of the duty of utmost good faith

1 Introduction

Waiver of the duty of utmost good faith has become very significant in the insurance market.

With respect to the corpus of the waiver principle, a new approach in considering whether there is a waiver of material facts by the assured has been introduced by Rix L.J. in *Wise Underwriting Agency Ltd v Grupo Nacional Prvovincial SA.*[450] The overarching notion of fairness on both sides of the parties must be taken into consideration. Alternatively, what must be considered is the question whether it would be unfair of the insurer to avoid on a ground on which he was put on inquiry and should have satisfied himself.[451] If the novel criteria are adopted, the role of the insurers in the duty of disclosure at the formation of contract stage will be directly effected. The insurers would have to be more active in getting the material facts from the assured. It even seems that the insurers would be subject to a duty to ask the assured or the brokers when the risks are placed in order to derive all material facts they need to know. What should be the proper position of the law regarding this issue is suggested in this chapter.

With respect to the effect of the insurance market practice upon the waiver of the duty of utmost good faith principle, two issues are considered in this chapter. The first issue concerns the situation where the brokers are the active party in effecting insurance and possess all the material information. In this situation, the assured is in the same position as the insurers. Under this type of insurance, there are contractual terms that limit the assured's liability and the insurer's right to avoid the contract. In other words, the scope of and liability under the duty of utmost good faith can now be

[450] [2004] Lloyd's Rep IR 764.
[451] Ibid., para. 62.

limited by an express waiver. The issues that must be examined are: what should be the scope of the express waiver that excludes the duty of utmost good faith; whether the fraudulent conduct of the brokers can be excluded from the assured's liability or the insurers' right to avoid the contract? To answer these questions, the House of Lords case *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank (Chase)*[452] must be scrutinised.

The second issue concerns an insurance contract effected online. Most online insurance does not leave room for the assured or his agent to perform his duty of disclosure. How does the duty of utmost good faith accommodate this situation? To be able to answer the current position of law, namely, an implied waiver based on the questions asked by the insurer, must be considered. The following questions are examined: whether the assured has to disclose matters not covered by the question asked; whether the assured's failure to answer questions or to answer them incompletely and yet the insurer still accepts the insurance amounts to a waiver of the assured's duty of disclosure by the insurer?

The solutions of the analyses illustrate the current principle of waiver entailing the understanding of the current and prospective position of law regarding the duty of utmost good faith as a whole.

2 The potential change in the corpus of the waiver principle

This potential change has appeared in the view of the Court of Appeal Judge, Rix L.J., in the case *Wise Underwriting Agency Ltd and others v Grupo Nacional Provincial SA (Wise).*[453]

This case involved a reinsurance contract for cross-border shipments from Miami to Cancun. The goods stolen included Rolex and other high-value branded watches, which were more susceptible to theft. There appeared to be a mistake when the reinsurance documents were translated from Spanish to English: the list of goods-in-

[452] [2003] 2 Lloyd's Rep 61.
[453] [2004] Lloyd's Rep IR 764.

transit sent to the Mexican insurer, Grupo Nacional Provincial (GNP), contained the Spanish word "Relojes" (which could be translated as "watches" or "clocks") whereas the English version presented by the broker in London to WISE (the underwriting agents of the reinsurer) mentioned neither "watches" nor "Rolexs" in the consignment list. The presentation slip stated that large quantities of these clocks were regularly shipped to Cancun. The reinsurers avoided the contract on the basis of non-disclosure that the shipment contained Rolex watches. Materiality, waiver and affirmation issues were also considered. At first instance, the judge found that the fact that high value branded watches were being carried was a material fact to be disclosed and dismissed an argument that disclosure had been waived by the reinsurers. The reassured challenged the conclusion on waiver without challenging the materiality issue.

The majority Longmore L.J. and Gibson L.J. decided for the reinsurers that there was no waiver by the reinsurers. The list of consignment goods in the presentation slip could be taken at face value. It was complete and reliable from the point of view of a reasonable careful insurer.

The principle the judges took into consideration was an implied waiver for non-enquiry. The judges followed the traditional analysis. Under this type of waiver the insurers can be expected to be given a fair summary of facts and can assume that there was nothing exceptional or unusual regarding the presented facts.[454] The judges must consider whether the facts which were disclosed in conjunction with those facts within the reasonable insurers' mind or presumed knowledge would raise in the mind of the reasonable insurer "at least a suspicion that there were other circumstances which would or might vitiate the presentation made to him".[455]If the answer is positive that the disclosed facts raise to the insurer a suspicion and if the insurer failed to enquire about the undisclosed facts, those facts would be regarded as being waived by the insurer. If the answer is negative, there is no waiver by the insurer and the assured is, as a result, in breach of the duty of utmost good faith at the pre-contractual stage. In this case, the answer was negative and it was held that there was no waiver by the insurers.

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[454] *CTI v Oceanus* [1984] 1 Lloyd's Rep 476, 523 per Stephenson L.J.
[455] Ibid., 511-512 per Parker L.J.

Hence, under this traditional analysis, it is not easy to allege that there is a waiver of material facts by the insurers. The assured must perform his duty of disclosure when placing the risks to the full extent. The judges did not want to lessen the duty of utmost good faith on part of the assured.[456] This can be seen from Gibson L.J.'s judgment in *Wise* who said that:[457] "the court should not subvert the duty of the assured to make a fair presentation of the risk by finding that the reinsurers were put on inquiry and failed to discover for themselves the material information save in a clear case."

This traditional analysis has long been accepted at common law. It can be extracted from the judgments of Parker L.J. and Stephenson L.J. in the classic case *CTI v Oceanus Mutual Underwriting Association (Bermuda) Ltd.* Parker L.J. said in his judgment that: [458]

"If the assured seeks to rely on waiver he must in my view show a clear case...In order to establish waiver by implication from non-enquiry the insurer must be put on enquiry by the disclosure of facts which would raise in the mind of a reasonable insurer at least a suspicion that there were other circumstances which would or might vitiate the presentation made to him"

Stephenson L.J. gave his judgment on the same issue as follows:[459]

"This is not a branch of insurance where the insurer shows what he regards as material by submitting questions in a proposal form to the insured. The marine underwriter may of course indicate what particular matters he wants to know, and he may be put on enquiry by what he is told and through negligence or stupidity or inexperience or pigheadedness not pursue enquiries which a prudent underwriter would have pursued...He cannot expect to be told everything, every minute detail; he cannot shut his eyes to obvious incompleteness and then complain of his bargain made in ignorance of the full story. He can expect to be given a fair summary and can assume that placing files which he has an opportunity of examining contain nothing

[456] MacGillivray, 446 para. 17-83.
[457] [2004] Lloyd's Rep IR 764 para. 130.
[458] [1984] 1 Lloyd's Rep 476, 511-512 per Parker L.J.
[459] Ibid.,529.

exceptional or unusual; for a summary which excludes such matters is not a fair summary..."

This traditional analysis has later been encapsulated in *MacGillivray* as follows:[460]

"The assured must perform his duty of disclosure properly by making a fair presentation of the risk proposed for insurance. If the insurers thereby receive information from the assured or his agent which, taken on its own or in conjunction with other facts known to them or which they are presumed to know, would naturally prompt a reasonably careful insurer to make further inquiries, then, if they omit to make the appropriate check or inquiry, assuming it can be made simply, they will be held to have waived disclosure of the material fact which that inquiry would necessarily have revealed"

Macolm Clarke has mentioned this type of waiver under the heading waiver for further information that:[461]

"*Waiver of Further Information.* Before the contract of insurance has been concluded, material information may be disclosed by the proposer but not in sufficient detail to allow the prudent insurer to assess its significance. At this point, the insurer may indicate that he does not wish to hear more on the subject from the proposer. If so, the result is that, although the undisclosed detail may be material, the insurer has waived performance of the rest of the duty as regards that information..."

From these judgments in considering the duty of disclosure of the assured, the waiver principle is a separate issue. This position of law is in favour of the insurers as there is an assumption that the facts represented by the assured are fair and they are entitled to take at face value what is said on the slip.[462] The burden to prove that the insurers have been put at least on suspicion is upon the assured. Maybe this unfairness was the reason why Rix L.J. proposed the new approach.

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[460] MacGillivray, 446 para. 17-83.
[461] Clarke, 741 para. 23-12A.
[462] [2004] Lloyd's Rep IR 764 para. 114.

Rix L.J., the minority judge, gave a judgment that shook the whole concept. He took waiver into considering the issue whether a presentation is unfair or not, he said: [463]

"In truth, it is not possible to determine whether a presentation is unfair or not without taking into account, where the issue is raised, the other side of the section 18 coin. It will be recalled that the setting of section 18 is that the utmost good faith is to be observed by both parties (s.17)...It would not in my judgment be fair to castigate a presentation as unfair and thus put an assured in peril of the draconian remedy of avoidance where an insurer had waived the relevant information. The mutuality of doctrine of good faith underlines this proposition"

Applying this law to the facts he said:[464] "...It must in my view be remembered that the question is ultimately not whether an "unfair" presentation has been waived, but whether, taking both sides of the matter into consideration, the presentation is unfair..."

He reached his judgment without separating the duty of disclosure and waiver. He put the notion of fairness into consideration. According to him, fairness applies to both parties even if the presentation starts with the would-be assured.[465] In his opinion, "the issue of fairness cannot be resolved without considering the matter in the round".[466]

Being based upon the notion of fairness, his test referred to a reasonably careful insurer and the facts presented to him and also the facts he knows or ought to know under s.18 (3) (b) of the MIA 1906. Having this information the insurer can then form the whole picture and decides whether he needs to raise queries. Applying this approach to the facts of the case, Rix L.J. held that there had not been an unfair presentation, by reason of waiver. There was nothing special about a Cancun retailer selling Rolex watches. Accordingly, the disclosure of the sale of valuables ought to have prompted a prudent underwriter to ask something about the nature of the clocks as such a question would have revealed the true position.

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[463] Ibid., para. 46.
[464] Ibid.
[465] Ibid., para. 65
[466] Ibid., para. 77

2.1 Criticisms

Even though Rix L.J.'s judgment may be seen as fairer in the case, the approach may create uncertainties in market practice.

The insurers cannot be certain whether the presentation of the assured is sufficient. There is no longer an assumption of fair presentation. The acceptance of the risk at face value has been dropped. Under Rix L.J.'s approach, the insurers have a proactive role in considering facts represented by the assured. From the facts of *Wise*, the insurer should have asked the assured about the goods insured even though it is specified in the slip. From the assured's position, the duty of disclosure of all material facts would be lessening. The assured would think of disclosing only limited facts as the insurers, if the judgment is applied, would have to take action in finding out relevant facts material to the risks.

However, it can be said that Rix L.J's approach is quite welcome as it limits the wide scope of the assured's pre-contractual duty of disclosure which sometimes is considered as harsh towards the assured.

It should be noted that even though Rix L.J. emphasised that his judgment was different from that of Longmore L.J. and the different outcome was not because of a disagreement over the application of the law to the facts,[467] it might be said that the same result may be reached by the application of the traditional approach to the facts by saying that there was a clear case of waiver. This can be seen when Rix L.J. answered the question: would a reasonably careful insurer have been fairly put on inquiry, given what he knew from the assured's presentation and his presumed knowledge? His answer to the question was "yes".[468] This way the same answer could have been reached. Indeed, Malcolm Clarke mentioned this possibility in his textbook under the issue of waiver of further information, as aforementioned, that:

[467] Ibid., para. 76.
[468] Ibid., para. 67.

