

Answer Guidance for Chapter 22 Practice Questions

Explain and give examples of the following expressions:

- the duty of utmost good faith;
- material non-disclosure;
- insurance is a contract of indemnity;
- insurance covers loss caused by an insured risk;
- attachment of risk.

- *Carter v Boehm* established that insurance is a contract of 'utmost good faith' – now to be found in s17 Marine Insurance Act 1907. The primary expression of the duty is the assured's pre-contract duty of disclosure to the insurer of all 'material facts', for example, providing an accurate description of the goods pointing out any non-obvious characteristics which might affect the likelihood of loss or damage. Similarly, claims records, in respect of previous similar policies, would require disclosure. Prior to the 2015 Act a breach of the duty permitted the innocent party to avoid the contract. This is now only the case in respect of fraudulent or reckless breaches.
- Material non-disclosure is a breach of the duty of utmost good faith where the assured fails to disclose or mis-discloses material facts. Material facts are those which would influence the judgment of a hypothetical prudent insurer in assessing the premium or whether to take the risk and which would have influenced the actual insurer. In addition, the examples in the previous section, 'moral hazards', which are perceived as increasing the risk of un-meritorious claims are material facts.
- In indemnity insurance, the insurer agrees to indemnify the assured against insured losses, that is to say return the assured to the financial position he would have been in had the insured loss not occurred. Thus for example where goods have been totally destroyed (unless the parties agree on a 'new for old' basis) the insured is entitled to the market value of the thing which has been lost ie its second hand value.
- Insurance offers cover for loss or damage from a particular cause or causes, though even 'all risks' cover does not cover all losses. At its most obvious, if I insure my car against fire and theft but it is damaged in an accident then, although I have suffered loss, I cannot recover for that loss under that policy. A more difficult example would be where I insure goods against loss or damage in transit because, although I do not own them, I know that if they arrive safely the owner will hire me to install them in his factory. Unless the policy covers this purely economic loss (which a standard goods in transit policy does not) then, although I would suffer if the goods never arrive or are damaged in transit, I can make no claim under the policy which provides

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an indemnity only against loss or damage to the goods themselves and not consequential loss like mine.

- For example, if I buy an engagement ring for my fiancé, (s)he has insurance covering loss or damage to all goods belonging to her/him