"The courts' response has not been consistent. One court may take a narrow view and hold that there has been non-disclosure of the detail or the related fact. Another court...finds that disclosure has been "fair", or finds that the insurer has waived further related information about the matters disclosed."[469]

In other words, it might be possible to follow the traditional approach as held by the majority judges but narrow down the scope of the assured's duty of disclosure. It has been said that when the doctrine was introduced by Lord Mansfield in *Carter v Boehm,*[470] the scope of the duty of utmost good faith was so narrow that the assured merely has to disclose facts which he privately knew, and the insurer is ignorant of and has no reason to suspect.[471] This way the insurers know that only peculiar matters can be regarded as material. They will be more cautious and more involved in finding the relevant material facts when they consider the risks. This way justice can be reached without affecting market practice to the extreme. This should be a sound solution as a recent case still follows the traditional approach. The case was *Rendall v Combined Insurance Company of America.*[472]

The case concerned Business Travel Accident insurance which provided "24 hour All Risk Hazard" for an employee on an authorised business trip. Reinsurers sought negative declaratory relief alleging that there was misrepresentation or non-disclosure, and that the losses were not covered by the direct policy.

It was held that there was no non-disclosure because further disclosure had been waived. The presentation of the assured contained information which should have prompted the reinsurers to make further investigations, but they failed to do. In particular, it was alleged that the figure of estimated travel hours had been arrived at by the application of assumptions and not on the basis of the actual travel experience of the assured's employees. The reinsurers were aware that the figure was estimated, they had experience in estimating travel data where historical data was not available and the reinsurers would have been aware that it was often impractical to get a very

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[469] Clarke, 746 para. 23-13.
[470] (1766) 3 Burr 1905.
[471] R. Hasson, "The Doctrine of Uberrima Fides in Insurance Law: A critical evalution," *Modern Law Review* 32 (1969): 615, 617.
[472] [2005] CLC 565.

detailed breakdown of business travel exposure. Hence, failing to do further investigation, the basis of the estimate was waived.

3 Waiver of the duty of utmost good faith by express agreement

The use of contractual terms to limit the duty of utmost good faith originates from the way business is done in the commercial insurance market. Unlike ordinary insurance placing process whereby the assured approaches a broker and requests him to obtain cover, this new type of business is an insurance developed by the brokers. They search for insurers of certain business and introduce the business to the insurers. After the insurers agree to the proposed business they then introduce the whole package to the assured. The assured has therefore little or nothing to do with the placement of the risk.

Hence, it is no longer the situation where the assured is the one who possesses all the information relevant to the risk and bears the duty of disclosure at placement. All the relevant facts are in the brokers' possession and the entire negotiation and process would take place between the broker and the insurers. As a result of this, the contractual terms that exclude the duty of utmost good faith have been created. They are intended to be the insulation for the assured's liability as he is not in a better position than the insurer. The duty of utmost good faith should fall upon the brokers who possess all the knowledge and experiences regarding the risks.

The House of Lord case *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank (Chase)*[473] is the highest and most recent authority considering this issue.

In this case, Chase was a participant in a syndicated loan arrangement with a film production company. The loans were to be repaid out of the revenues generated by the films to be made by the company. The security was taken in the form of an assignment to Chase of a share of receipts from the film and of the benefit of a policy of time variable contingency (TVC) insurance, under which, if there was a shortfall

[473] [2003] 2 Lloyd's Rep 61.

on a given day, the policies would make up the difference. The production company and the lending bank were to be co- assured, but the production company was to assign to the bank all its rights under the policy. TVC had been developed by brokers, Heaths, and had been sold by them as a package to the London market. Chase had no involvement in the placement process, and the entire negotiation was carried out by Heaths. In the contract there were clauses called "truth of statement clauses" which excused the assured's personal duty of utmost good faith, liabilities and restricted the insurers' right to avoid the policy. The construction of these clauses was the focus of the House of Lords. It is enough here to cite the phrases involved:

"(6) The insured will not have any duty or obligation to make any representation, warranty or disclosure of any nature, express or implied (such duty and obligation being expressly waived by the insurers and
(7) Shall have no liability of any nature to the insurers for any information provided by any other parties and
(8) Any such information provided by or non-disclosure by other parties including, but not limited to Heath shall not be a ground or grounds for avoidance of the insurers' obligation s under the policy or the cancellation thereof"

The controversial issues were as follows:

1) Whether waiver under phrase (6) should include the broker's duty of utmost good faith;

It was unanimously held that the phrase was a waiver personal to the assured. This was possible because an agent to insure has a separate duty of disclosure under s. 19 from that of the assured under s.18 of the MIA 1906. The assured was relieved from the obligation to make a disclosure under s.18, representation under s.20 or warranty. The agent to insure was still subject to the duty of utmost good faith under s.19 and s. 20.

2) Whether phrases (7) and (8) apply to negligent and fraudulent misrepresentation and non-disclosure.

With respect to phrase (7), the wording was broad with the intention to limit the assured's liability of any nature as a result of misrepresentation or non-disclosure of the broker or any other parties. This phrase was probably designed to accommodate the situation where there are additional rights given to the insurers in the case where the broker negligently or fraudulently misrepresent the facts to the insurers apart from an entitlement to avoid the contract for non-disclosure under s.19 and 20, as the insurers' rights to avoid were restricted under phrase (8).

The representor, in this case the broker, is liable in damages for negligent misrepresentation under s s.2 (1) of the Misrepresentation Act, 1967 and fraudulent misrepresentation under the common law tort of deceit.[474] Not only may the insurers claim for damages directly from the brokers who negligently or fraudulently misrepresent the risk, they can also claim damages from the assured under the principle of vicarious liability as the broker is the agent of the assured. By using the wordings "the insured shall have no liability of any nature" as stated in phrase (7), it seems that the assured should not be held liable for any breach of the duty acted by the broker. Their Lordships held unanimously that the clause extended to negligence, but not to fraud, with Lord Scott dissenting on the fraud issue. As to negligence, their Lordships focused on the commercial purpose of the clause and construed that phrase (7) did preclude the liability of the assured for damages under s.2 (1) of the Misrepresentation Act 1967 for any negligent misrepresentation by the brokers. The absence of any express reference to negligence was in the circumstances irrelevant.

As to fraud, the judgments were not unanimous. The majority was of the view that fraud and negligence are different. In entering into a contract the principle is that contracting parties are assuming honesty or honest dealing.[475] Hence, the fraud of an agent could be excluded only if there is clear wording. From the case, the wording was not appropriate and was not clear enough to extend to fraud, Lord Scott dissented.

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[474] [2003] 2 Lloyd's Rep 61, 66 per Lord Bingham.

[475] Ibid., 68 per Lord Bingham: " But each party will assume the honesty and good faith of the other; absent such an assumption they would not deal"; 76 per Lord Hoffmann: " I think that in the absence of words which expressly refer to dishonesty, it goes without saying that underlying the contractual arrangements of the parties there will be a common assumption that the persons involved will behave dishonesty.."; 81 per Lord Hobhouse: " Fraud and negligence are different from each other in kind. Commercial men recognize the risk of want of care or skill; they do not contemplate fraud in the making of the contract.

The majority of the judges left the issue as to whether there is a rule of law, based on public policy, which prevents the use of a contract term to exclude liability of a principal for the fraud of his agent. Only Lord Scott and Lord Hobhouse considered this issue. They were not of the same view. Lord Scott was the minority in the case who supported the existence of this type of clause and the broad interpretation of the wording of the clause as he held that the wording in phrases (7) and (8) was broad enough to exclude an agent's fraud from the assured's liability and to disentitle the insurers to avoid the policy for the agent's fraud. Lord Hobhouse based his argument on two reasons, one was public policy and the other was on a contractual point that if consent to a policy was obtained by fraudulent presentation of the risk, then a clause relieving the assured for liability from the broker's fraud could not itself have been validly consented by the insurers.

With respect to phrase (8), their Lordships gave the two paragraphs much the same interpretation as phrase (7). The difference between the two phrases is that phrase (8) focused on the insurers' rights to avoid instead of the assured's liability. In particular, the phrase limited the insurers' right to avoid for non-disclosure of the agent to insure under s.19 and the right to avoid for misrepresentation under s.20 of the MIA 1906. Their Lordships unanimously held that phrase (8) removed the right of the insurers to avoid the policy for innocent and negligent non-disclosure or misrepresentation. As to fraud, in a similar manner as phrase (7), the majority view was that the wording could not extend to fraud, Lord Scott again dissented. He was of the view that it is conceptually possible to exclude the right of avoidance in respect of fraud of the assured's broker.

From the case, it is clear that it is now possible to restrict the use of the duty of utmost good faith. It is said that there are four different forms of agreement that can be reached between the insurer and the assured under which the duty of utmost good faith is restricted:[476]

1) an agreement restricting the duty of utmost good faith itself, so that no disclosure is required by the assured or his broker;

[476] Merkin, *Calinvaux & Merkin's Insurance Contract law,*10857 para. A- 0897.

2) an agreement restricting the assured's duty, or that of his broker, to disclose specific types of information;
3) an agreement restricting the authority of an agent or broker to make statements on the part of the assured;
4) and agreement restricting the insurer's right to avoid the insurance policy in the event of misrepresentation or non-disclosure by the assured.

This is consistent with the development of the market as illustrated from the facts of the case itself that the assured was not in a better position than the insurers which renders the imposition of the duty of utmost good faith upon the assured unjustifiable and unnecessary. As this is a new approach there are no guidelines as to how far this type of contractual term can go. At this stage, the thesis focuses on the issue which was left unsettled in *Chase* whether there is a rule of law, based on public policy, which prevents the use of a contract term to exclude liability of a principal for the fraud of his agent. What should be the better solution and consistent with current insurance market practice?

3.1 Is there a rule of law preventing the use of a contractual term to exclude liability of a principal for the fraud of his agent?

It is settled that there is a rule of law, based on public policy that a person cannot benefit from his own fraud. Applying this rule of law to the facts of *Chase*, it is indisputable that the assured cannot contract that he shall not be liable for his own fraud. This was unanimously accepted by their Lordships. However, it is not clear whether he can contract that he should not be liable for his agent's fraud.

In order to answer the question, it should be borne in mind that the relationship between the agent to insure and the insurers is special. An agent to insure is employed to place the insurance contract. The insurer is entitled to contract on the basis that the person with whom he is dealing, being someone authorised by the assured so to act,

has disclosed all facts within that person's knowledge.[477] The agent to insure has a separate duty of disclosure.

In *Chase*, Lord Hobhouse supported the existence of this rule of law. He was of the view that allowing the principal to be excluded from his agent's fraud involves the principal relying upon and seeking to take advantage of the very fraud for which he is liable.[478] His statement is quite true if the agent is the alter ego of the principal or agent to know who is authorised to perform certain tasks on behalf of the principal and therefore has to duty to inform the principal of all facts involving the task. The knowledge of these types of agent must be imputed to the assured. In other words, the relationships between the assured and the predominant agent or agent to know are so close and based upon the imputation of knowledge principle. The knowledge of fraud of these agents in relation to the risks is imputed to the assured. Hence, a contractual term allowing the assured to exclude this type of fraud can be a clause which allows the assured to take benefit of his own fraud and should be barred by the rule of law.

However, *Chase* involved a different type of agent, namely an agent to insure who has a separate duty of utmost good faith. An agent to insure must disclose material facts within his knowledge and his knowledge is not to be imputed to the assured. In addition, the facts of the case itself were so special that the brokers were the ones who possessed all the information and arranged the insurance and presented the whole package to the assured. Hence, in this case the whole insurance was effected based on the brokers' expertise without any involvement of the assured. These two factors render it possible to exclude the agent's fraud from the assured's liability. Lord Scott clearly supported this view and ruled in *Chase* that there was no public policy objection to the existence of this type of contractual term.[479] However, this does not mean that the assured can escape liability completely, honesty of the assured is still important. According to Lord Scott's view if the agent's principal, in this case the assured, knew of or was complicit in the fraud, the public policy rules come into play.[480]

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[477] *Blackburn Low v Vigors* [1887] LR 12 App Cas 531, 541 per Lord Watson; *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241, 259 per Saville L.J.
[478] [2003] 2 Lloyd's Rep 61, 81-82.
[479] Ibid., 85.
[480] Ibid.

3.2 What should be the proper interpretation of the agreement; should it subsume the fraudulent act of the broker and therefore exclude the assured's liability?

The majority's view held that fraud and negligence are apart and that honesty and fair dealings are assumed when parties entered into the contract. It was unanimously held that the facts of the case were special and it would be unfair for the assured to be obliged to the duty of disclosure or to be liable for non-disclosure or misrepresentation of the brokers or be deprived of the contractual rights because of the brokers' innocent or negligent non-disclosure or misrepresentation. To create a fair dealing, the majority of the judges therefore allowed the "truth of statement" clauses to have an effect.[481] They agreed that in entering into the contract the risk of negligence is recognisable but to accept fraud is another thing. There must be express wording if the assured wants to guard himself from his agent's fraud.[482] In other words, they prefer a narrow construction if it comes to the exclusion of fraud. Lord Scott on the contrary, even though also based upon the special relationship between the assured and the insurers in constructing the clauses, held that the exclusion of fraud can be reached by the use of general language in the contract.[483] According to him, if the clauses were designed to protect the assured, it should protect the assured completely. He mentioned in his judgment that:[484]

"...Chase had no reason at all to expect to bear the risk of Heaths' dishonesty in dealing with the insurers. On the footing that the commercial purpose of the phrases (6), (7) and (8) was to insulate Chase from the broking process, and the evidence at trial may well confirm that to be so, that purpose is as much undermined by making Chase responsible for Heaths' dishonesty as it would be undermined by making Chase responsible for Heaths' negligence. There is in my opinion, no logic in the distinction proposed to be drawn between Heaths' dishonesty and Heaths' negligence in the bringing into being of the insurance contract. The contractual words should as a

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[481] [2003] 2 Lloyd's Rep 61, 80 per Lord Hobhouse.
[482] Ibid., 78 per Lord Hoffman who cited *dicta* given by Lord Loreburn L.C. in *Spearson &Son Ltd v Dublin corporation* [1907] AC 351.
[483] [2003] 2 Lloyd's Rep 61, 85.
[484] Ibid.

matter of principle, be given their normal meaning if the normal meaning is consistent with the commercial purpose of the truth of statement, objectively ascertained ..."

It is true that this judgment was inconsistent with the majority of the court. However, it can be said that the position of the assured in Lord Scott's eyes is the true expectation of Chase who was the assured in the case. In accepting the business he certainly did not expect to be liable for any conduct of the brokers' and especially not in the case of fraud. It should be emphasised that the truth of statement clauses were in the insurance contract to create a fair dealing between the parties and that the majority's view was correct that fraud is not acceptable. What Lord Scott said was that fraud is excludable from the assured's liability from general wording because of the facts of the case. He clearly did not say that the brokers were excused from their fraudulent conduct. Indeed, a broker potentially faced personal liability in damages if the insurers could prove loss arising from the broker's conduct. Even though the general case is that the insurers will not suffer any loss, for they have the right to avoid the policy but in this case, if Lord Scott's construction is applied, that right would be lost because of the contractual terms restricting the insurers' right to avoid the policy for innocent, negligent or fraudulent non-disclosure or misrepresentation. Hence, the insurers can claim damages from the brokers.[485] In other words it is merely a shift of responsibility from the assured to the brokers who were the party who committed the fraud.

In addition, if clear express wording must be used as held by the majority it is very unlikely that the market could operate without obstacles as it is extraordinarily unlikely that parties to a contract will agree to a term which clearly uses the words to exclude fraud as this from the insurers' point of view might be an indication to fraudulent intention of the brokers.

Hence, it would not be surprising if Lord's Scott broad construction is accepted in future cases. However, since the majority held that express wording is required to exclude the assured's liability from his broker's fraudulent conduct, a clear exclusion clause regarding fraudulent conduct of the broker is required. Maybe a clause

[485] Can be tortious or contractual liability. Clarke, 271 para. 9-1.

indicating a shift of liability from the assured to the broker can solve the issue for the time being.

4 Electronic insurance and the duty of utmost good faith

Nowadays, there is an increased of number of insurance contracts effected online both in consumer and commercial insurance. The problem regarding the duty of utmost good faith arises when online insurance does not provide blank spaces for the proposers to type additional information relevant to the risks.[486] This is because online insurance is normally made as simple as possible for proposers to apply online. In addition, most of the forms do not remind the proposer of the duty of disclosure at the formation of contract stage. Because of these characteristics of online insurance, it may be said that there is a waiver by the nature of the insurance. The insurers have found that this is a cost-effective way of selling insurance and have taken the risk of adverse selection.[487]

Online insurance without spaces for the assured to disclose material facts is analogous to situations where insurers ask the assured specific questions by using proposal forms. This situation can often be seen in consumer insurance. The issues that must be examined are as follows: from the questions or the answers that appear on the proposal form should there be a presumption that in this case the insurers have waived the assured's general duty of disclosure in this situation; what should be the position of the assured's duty of disclosure in this situation; what is the consequence of the assured's failures to answer any question on the proposal forms or answer it incompletely and yet the insurance is accepted by the insurer?

4.1 The assured's duty of disclosure where questions are provided by the insurers for the assured in the proposal forms

[486]For example online insurances in www.esure.com; www.norwichunion.com; www.churchill.com
[487] Clarke, 745 para. 23-12c.

In the case where a proposal form is used, even though it is supposed to be proposed by the assured, it is a ready made form created by the insurers. Insurers have put forward questions for the assured to answer. The law is that, there is no presumption that matters not dealt with in the proposal form are not material. The use of a proposal form will generally not revoke the assured's duty of disclosure, although it might enlarge or restrict it.[488] The mere fact that the proposal form does not ask a particular question does not mean that the insurer intended to waive disclosure of such matters. This rule of law can be seen in *Schoolman v Hall (Schoolman).*[489]

In this case, the proposal contained questions relating to the assured's trade and the assured's previous insurance history. In particular, whether there had been refusals to insure and whether the assured had suffered any loss during the previous five years. The proposal form also asked for two references from the assured's trade without limiting the period of time as to when this happened. The insurers alleged that the assured failed to disclose a material fact, namely a criminal record that happened 14 years before the policy was issued. The assured argued that the insurer waived disclosure of this fact because of the questions which were asked of the assured. The Court of Appeal held for the insurers that the question concerning character was not limited temporally.

With respect to specific questions asked by the insurers, Asquith L.J. said that whether there has been a waiver depends on the questions asked, not those answered; if the question has been so formulated that it implies necessarily that the underwriter requires only information touching upon a particular subject or falling within a defined compass, then there has been a waiver of his right to disclosure of all other matters.[490] Cohen L.J. used the formulation of Mathew J. in *Laing v Union Marine Insurance Company*[491] that the insured is not bound to give information "which the underwriter waives as to which the assured may reasonably infer that the underwriter is indifferent." And Birkett L.J. contended so himself relying on the third edition of *MacGillivray* where it was said merely that "the form and nature of the questions, or

[488] *Roselodge Ltd v Castle* [1966] 2 Lloyd's Rep 113, 131 per McNair J.
[489] [1951] 1 Lloyd's Rep 139.
[490] Ibid., 143.
[491] [1895] 1 Comm Cas 11, 15.

the declaration by the assured, or the conditions in the policy may substantially modify the duty of disclosure".

The judges came to the same result that criminal convictions must be disclosed. It is said that different judges formulate the same concept in somewhat different terms.[492] However, one thing was certain. There was no presumption that the insurers had waived the assured's general duty of disclosure by asking specific questions. Another thing derived from the judgments was the insurers' intention. In particular, the judges looked at the insurers' intention in considering whether there should be waiver.

The intention of the insurers can be understood by considering the insurers' intention as a whole, namely, by looking at the questions asked and the policy itself. A good example of questions to which waiver can be implied is where the insurer asked for certain information relating to a particular period of time such as questions about previous losses within the last five years as appeared in *Schoolman* itself.[493]

In the situation where the assured fails to answer the questions asked or answers them incompletely and yet the insurers still accept the proposal, the position of law is not much different. Inference must be drawn from the absence of a complete answer whether there remains further material information to be communicated.[494] In other words, if a question is not answered by the assured in completing a proposal form, the underwriter will be put on enquiry and will be held to have waived disclosure if he accepts the insurance without pursuing the enquiry, unless the applicant intended, as discerned from the perspective of a reasonable person, the unanswered question to represent a definitive answer. For example, in *Roberts v Avon Insurance Company Ltd.*[495] a proposal contained a declaration that read "I have suffered no similar loss, except..." The assured did not fill in an answer. It was held that any applicant completing this form would appreciate without doubt or ambiguity that the insurers required particulars of any previous loss and that the obvious inference of the assured

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[492] *Doheny & Ors v New India Assurance Company Ltd & Ors* [2005] Lloyd's Rep IR 251 per Longmore L.J., para. 19.
[493] *Revell v London General Insurance Co Ltd* [1934] 50 Ll LR 114; *Taylor v Eagle Star Insurance Co Ltd* [1940] 67 Ll LR 126; *O'Kane v Jones* [2004] 1 Lloyd's Rep 389.
[494] MacGillivray, 447 para. 17-85.
[495] [1956] 2 Lloyd's Rep 240.

failing to fill in the blank was to answer the question negatively that the assured had suffered no loss.

To sum up, whether there is a waiver depends on the questions asked and the policy must be looked at as a whole to draw intention of the insurers in asking those questions. The failure of the assured to answer the questions or answer them completely and yet the insurers accept the policy might imply waiver of the insurer as in the normal case the insurers are put on enquiry in this situation. However, if it can be drawn by looking at the questions and the policy as a whole[496] that the assured intended to give a negative answer, the insurers would not be held to have waived the material facts in this situation.

Even though this is the position of law, there are some cases which seem to say that the insurers have waived disclosure of the particular material facts because they have not asked questions relating to those facts. If this is the position of law, it would leave no room for the rule that immateriality is not to be presumed as regards information not being the subject of express questions, which is the rule extracted from *Schoolman*. This issue merits a closer consideration.

4.2 Is the assured obliged to disclose facts not covered by the questions asked in the proposal form?

This suggestion of the law is subject to doubt as if there is a waiver, the duty of disclosure would be transferred to a duty on the insurer to ask questions.[497] In addition, the authorities supporting the view are not totally convincing.

Hair v Prudential Assurance.[498]

In this case, the assured effected a fire policy. There was a local authority closing order in force in respect of the assureds premises, but no specific question was asked

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[496] Eggers and Foss, 184 para. 8.48.
[497] *Arterial Caravans Ltd v Yorkshire Insurance Co Ltd* [1973] 1 Lloyd's Rep 169.
[498] [1983] 2 Lloyd's Rep 667.

about this possibility and the assured did not disclose it. The declaration at the foot of the proposal form provided that:

"I wish to insure as above with the Prudential Assurance Company Limited in the usual form for this class of insurance and warrant that all the information entered above is true and complete and that nothing materially affecting the risk has been concealed."

This clause was the basis of the contract. Applying the rule provided in *Schoolman*, it should be said that the undisclosed fact, the local authority closing order in force in respect of the assured premises, was material and should have been disclosed irrespective of the silence of the proposal. This, however, was not what the judge said in the case. Woolf J. said in his judgment that:[499]

"Reading that sentence as a whole, coming as it does at the end of the proposal form, it appears to me that it is reasonable to regard the question as requiring the proposer to make it clear that he or she has given a true and complete answer to the questions which appear above, and, what is more, that the proposer has not failed to disclose anything materially affecting the risk with regard to matters on which he is being questioned. I am bound to say, that, if it was intended that an assured should answer matters even though he is not being questioned about them, I would expect a different form of statement from the one to which I have just made reference. I would have expected something to be said which clearly indicated to a proposer that, although they had not been asked any specific question about the matter, if there was something which was relevant to the risk which they knew of, but which was not covered by the questions, they should still deal with it, and leave a space for them to do so."

It should be noted that the judge decided the case based upon the construction of the meaning of the case. The decision did not affect the rule regarding the duty of

[499] [1983] 2 Lloyd's Rep 667, 670

disclosure as such. Hence, this case cannot be regarded as upsetting any fundamental of principle of insurance law. [500]

Nevertheless, there were cases where the wording of the judges seemed to have decided upon the duty of disclosure.

Roberts v Plaisted.[501]

In this case, the proposal form contained questions directed to the use of the assured's premises as a hotel. There were a number of specific questions asked about the use of the premises for particular purposes, for example, whether the premises were an inn or hotel and whether there was a casino in any part of the building. There was also a question whether the premises were used for any other purpose, although the Court of Appeal construed this question to be limited to alternative uses of the whole premises and not any part of the premises. There was no question asked as to the discotheque, and the assured did not disclose its existence. The insurer sought to avoid the policy on the grounds of non-disclosure of the fact that a discotheque was in operation on the premises. The Court of Appeal held that the insurer was not able to avoid the policy, as disclosure of the relevant information had been waived. Purchas L.J. said in his judgment that:

"I cannot accede to the submission that the effect of the proposal form can be so limited as to leave unaffected the common law duty upon the assured to make disclosure...[B]y presenting the proposal form [the] insurers waived any right they may have had to repudiate."

Another case was *Johnson v IGI Insurance co Ltd.*[502] The case concerned a medical insurance policy. The insurer asked no questions about the assured's medical history. The Court of Appeal concluded that the insurer had waived that material fact.

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[500] Merkin, *Calinvaux & Merkin's Insurance Contract law,*10860/4 A- 0901; see also *Insurance Corporation of the Channel Islands Ltd v The Royal Hotel Limited* [1998] Lloyd's Rep IR 151 per Mance J.
[501] [1989] 2 Lloyd's Rep 341.
[502] [1997] 6 CL 358.

From the two cases, it seems as if there was a waiver in the absence of inquiries. However, if one looks at each case, it can also be said that what the judges did, was merely look at the questions as a whole and use their discretion as to whether waiver could be implied in each case as laid down in *Schoolman*. Hence, it may be the case that the judges construed the insurance terms and decided that insurers had waived the general duty of disclosure in this case.

In any event, if these two cases are supposed to be based upon the law, it should be said that on the balance of the authorities a failure to ask express questions will not generally be construed as a waiver, even if the information is highly material.[503] The latest case supporting this position of law was *Doheny v New India Assurance Co (Doheny).*[504]

The case involved property insurance. The assureds, Mr. and Mrs. D. completed two proposal forms, one for their company and one for themselves. The proposal forms asked for a declaration in the following terms:

"No director/ partner in the business, or any Company in which any director/ partner have had an interest, has been declared bankrupt, been the subject of bankruptcy proceedings or made any arrangement with creditors."

The assureds had been directors of three insolvent companies. They signed the declaration and did not disclose these matters. The Court of Appeal held that there was a breach of the declaration. While the word bankrupt could not on its own meaning be applied to a company, the word was often used colloquially to describe insolvent companies and it was clear to a reasonable proposer what the declaration was referring to. Since the meaning was clear, the *contra proferentem* principle was not applied. The case was decided upon the fact that there was a false answer from the assured that was the basis of the contract.

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[503] *Marc Rich & Co AG v Portman* [1996] 1 Lloyd's Rep 430; *James v CGU Insurance* [2002] Lloyd's Rep IR 206.
[504] [2005] Lloyd's Rep IR 251.

The waiver issue considered by the Court of Appeal was merely *obiter dicta.* Longmore L.J. concluded on this issue that: "...different judges sometimes formulate the same concept in somewhat different terms..."[505] He did not qualify what was said in the sixth edition of *MacGillivray* at paragraph 17-19 that : "... whether or not such waiver is present depends on a true construction of the proposal form, the test being , would a reasonable man reading the proposal form be justified in thinking that the insurer had restricted his right to receive all material information, and consented to the omission of the particular information issue?" However, from his *obiter* he paid attention to the construction of the terms of the policy and what can be implied from them. He rejected the suggestion that the waiver principle was confined to "consumer" insurance.[506] The two other judges did not consider this issue in detail.
It seems therefore that the real position of law in this situation depends on the construction of the facts of each case. Whether insurers intend to limit the general duty of disclosure must be construed from the questions asked in those forms. But as a result of *Doheny's* analysis proposal forms maybe found to contain an implied waiver of the duty of disclosure. A range of questions put in a formal way, in a proposal form, implies waiver of information which the insurer does not ask about. In other words, the scope of the inquiry determines the scope of the duty of disclosure.[507]

It may be said that an insurers' intention to restrict the assured's duty of disclosure to questions they asked can be more easily drawn in consumer insurance proposal forms. The insurance industry has agreed to a series of guidelines in Statements of Insurance Practice 1986. These guidelines impose on the insurers of consumers the requirement to ask questions on all matters commonly found to be material. The guidelines are now replaced by the Financial Services Authority (FSA) with the Financial Services Authority's Insurance: conduct of Business rules (ICOB) rule 7.3.6. This obligation may lead to findings of waiver in the absence of express questions. Indeed, the position of the Insurance Ombudsman Bureau (IOB), as regards the insurance contracts of consumers that are within the Bureau's remit, is that the scope of the proposer's duty of disclosure is determined by the questions put by the insurer.[508] This

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[505] Ibid., para. 19.
[506] Ibid., para. 20.
[507] Clarke, 743 para. 23-12B.
[508] Clarke, 741 para. 23-12A.

can also be seen in the judgment of Simon L.J. in *Economides v Commercial Union Assurance Co plc,* who said that:[509]

"Where...material facts are dealt with by specific questions in the proposal form and no sustainable case of misrepresentation arises, it would be remarkable indeed if the policy could then be avoided on grounds of non-disclosure."

Therefore, in conclusion, the *Schoolman* principle should still be applied. However, in the case of consumer insurance the insurers' intention to acquire information may be limited to those questions asked.

4.3 How does the law apply to electronic insurance?

From the above analysis, the current position of the law depends on the construction of the questions in the proposal forms. The policy may be regarded as containing an implied waiver if the insurers did not ask a specific question. The judges can exercise their discretion differently in each case. Hence, the outcome of each case may be different.

Applying the current position of law to electronic insurance, it is hard to see why the judges should hold that insurers require the assured to reveal other facts apart from those asked if the insurer did not provide any blank space for the assured to add other material information which would show their intentions that they require other material information to be disclosed even though they have not put a specific question for it.

It should be noted that from the insurers' position, it is not impossible for them to provide a blank space into their online forms.[510] This way, the insurers' intentions to acquire all material information still exist. In this case, it is worth seeing how the court would decide this situation where the assured is not protected by the Statements of Insurance Practice which is now regulated by the FSA. It is more likely that the

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[509] [1998] QB 587.
[510] http://www.a-home-insurance-plan.Couk/home_insurance_quote.php?int=30

current position of law is applied to this situation, namely, if the assured did not disclose material facts, the insurers should be entitled to avoid the contract.

However, it should be borne in mind that online insurance is intended to be an easy and simple way to get insurance cover. By holding on to the general duty of disclosure and putting extra space for the assured to disclose material facts might make the insurance cover less attractive to the assured. Therefore, it is most probable that proposal forms used online will most likely be simple and create less hassle to the assured.

5 Conclusion

The novel approach in considering the issue of waiver introduced by Rix L.J. may create uncertainty in market practice and has not been supported by subsequent cases. It is understandable that the mitigation of the assured's pre-contractual duty of utmost good faith is very welcome. However, as mentioned in chapter two, the assured's pre-contractual duty of utmost good faith has been decreased as now it is not easy for the insurer to prove inducement and there is no presumption of inducement as such. A plausible solution may be reached by considering the facts of each case separately but sticking to the assumption of a fair presentation so that certainty in formation of contract still persists. The judges are given discretion in considering what amounts to waiver. A narrower scope of the duty of utmost good faith can be introduced to the market gradually by the common law judges.

With respect to waiver and insurance market practice, it can be seen that a new type of waiver has been introduced. This can be seen from the use of express contractual terms to limit the duty of utmost good faith which has become a necessity in certain types of insurance where the duty of utmost good faith should be shifted from the assured to the broker as he is the one who creates the insurance and possesses all the relevant information. Until now, it has not been clear as to the scope of these types of terms restricting assured's liability for fraudulent conduct of the broker. Considering that the rationale behind the terms is the shifting of the burden of the duty of utmost good faith from the assured to the broker, this type of clause should be plausible.

However, it has been held that clear wording must be applied for this type of term to be applicable, which would at the end of the day be very unlikely in practice as it is hard to think of a situation where the insurer would agree to a term accepting fraud of the other party. Maybe the intention to shift the burden of the duty of utmost good faith from the assured to the broker should be emphasised and not merely the intention to limit the assured's liability.

With respect to electronic insurance, whether there is a waiver by the insurer or not should depend upon the construction of the questions asked and the policy involved as a whole. If the online proposal form provides a blank space for proposers to provide information, the general rule that the assured is subject to general duty of disclosure should be applied. The consumer assured may be protected from the Statements of Insurance Practices but this is not so in commercial insurance cases.

To sum up, waiver has become a method the market has used to limit the scope of the duty of utmost good faith and must be taken into consideration when one looks at the duty of utmost good faith especially those types of waivers that clearly are expressed in the contract by using contractual terms as they really have an effect upon commercial insurance.

Chapter 7

The London Market Principles 2001: The Long term solution

1 Introduction

This thesis focuses on the problems arising from the way the London insurance market operates regarding the duty of utmost good faith. Chapter three to chapter six illustrated the market practices and pointed out difficulties in applying the duty of utmost good faith and how the market and the common law judges are trying to find immediate solutions to the arising difficulties.

This final chapter focuses on recent updates to the market practices introduced by a joint working group of practitioners involved in the market: both insurers and brokers through the London Market principles 2001 (LMP 2001). Could the LMP2001 be regarded as the long term solution to the problems?

The chapter is divided into two parts. The first part sums up the problems regarding the duty of utmost good faith as a result of the way the market practices as mentioned in chapters three to six and the current way out of these problems.

The second part of the chapter considers the governing legislation regarding the insurance market from past to present. The scope of the current legislation, the Financial Services and Markets Act 2000, entails the understanding of the importance of self-regulation in the insurance market that regulates those areas where it is believed to be best left to the free market. At this stage, the LMP 2001 is considered as it is the most important form of self-regulation which has direct effects on the insurance market practice and affects the application of the duty of utmost good faith to insurance contracts. At this part, the chapter examines how the LMP 2001 can create a long term solution to the problems that are not completely solved at the moment by the common law with respect to the problems arising from market

practice. This culminates in the conclusion of the thesis that the problems in relation to the duty of utmost good faith as a result of market practices are now mitigated by the innovative market mechanism itself.

2 The problems relating to the duty of utmost good faith as a result of market practice

The problems arising from the market practices contemplated in chapters three to six are considered by the common law judges. Some of them can be solved through the common law but some are left open. It is therefore worth seeing whether these problems can be solved through the LMP 2001. The problems and the common law solutions from chapters three to six can be summarised as follows:

2.1 Chapter three: the use of the slip at the placing process in the London market and the duty of utmost good faith

The London market is a subscription market whereby each underwriter accepts only a proportion of the risk and his liability is several and not joint. However, the risk is normally negotiated by the lead underwriter/s who agrees with the broker the premium, and the terms and conditions of insurance at the outset. The following markets normally merely subscribe to the slip agreed by the leader without negotiating with the broker. Hence, it is suggested that the following underwriters are entitled to avoid the contract for non-disclosure or misrepresentation of the material facts made to the leading underwriter only under the "deemed communication rule". The idea of the rule is welcome. However, the justification that the leading underwriter and the following underwriters are no longer individual but a syndicate[511] is subject to criticism in subsequent cases.[512]

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[511] Arnould, Sr., *Arnould's Law of Marine Insurance and Average,* Michael J. Mustill, Jonathan C. B. Gilman, eds., 16th ed. (London : Stevens, 1981), para. 623; *Pawson v Watson* (1778) 2 Cowp 785, 789; *Barber v Fletcher* (1779) 1 Dougl 305; *Marsden v Reid* (1803) 3 East 572; *Feise v Parkinson* (1812) 4 Taunt 640.

[512] *General Accident Fire & Life Assurance Corp v Tanter (The Zephyr)* [1985] 2 Lloyd's Rep 529; *Bank Leumi Le Israel BM v British National Insurance Co* [1998] 1 Lloyd's Rep 71.

The common law cases introduce two alternative solutions. The first is that a false statement or non-disclosure of material facts made to the leading underwriter is of itself a material fact and should be disclosed to the following underwriters, non-disclosure entitles the following underwriters to avoid the insurance policy.[513] The second solution concentrates on the fact that the cover is a specialised cover. The following market therefore has to rely upon the presentation made to the leading underwriter and the leading underwriter's judgment in considering the risk.[514] The first solution is subject to criticism in situations where the assured or the broker is innocent and does not know that he has failed to disclose or has misrepresented material facts, it is hard to say that at the time he approaches the following underwriters, he possesses the knowledge of this type of material fact. The second solution is subject to the proof that the following underwriters have relied upon the leading underwriter's specialisation in considering the risk.

Another solution which can be extracted from one of the cases[515] was that there is an implied representation made to the following underwriters that all material circumstances have been accurately provided to the leading underwriter. This solution would entitle the following underwriter to avoid the contract without the need to prove that they have relied upon the judgment of the leading underwriter and would not have accepted the risk, had the leading underwriter not accepted the risk. The last solution is however not suggested by any common law judges, it can therefore not be said the solution has been adopted by the common law.

The common law therefore is still not clear as to the solution to the problem arising from the placing process.

Market practice has its own solution by using the leading underwriter clause. In the case where the leading underwriter is authorised to settle the disputes on behalf of the

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[513] *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins Ltd* [2002] 1 Lloyd's Rep 157; *International Lottery Management Ltd v Dumas and Others* [2002] Lloyd's Rep IR 237; *International Management Group (UK) v Simmonds* [2004] Lloyd's Rep IR 247; *Brotherton v Aseguradora Colseguros SA and another (No. 3)* [2003] Lloyd's Rep IR 762; *Forrest & Sons Ltd v CGU Insurance plc.* 23 September 2005, unreported (forthcoming in [2006] Lloyd's Rep IR).

[514] *Toomey v Banco Vitalicio De Espana Sa De Seguros y Reaseguros* [2004] Lloyd's Rep IR 354 (Comm); (2005) Lloyd's Rep IR 423 (CA).

[515] *Bank Leumi Le Israel BM v British National Insurance Co* [1998] 1 Lloyd's Rep 71. This solution appeared in the award given by the arbitrator.

following underwriters, the assured may sue a representative underwriter, in return for an agreement from the others to be bound by the result of such action.[516] In this case therefore the leading underwriter clauses give the leading underwriter the right to defend liability on behalf of the market. However, the scope of the leading underwriter clause is broad and not consistent. Not every leading underwriter clause provides the leading underwriter with the power to settle disputes. What should therefore be the effect of the LMP 2001 upon this issue?

2.2 Chapter four: Declaration policies and the duty of utmost good faith.

The chapter divides declaration policies into four types. The first type is the open cover or treaty which is agreed between the assured and the insurer or between the broker who is acting on behalf of the assured and the insurer. Open cover or treaty is obviously not an insurance contract. An insurance contract is entered into only when declarations are made thereunder. However, because of its obligatory or facultative obligatory nature, it is said that the pre-contractual duty of utmost good faith should be applied to the open cover or treaty itself.[517] There are different justifications but the most justifiable one is probably where it is said that obligatory or facultative obligatory open cover or treaty is a contract for insurance which attracts the duty of utmost good faith and that there is a waiver of the duty of utmost good faith by the insurers when declarations are made thereunder.[518] It can thus be said that even though the common law does not provide a clear explanation of why the duty of utmost good faith should be applied to an open cover or treaty, it is undeniable that the duty exists and is applied to this type of declaration policy. The difference between an obligatory and a facultative obligatory open cover or treaty is that while declarations under an obligatory open cover can be made retrospectively of the loss and even if the loss is known to the assured,[519] the assured under a facultative obligatory open cover or treaty, even though he is able to declare the risk retrospectively of the loss, must not possess the knowledge of the loss at the time of

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[516] Ibid.
[517] *Glasgow v Sydmonson* [1911] 16 Com Cas 109.
[518] Merkin, *Colinvaux & Merkin's Insurance Contract Law,* 10713 para. A- 0737.
[519] *Glencore International AG v Ryan (The Beursgracht)* [2002] Lloyd's Rep 574.

making the declaration.[520] In addition, it should be noted that an open cover or treaty may be obligatory and facultative obligatory in nature. Hence, the arising problems in the market regarding open cover and treaty do not really involve the duty of utmost good faith as such but relate to the wording provided in the open cover or treaty with respect to its nature. The LMP 2001 therefore comes into play to this extent.

The second type of declaration policy explained in chapter four is an open cover which is agreed between the broker and the insurers in advance prior the existence of the assured.[521] The common law solves the problem by using the ratification principle. The assured ratifies the brokers' conduct prior to the existence of the contract. Hence, if the broker failed to disclose material facts when he agreed the open cover with the insurers, this would affect the assured when he later accepts the offer of the insurers.[522] This problem is therefore solved by the common law.

The third type of declaration policy is the binding authorities given to other intermediaries to accept risks on the insurers' behalf. If the binding authorities are facultative obligatory in nature, the insurers must accept all risks accepted by those other intermediaries. For this reason, it is suggested that the duty of utmost good faith should come into play. The common law cases illustrated that there is a duty close to the duty of utmost good faith but it is not the duty of utmost good faith as such. There is a fiduciary duty owed to the insurers by the coverholder who is granted the authority by the insurers under the binding authorities. The duty is close to the duty of utmost good faith but not alike. It does not include innocent failure to pass on information.[523] The broker effecting a binding authority on behalf of the coverholder also owes a duty similar to the duty of disclosure to the insurers which is his personal responsibility towards the insurers. [524] This obligation arises as a result of the way the insurance market operates whereby it is accepted that the broker owes a separate duty

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[520] *Glencore International AG v Alpina Insurance* [2004] 1 Lloyd's Rep 111.
[521] *Berger v Pollock* [1973] 2 Lloyd's Rep 442.
[522] *General Accident Fire and Life Assurance Corp v Tanter (The Zephyr)* [1985] 2 Lloyd's Rep 529.
[523] *Sphere Drake v Euro International Underwriting* [2003] Lloyd's Rep IR 525.
[524] *Pryke v Gibbs Harley Cooper Ltd* [1991] Lloyd's Rep 602; *L'Alsacienne Premiere Societe Alsacienne et Lorraine D'Assurances Centre L' Incendie Les Acciden et Les Risques Divers v Unistorebrand International Insurance A.S. and Kansa Reinsurance Co Ltd* [1995] LRLR 335; *HIH Casualty and General Ins. Co Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30 first instance judgment.

of disclosure to the insurers. This is correct as a binding authority is merely an agency contract which confers the right to accept risks to other intermediaries.

This chapter examines how the LMP 2001, now applied to binding authorities, can enhance the clarity of the contract and benefit the London market as a whole.

The last type of declaration policy considered in chapter four is the line slip. The line slip is similar to a binding authority in that insurers use these facilities to authorise another party to accept the risks on their behalf. The difference is that while the insurers authorise other intermediaries to accept the risks on their behalf under the binding authority, the insurers authorise the leading underwriter to accept risk on their behalf under the line slip. The function of the line slip should subsume an open cover or treaty and contain a leading underwriter clause which allows the leading underwriter to accept declarations for the following underwriters who signed the open cover slip.[525] The controversial issue has been regarding the relationship between the leading underwriter and the following underwriter. What should be the basis of the relationship between the leading underwriter and the following underwriter? Should it be based upon a fiduciary duty under an agency contract[526]or should the leading underwriter clause merely provide a trigger event by which the following markets themselves become bound by the declaration.[527] Since the function of the leading underwriter under an open cover in this case is analogous to the line slip, the LMP line slip should thus be under scrutiny. In particular, what should be the relationship between the leading underwriters and the following underwriters under the LMP line slip?

2.3 Chapter five: Agency and the duty of utmost good faith

Even though, the existing law in the MIA 1906 s. 19 is the only section dealing with the agent's duty of utmost good faith, it can accommodate all circumstances relating to agency arising from market practice. The wording of the duty under s.19 and its

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[525] *Denby v English & Scottish Maritime Insurance Co Ltd* [1998] Lloyd's Rep IR 343.
[526] *Roadwords (1952) Ltd v Charman* [1994] 2 Lloyd's Rep 99.
[527] *Mander v Commercial Union Assurance* [1998] Lloyd's Rep IR 93.

exceptions, provided under s.18 (3) of the MIA 1906 subsume all material facts which should be disclosed.

The complexity of market practice creates three different types of agents; the predominant agent; the agent to know and the agent to insure. The last two types of agent are controversial. On the balance of the authorities, it can be said that the knowledge of both types of agent, the agent to know and the agent to insure must be disclosed to the insurer as a result of s. 19. Even though s.19 merely mentions the agent to insure but the scope of material facts includes facts which he ought to know in the ordinary course of business[528] provided the agents act under the same contract and the chain of agents has not been broken.[529] In the case of dual agency, the insurers must bear the broker's failure to disclose material facts.

Even though the common law is settled, clarity of contract as recommended in the LMP 2001 would help specifying the chain of broker involving the same risk. This would get rid of the question of who is the agent to insure in the contract.

2.4 Chapter six: Waiver of the duty of utmost good faith

There has been an introduction to take waiver into consideration when considering the assured's duty of disclosure basing upon the notion of fairness. This introduction was made by Rix L.J. in *Wise Underwriting Agency Ltd v Grupo Nacional Provincial SA.*[530] It is, however, merely an *obiter dictum.* Therefore it may not be regarded as the current position of the law. The majority and the authorities still follow the traditional approach in considering the waiver issue. The assured must make a fair presentation to the insurers. Waiver only exists when this presentation has put the insurers on enquiry and they fail to do so.[531] The law regarding waiver has thus not in fact been changed.

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[528] *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241; *Group Josi Re v Walbrook insurance Co Ltd* [1996] 1 Lloyd's Rep 345.
[529] *Blackburn Low & Co v Thomas Vigors* [1887] LR 12 App Cas 531; *ERC Frankona Reinsurance v American National Insurance Company* [2005] EWHC 1381 (Comm).
[530] [2004] Lloyd's Rep IR 764.
[531] *CTI v Oceanus* [1984] 1 Lloyd's Rep 476; *Rendall v Combined Insurance Company of America* [2005] 1 CLC 565 (Comm).

The waiver principle also plays a significant role in the case of online insurance. Online insurance mostly provides specific questions and does not leave any space for the assured to disclose any other material facts apart from those asked. It is therefore said that there should be a waiver by the insurers. This is most likely so in the case of consumer insurance. In the case of commercial insurance, the insurance slip is now influenced by the LMP slip. How can the LMP slip solve this issue?

Another issue which must be considered is when waiver is used to limit the assured's duty of utmost good faith and the insurers' rights to avoid for breach of this duty.[532] The unsettled issue is whether the express exclusion of the assured's liability should also exclude the broker's fraudulent act. The majority of the House of Lords held that if it is applicable clear wording must be used. This is the point where the LMP 2001 comes into play.

What must be considered at the next stage are the existing insurance regulations, in particular, the London Market Principles (LMP) 2001 which revamps the whole market infrastructure to see what effects it has upon the market and the duty of utmost good faith. It is worth considering existing legislation in order to have the picture of the insurance regulations as a whole.

3 Insurance regulations

3.1 Past to present legislations

Insurance legislation in the U.K. aims at the financial stability of an insurer to make payment. The first piece of legislation dates back to the Life Assurance Companies Act 1870.[533] Under the act, legislation to secure insurers' solvency was done by requiring all new life insurers to deposit a significant sum of money, £20,000, with the court as a guarantee of solvency. In addition, special provision was made for the amalgamation and winding up of these companies, and certain provisions of the

[532] *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*[2003] 2 Lloyd's Rep 61.
[533] Later amended by the Life Assurance Companies Act 1871 and the Life Assurance Companies Act 1896.

Companies Acts were applied to non-incorporated life offices. As the market has developed, regulations, under the legislation, have become more sophisticated and have expanded to other areas of insurance. The deposit scheme was extended to employers' liability insurance in 1907, and the Assurance Companies Act 1909, replacing the 1870 and 1907 Acts, applied the principle of control to fire and accident insurance and to bond investment business. Motor insurance business was added by the Road Traffic Act 1930 and aircraft insurance by the Air Navigation Act 1936. Marine and transit insurance, which remained the chief forms of unregulated business, were brought within the legislation by the Assurance Companies Act 1946. The Assurance Companies Act 1946 introduced a framework designed to assure that the assets of companies carrying out non-life business should always exceed their liabilities by 50,000 pounds or one-tenth of their annual premium, whichever sum was the greater. The scheme was retained by a consolidating and amending Act, the Insurance Companies Act 1958. There have been several amendments consolidating the Insurance Companies Act 1958.[534] The latest one was the Insurance Companies act 1982. The act introduced other security measures to regulate the insurers' solvency, e.g., prior authorisation, the controllers of insurance companies, business transfers, accounting methods, the strict division between life and non-life insurance and participation in non-insurance activities. In addition, since 1975 the law has sought to protect policyholders from the consequences of financial failure. It is said that the history of insurance regulation might be seen as reform prompted by the failure of an insurer.[535]

Until this time, insurance legislation has been separated from other financial services. This was changed by the introduction of the Financial Services Act 1986 the purpose of which was to introduce a single legislative framework for all investment contracts. By the late 1980s, there were ten financial regulators. This fragmented system of regulation did not work because the financial industry did not operate in neat, self-contained segments; multi-functional financial conglomerates had emerged. Two regulators may have different interpretations of the facts.[536] The 1986 Act only applied to investment contracts which incorporated most forms of long-term

[534] Insurance Companies Act 1967; Insurance Companies Act 1973 and Insurance Companies Act 1974.
[535] Lowry and Rawlings, 12.
[536] Lowry and Rawlings, 14.

insurance.[537] Hence, at that time general insurance was regulated by the 1982 Act and long-term insurance was regulated both by the 1982 and by the 1986 Act, with appropriate measures to prevent duplication. Later the U.K. legislator sought to harmonise the regulations of all forms of financial services in one Act, the Financial Services and Markets Act 2000 (FSMA).

With respect to insurance regulations, the FSMA 2000 has established the Financial Services Authority (FSA) as the regulator for most of the financial services industry and which combined prudential supervision, the solvency of the firms, with a conduct of business which are the rules on how the firms deal with those who buy their products.[538] To the extent of prudential supervision, it has maintained, albeit in a different form, virtually all of the provisions of the Insurance Companies Act 1982 and the marketing rules applicable to investment business developed under the Financial Services Act 1986. Hence, the scope of the Act regarding insurance contracts is about prior authorisation; which activity falls under the definition of regulated activity; accounting methods; the controllers of insurance companies themselves.

The difference of FSMA 2000 from other legislation is that many of the schemes which were self-regulatory have been given statutory status. Insurance Ombudsman Bureau or Lloyd's self-regulation formalised in the Lloyd's Act 1982 which was regarded by the government as unsuccessful and the 2000 Act now contains provisions whereby Lloyd's can be brought into the regulatory process. The FSA, the regulator of the 2000 Act, is required to keep itself informed about the way in which the Council supervises and regulates the Lloyd's markets and is free at any time to vary the authorisation (s. 315). Also, the General Insurance Standard Council (GISC) which was established in the wake of the repeal of the Insurance Brokers Registration Act 1977 and used to regulate general insurance business under a system of self-regulation is now regulated by the FSA since January 2005. The GISC had rules that incorporate two codes of conduct, one dealing with private customers and the other covering commercial customers and procedures to enforce the rule by way of

[537] There were some exclusions: death and sickness benefits contracts; policies providing for payment on death only within a period of 10 years; and single premium policies with no surrender value. See the Financial Services Act 1986, Sched. 1, para. 10.
[538] Lowry and Rawlings, 19.

disciplinary procedures. With respect to the duty of utmost good faith, these codes of conduct required members to explain the duty of disclosure to their customers both at inception and on renewal of a policy.[539] These rules are now only helpful in cases of disputes, such as where customers have complaints against former GISC-regulated firms. As the Financial Ombudsman Service would be unable to take over any investigation that the GISC had already begun, the GISC extended its Dispute Resolution Facility to see through to conclusion where possible any enquiries outstanding as at 13 January 2005. The FSA and the Financial Ombudsman Service fully supported this decision, and in September 2004 confirmed their expectation that firms which had been regulated by GISC up to and including 13 January 2005 would continue to co-operate in the resolution of complaints in accordance with the GISC Rules Practice Requirement.[540]

To the extent of the conduct of business, the FSA makes the Insurance Conduct of Business rules (ICOB) which provide rules in conducting insurance business. The reason the FSA makes the ICOB rules is because the European Parliament passed the Insurance Mediation Directive (IMD) but it was for the UK government to decide how the Directive should be implemented. HM Treasury decided that this should be within the regulatory framework of the FSA. The FSA has four objectives and the ICOB rules made accordingly. The regulatory objectives are listed in s.2 (2): "(a) market confidence; (b) public awareness; (c) the protection of consumers; and (d) the reduction of financial crime." With respect to the duty of utmost good faith, the rules seem to be applied to consumers and not commercial insurance.[541] This may be because one of the FSA's objectives is to protect consumers.[542]

It can thus be concluded that the existing legislation from a commercial aspect focuses on the stability of the financial market as a whole. The government leaves the

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[539] "Section C – The GISC General Insurance Code for private customers,"<http://www.gisc.Co uk/section.asp?Section_ID=3&st=>(1 July 2005); "Section D- The Commercial Code," <http://www.gisc.Couk/section.asp?Section_ID=4&st=> (1 July 2005).

[540] "GISC no longer regulates firms offering general insurance," < http://www.gisc.Couk/Rules.asp> (1 July 2005).

[541] ICOB Rules 7.3.6; rule 4.3.2 (3); and rule 4.3.

[542] "FSA, statutory objectives"< http://www.fsa.gov.uk/Pages/about/aims/statutory/index.shtml > (10 October 2005).

market to find proper mechanisms to solve the arising problems as a result of practices or to enhance its competitiveness to other markets.

In the year 2001, the London market has released the London Market Principles (LMP) 2001, a form of self-regulation, which has an impact on the way market operates in London as it replaces the old pattern of practices with a modern infrastructure. The London Market Principles 2001 thus merits closer consideration.

3.2 Self-regulation: The London Market Principles 2001

The London Market Principles 2001 (LMP 2001) are result of a Joint Working Group known as the Protocols and Standards Group (P&S Group) consisting of the International Underwriting Association (IUA), Lloyd's and the London Market Insurance Brokers Committee (LMBC) and Lloyd's underwriters. The incentive of its creation can be seen in the introduction of the LMP 2001 itself. In particular, the market realises that its processes and systems that have evolved are outdated. The LMP 2001 is intended to update working practices of the London market and is regarded as a solution to many of the problems that arise from the way business is done. The recommendations are not coercive but if accepted must be accepted as a package or not at all. In May 2000 a consultative document was set out to ask for the market's feedback. Then a revised plan was introduced to the market again with the hope that the market would formally support the program by signing the 'letter of intent' to agree to the plan.

The LMP 2001 focuses on four areas: 1) The Placing process; 2) The Claims process; 3) Performance monitoring; 4) Technology dependencies. The summary of the reforms can be seen in the LMP 2001 as follows: [543]

"These reforms seek to enhance the clarity of contracts and payment terms, and provide the broker with a single underwriter contact. However, vitally, individual organisations will remain in control of their own business decisions, and safeguards

[543] "LMP 2001 Report (Green book)," 12 Feb. 2001, <http://www.lmp2001.com/ ArchivedPubs.htm> (1 July 2005).

have been built in to protect followers. Clarity combined with flexibility, will allow incumbent practice to continue where it is favoured, with new mechanisms provided to achieve best practice where it is lacking. In summary, the reforms include:

- Changes to ensure roles, responsibilities, and schedules are clearly set out during placing for all required actions, including the resolution of outstanding issues and tbas (to be agreed).

- Premium and claims payment terms must be agreed during placing. They become a contractual obligation, with any consequences for non compliance clearly set out.

- Underwriter agreement clauses and supporting schemes will define the approaches for processing of contract changes and claims management.

- The approach for post-placement contract changes will allow the leader (and, where required, other agreement parties) to act for the whole of the following market, but with procedures built in to safeguard their interests.

- The claims agreement approach will be defined during placing, and will be by leader-only where desired, but with procedures to allow for the identification of additional agreement parties.

- A nominated lead underwriter will be the single point of contact with the broker/client during claims administration.

- A single insuring document will produced for IUA/Lloyd's participation, providing the client with a single evidence of cover.

- Uniform standards will allow, for example, a common contract management register for both Lloyd's and companies.

- Introduction of a benchmarking scheme will allow participants to understand how their performance in a number of areas compares to that of the market.

- Secure, robust, collaborative technology will allow for concurrent access to contract and claims information by authorised parties.

- Initial measures will begin immediately and continue into 2001, with the bulk of reforms being tackled throughout 2001."

To make the recommendations clearer and easier to understand, four detailed user guidelines describing the elements of the LMP 2001 programme at a business practitioner level have subsequently been published: 'The Purple Book' dealing with the London Market Contract Management Scheme and User Guide; 'The Blue Book' with the London Market Claim Scheme and User Guide; 'The Grey Book' with the London Market Systems Architecture and Best Practice Guidelines; and 'The Red book' with the Performance Monitoring Manual and Guidelines.

The LMP 2001 is dynamic and evolves with the market. In the year 2004, the LMP was established for use with binding authority agreements[544] and line slips in the year 2005 consecutively for clarity and certainty of contract. The thesis makes the assumption that the LMP 2001 should be the long-term solution to the problems regarding the duty of utmost good faith arising from the market practices. The next stage therefore illustrates the effect of the LMP 2001 upon the practice of the market and how it gets rid of the problems and creates the long term solution to the problems.

4 The London Market Principles 2001 and the duty of utmost good faith

4.1 The LMP 2001 and problems relating to the duty of utmost good faith at the placing process

[544] Five new model Binding Authority Agreements have been produced by the London Market Association (LMA) to meet the requirement of the new Lloyd's Delegated Underwriting Byelaw, namely, non-marine US LMA 3002; non – marine UK LMA 3003; non- marine International LMA 3004;marine LMP 3005; non- marine Canadian LMA 3006. LMP Slip templates have been developed for each of these and are available on the LMP website :
http://www.lmp2001.com/Binding_Authorities.htm
Alternatively, LMP slip guidelines for binding authority business shall be used to ensure that the LMP requirements are complied with. The LMP slip guidelines are also available on the same website.

It is said that problems regarding duty of utmost good faith at the time of placing where there is a non-disclosure or misrepresentation of material facts by the assured/ broker at placing of contract stage but not to the following markets can be solved by market practice through the use of leading underwriter clauses. This can be seen in *Bank Leumi Le Israel BM v British national Insurance Co (Bank Leumi).*[545] where it is said that in the event of dispute, the assured sues a representative underwriter, in return for an agreement from the others to be bound by the result of such action. In this case, therefore the leading underwriter clauses give the leading underwriter the right to defend liability on behalf of the market. However, it should be noted that there is no consistency in the market at the time regarding the scope of the leading underwriter clauses. Thus, it cannot be said that the authority to settle any dispute is always rested upon the leading underwriter.

As one of the key reforms in the LMP 2001 is to create clarity and certainty of contract, it is worth seeing whether it can bring about the certainty of this type of leading underwriter clause to every contract. What is therefore the effect of the LMP 2001 upon the placing process?

With respect to the placing procedure itself, the LMP 2001 has not changed anything. The LMP 2001 is not intended to interference with the existing risk placing method nor to determine the media or methods by which placing is achieved. It is merely intended to enhance the market capacity. Hence, at placing under the LMP 2001 there is the use of paper slips; emails to pass slips and other documents between market participants; document repositories with internet style access for the storage and communication of contract data; brokers' and underwriter's own electronic trading platforms.[546]In other words, under the LMP 2001 electronic means has become an important medium of communication between the assured/ broker and the insurers and amongst the insurers themselves in every process: placing; claiming; or performance monitoring. Therefore, the procedure of the placing process has not been changed as such but merely facilitated by the electronic means for easier access and less documentation.

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[545] [1998] 1 Lloyd's Rep 71.
[546] "LMP 2001 Placing version," 12 Feb. 2001, < http://www.lmp2001.com/ArchivedPubs.htm > (1 July 2005) at p. 4.

The LMP 2001, however, introduces several reforms to the market to create clarity and certainty of contract including specifying the scope of leading underwriter clauses. This has been achieved through subsequent release of several documents dealing with market placing: 1) the placing vision (Purple Book), released in February 2001; 2) the LMP slip which was introduced in October 2001 and was mandated by the Lloyd's Franchise Board for business incepting in Lloyd's from the 2nd January 2004. The LMP slip is now mandated and was last updated in April 2005;[547] 3) the General Underwriting Agreement (GUA). Online copies of these documents are situated in the LMP website at www.lmp2001.com

The LMP slip contains four separate sections:

1) Risk Details;
2) Subscription Agreement;
3) Information;
4) Fiscal and Regulatory

Under each section are minimum standard headings which must be clear from the start. Some variation can be made to the LMP slip to create persistent e.g. change of headings under risk details sections such as using "name of client" rather than "insured" or there will be contract specific slip headings that will need to be incorporated into the LMP slip to allow for any unusual or additional RISK DETAILS as deemed necessary. [548] At the same time to create clarity and certainty contract change cannot be made to "Subscription Agreements" headings. It is said that this part must not be changed, deleted, reordered or added to in any way and also must not include any additional headings. If there are particular provisions underwriters do not wish to apply to them, these can be explicitly stated against the relevant subscription

[547] After the introduction of the LMP slip in October 2001, the LMP slip has been enhanced referred to as the LMP BRAT [Broker Reform Action Team] slip. The LMP BRAT was the form first intended to be mandated on 2nd January 2004. However, because of changes and exemptions to the mandate, recent regulatory changes and further feedback from the market, the latest version of the LMP slip issued in April 2005 has been introduced and is used when this thesis is in writing.

[548] "The LMP Slip, April 2005," 14 Apr. 2005, <http://www.lmp2001.com/LMP_Slip1.htm>; <http://www.lmp2001.com/documents/Publications%20-%20LMP%20Slip/Theslip051.pdf> (1 July 2005) at p. 4.

agreement heading or specified as stamp condition.[549] To create clarity of contract, the use of any TBA's (To be Agreed/ Advised) that do not indicate the appropriate action to be taken by whom and by a specific date should be avoided. [550]

In order to derive consistent policy terms and claim agreements amongst the underwriters, the LMP 2001 enhances the use of the lead underwriter which is clearly specified on the slip from the start. The slip leader is specified in the Subscription Agreements part[551] and claim agreement parties. The scope of the slip leader introduced in parallel with the LMP slip is the General Underwriters Agreement (GUA) in the LMP slip, the latest version of which was issued in May 2005. The GUA provides that:[552]

"The GUA determines the basis upon which the specified slip leader and agreement parties for insurance and reinsurance risks to which this GUA is applied may act as agents of the other Underwriters subscribing to those risks, each for its own proportion severally and not jointly, in dealing with certain alteration(s), amendment(s) and additions to the contract of insurance or reinsurance evidenced by a slip, policy, certificate or otherwise."

There are six associated Class of Business (COB) schedules in the GUA covering Marine Hull, Marine Cargo, Marine Liability, Energy, Non-Marine and Treaty/ XL Reinsurance. The schedules identify the changes that may be agreed under the terms of the GUA and the number of Underwriters that are required to agree them. Changes under each COB may be agreed by the Slip leader alone on behalf of all underwriters or by the leader and Agreement Party(ies) on behalf of all underwriters or by each underwriter individually for their own proportion.[553]

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[549] Ibid., 5.
[550] Ibid.
[551] There may be more than one slip leader if the business involves external market. In such a case there may be London Market Slip leader and overall slip leader.
[552] "The General Underwriter Agreement, May 2005," 3 May 2005, <http://www.lmp2001.com/GUA.htm> (1 July 2005).
[553] "General Underwriters Agreement FAQs (Frequent asked questions)," 6 Feb. 2002, <http://www.Lmp2001.com/GUA.htm> (1 July 2005).

The GUA therefore provides consistent terms of leading underwriter agreements. However, if one looks at the schedules closely, it can be seen that the GUA merely deals with the alteration of the contract not the dispute settlements.[554] It should be borne in mind that the use of the GUA is not mandated. LMP Slips can use the GUA, existing Leading Underwriter clauses or any other risk specific agreement provision.[555] Nevertheless, most of the leading underwriter agreements deal also merely with alterations of risks and not dispute settlements.

The Subscription Agreements must therefore be looked at further as they mention about lead claim underwriters. Apart from having the slip leader agree to any change to the contract, the slip is leader is also involved in the claims agreement. The LMP 2001 Claims Protocol was first released in February 2001 followed by the LMP 2001 Claims vision, released also in February 2001. In the LMP 2001 Claims Protocol, the role and responsibilities of the slip leader are adjusting claims, negotiating with the insured or its broker and notifying all insurers of any proposed payments or settlements of a claim and other responsibilities dealing with the management of claims e.g. preparing claims files with all relevant information, entering data into CLASS,[556] consulting with other claim agreement parties, if any, to decide the course of action to be taken etc. and the rejecting or paying of claims.[557] Again nothing about dispute settlement is mentioned. The only thing mentioned regarding disputes is that the slip leader must inform the broker in the case where a dispute is likely to occur so that the broker can advise the assured.[558] Therefore it cannot be said that the leading underwriter agreements authorising the slip leader to deal with disputes on behalf of the others underwriters appear in every slip as part of the mandated LMP slip.

The arising question is therefore what real effect has the LMP 2001 upon the duty of utmost good faith?

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[554]"The General Underwriter Agreement, May 2005," 3 May 2005,<http://www.lmp2001.com/GUA.htm> (1 July 2005).

[555] Leading Underwriter Agreement General Marine (LUAGM); Leading Underwriter Agreement for Marine Cargo (LUAMC); Leading Underwriter Agreement for Marine Hull (LUAMH).

[556] The London Processing Centre (LPC) claims advice and settlement system as improved and upgraded to provide the functions required to support this protocol and to provide access to electronic claim files and relevant policy and premium information.

[557]"LMP 2001 Claims Protocol," 12 Feb. 2001, <http://www.lmp2001.com/Claims.htm> (1 July 2005) at p.7 para. 11.

[558] Ibid., 8 para. 11.9.

One of the LMP 2001's key reforms is clarity of contract from the outset. This is indeed what may minimise the defence of non-disclosure or misrepresentation by the underwriters since the obligations and the terms of the slip are clear from the beginning between both parties. In addition, if one looks at the LMP slip there is a section on the slip called "information". Under this section details of any information provided to the underwriters to support the assessment of the risk at the time of placing must be represented. In the case where the size or format of the information is not suitable for inclusion, it is said that it should be clearly referenced in this section and should be made available to all underwriters during placing.[559]

As for the following underwriters, the slip is usually the only evidence that they look at when they accept the risk, if in the information section, the broker or the assured fails to specify facts material to the risks, it should amount to misrepresentation or non-disclosure to each underwriter to whom they represent the slip. This would therefore get rid of the problem at placing regarding duty of utmost good faith by the assured or broker.

It can thus be said that the LMP slip plays a very important role in creating clarity of contract. One might argue that the LMP slip is mandated only at Lloyd's there is therefore no guarantee that there will be a widespread use of the slip in the whole market. The practice is however different. Even though the mandate does not apply to the IUA insurers; the IUA has published information to their members regarding the mandate and strongly encourages its use. In addition, it is not anticipated that brokers will prepare two formats of slip for the companies and Lloyd's markets, therefore the LMP slip will become the London Market standard.[560] Recent news letters of the market illustrated the increased use of the LMP 2001 and its success.[561]

Hence, it can thus be said that the LMP slip is the long term solution which solves the problem from the root. Its quality is maintained by a working group, Lloyd's slip

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[559] "The LMP Slip, April 2005," 14 Apr. 2005, <http://www.lmp2001.com/LMP_Slip1.htm> ; <http://www.lmp2001.com/documents/Publications%20-%20LMP%20Slip/ Theslip051.pdf> (1 July 2005) at p. 14.

[560] "The LMP Slip – Compliance with the mandate," <http://www.lmp2001.com/Documents/ Publications%20-%20LMP%20Slip/ Lloyd%27s_mandate_FAQs.doc > (1 July 2005).

[561] "Newsletters," <http://www.lmp2001.com/Reform_Newsletter.htm > (1 July 2005).

audit team, which regularly checks the quality of the slip. In addition, there is also a checklist for the parties involved to follow the requirements of the slip more easily.

4.2 The LMP 2001 and the contract for insurance

Even though facultative/obligatory open cover or treaty is not itself a contract of insurance but because of its obligatory nature upon the insurers where the insurers are bound to provide insurance as soon as in the case of obligatory open cover/ treaty is agreed by the insurers or in the case of a facultative obligatory cover as soon as declarations are made, it may be argued that the LMP slip should be applied. By using the LMP slip, the terms or conditions must be clear from the outset. As a result of this, disputes regarding duties and obligations of the assured and insurers arising from unclear wording or clauses specifying the nature of the open cover/ treaty would be mitigated. The assured would know from the outset that the open cover/ treaty even though obligatory in nature may contain clauses which make the open cover/ treaty become facultative obligatory which means that the assured must declare the risks in good faith for the risks mentioned in those clauses to be attached to the policy even though the clause is specified in an obligatory open cover/ treaty where declaration does not play any role in the risk attachments.

With respect to binding authorities, insurers delegate their authorities to enter into the contracts of insurance to the coverholder: other intermediaries, other insurers (insurers in foreign countries). It is said there is a fiduciary duty owed to the insurers by the coverholder.[562] In addition because the coverholder is given the underwriters' pen to write contracts of insurance, it is said that the relationship between the coverholder and the insurers is one of the highest degree of trust.[563] Hence, the coverholder must disclose all material information in relation to the binding authorities and business written under it. The duty of disclosure however does not include innocent failure to pass information. Hence, it is not the same as that under the duty of utmost good faith in insurance law.

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[562] *Sphere Drake Insurance v Euro International Underwriting* [2003] Lloyd's Rep IR 525.
[563] Ibid., paras. 42-46.

The LMP 2001 has now established a slip to be used with the Binding Authority Agreements (BAA). It introduces an LMP Slip for BAA business which has been mandated on 28 October 2004. Five new model Binding Authority Agreements have been produced by the Lloyd's Market Association (LMA) to meet the requirements of the new Lloyd's Delegated Byelaw.[564]The LMP Slip templates have been developed for each of these and are available on the LMP website- www.LMP-reforms.com. The LMP Slip for BAA business comprises five sections:[565]

1) Schedule
   This part is associated with the BAA wording. The new Lloyd's Delegated Underwriting Byelaw defines the details that must be covered within the schedule.
2) Non-Schedule Agreements
   Additional contractual information that should be declared to the coverholder.
3) Subscription Agreement
   Primarily to incorporate within specific headings the details previously listed as 'Internal Arrangements'.
4) Information
   Information provided to the underwriters to support the placement of the Binding Authority. e.g. previous premium/claims history, Estimated GPI.
5) Fiscal and Regulatory

One of the objectives of creating the LMP slip for a binding authority is also to create clarity and certainty of contract. This indeed is the reason why disputes regarding the non-disclosure of material facts under binding authorities would be mitigated as a whole.

Lastly, there was confusion about the legal basis of the relationship between the leading underwriter and following underwriters under the line slip, open cover or treaty. This is because the leading underwriter is delegated duties to accept risks on the following underwriters' behalf. The confusion was because of the clash of the

[564] Non-Marine US LMA 3002; Non-Marine UK LMA 3003; Non-Marine International LMA 3004; Marine LMA 3005; Non-Marine Canadian LMA 3006.
[565] "LMP Slip Guidelines for Binding Authority Agreements," 17 Sept. 2004, <http://www.lmp2001.com/Binding_Authorities.htm> (1 October 2005).

authorities. On the one hand, it is said that the leading underwriter is not an agent of the following underwriters but merely provides a trigger event by which the following market themselves comes to be bound by the declaration.[566] On the other hand, it is said that the leading underwriter is the agent of the following market.[567]

The LMP 2001 can clarify this solution as it introduces the General Underwriters Agreement (GUA) whereby the scope of the slip leader is clearly specified. It is clear that the GUA deals merely with alterations of risks and not risks acceptance. Hence, in authorising another insurer to accept risks on the insurers behalf, the line slip will come into play as it will be mandated from 1st October, 2005. There will be no usage of the leading underwriter to accept risks. The LMP lineslip clearly states that the lineslips are used by brokers to access a group of insurers who wish to delegate their authority to enter into contracts of insurance to another insurer in respect of business introduced by a broker named in the agreement.[568] It is clear from the word used "...delegate their authority..." that relationships between them are based upon agency. This is more an agency contract than a binding authority as in this case underwriters did not give away their pens completely. Underwriters in this case have closer relationships than those between underwriter and coverholder under binding authorities. Clarity of the LMP lineslip mitigates concerns that the slip leader will act beyond his authority which was the reason behind the introduction of the trigger by the authority.

4.3 The LMP 2001, agency and the duty of utmost good faith

It is clear that s. 19 of the MIA 1906 can accommodate all circumstances relating to agency arising from market practice. The wording of the duty under s.19 and its exceptions, provided under s.18 (3) of the MIA 1906 subsume all material facts which should be disclosed. It can be said that the knowledge of both types of agents, the agent to know and the agent to insure must be disclosed to the insurer as a result of s. 19. Even though s.19 merely mentions the agent to insure but the scope of material

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[566] *Mander v Commercial Union Assurance* [1998] Lloyd's Rep IR 93.
[567] *Roadworks [1952] Ltd v Charman* [1994] 2 Lloyd's Rep 99.
[568] "The LMP Lineslip," 26 July 2005, <http://www.lmp2001.com/Lineslip.htm> (28 August 2005) at p. 3.

facts includes facts which he ought to know in the ordinary course of business provided the chain of agency has not been broken.

As said earlier in this chapter, the use of the LMP slip is now mandated which potentially will be the usage of the entire London market. It is compulsory under the LMP slip that a UMR (Unique Market Reference) is used. It is said that: "... (vi) In respect of mid term market changes, where the handling broker changes, the new broker must keep and use the old broker's UMR. When the contract renews the handling broker can amend the UMR." [569]

Hence, the chain of brokers will appear in the slip if it is the same contract for reference. This would get rid of the question who is the agent to insure in the contract.

4.4 The LMP 2001 and waiver of duty of utmost good faith

Electronic insurance is now a common means in the commercial market. Since March 1992 it has been possible at Lloyd's to conclude contracts electronically by placing risks in the market by data interchange. The system allows the presentation of a risk package or proposal (and amendments to it) on screen: an electronic version of the traditional slip.[570] The problem as to whether there is a waiver of material facts by the insurers is unlikely to occur under the LMP 2001. They clearly support the idea of online insurance. However, the LMP slip, which is now compulsory at Lloyd's, still provides the heading "information" where the assured must provide details of any information supporting the assessment of the risk at placement.[571] This way, the insurers' intentions to acquire all material information still exist. It is therefore hard for the assured to allege that there is a waiver by the insurers.

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[569] "The LMP Slip, April 2005," 14 Apr. 2005, <http://www.lmp2001.com/LMP_Slip1.htm>; <http://www.lmp2001.com/documents/Publications%20-%20LMP%20Slip/ Theslip051.pdf> (1 July 2005) at p. 14.

[570] Clarke, 348 para.11-3A.

[571] "The LMP Slip, April 2005," 14 Apr. 2005, <http://www.lmp2001.com/LMP_Slip1.htm>; <http://www.lmp2001.com/documents/Publications%20-%20LMP%20Slip/ Theslip051.pdf> (1 July 2005) at p. 14.

With respect to the use of express waiver to limit the assured's duty of utmost good faith and the insurers' rights to avoid for breach of this duty,[572] the unsettled issue is whether the express exclusion of the assured's liability should also exclude the broker's fraudulent act. The majority of the House of Lords held that if it is to be applicable clear wording must be used.

The LMP slip provides that under the risk details section all obligations are clearly stated under the heading conditions, clauses in basic form must be specified and in the case where there is any amendment it must be clearly stated. Any non-standard wording or clauses must be referred to here and attached to the slip. Hence if there is any condition relating to the duty of utmost good faith e.g. express waiver of the duty of utmost good faith clauses must be clearly stated here. As the LMP 2001 also introduces a market wording database, consistency in the use of different clauses will be created.[573]

5 Conclusion

It is undeniable that commercial insurance market practice does not allow the duty of utmost good faith to operate without difficulties, especially the way the risks are placed in the market whereby the slip is used as a means to facilitate subscription placing. This thesis illustrates how the London market tries to find a way out by brainstorming all relevant sectors to get rid of all problems arising from the old infrastructure inherent in the market for hundreds of years. The thesis proves that the London Market Principles 2001 are the way to solve problems arising from market practice. The principles go to the root of the problem by creating clarity and certainty of contract from the outset. Hence, all facts material to the assessment of the risks must be presented on the slip from the start under the information section. As it is appeared on the slip, if the slip contains false information when a broker approaches each underwriter, there is a non-disclosure or misrepresentation of material facts to each of them. This way problems regarding duty of utmost good faith at the placing of the contract are solved.

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[572] *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd's Rep 61.
[573] "Market wordings database," < http://www.marketwordingsdatabase.com/ >, (1 July 2005).

In addition, clarity and certainty of contract applies to the terms and conditions of the slip. Hence, if there is a clause which limits the duty of utmost good faith clarity of contract will assist its usage and can avoid disputes amongst the parties. Moreover, the concept of clarity and certainty has been expanded to binding authorities and lineslips. As a result, the duties and obligations of the parties under them are clear from the start. Furthermore, the LMP 2001 introduces an audit team so that the tools of contract: the LMP slip, the binding authority and the LMP lineslip are regularly updated. This is very useful for future developments and suits the dynamic characteristic of the commercial insurance market.

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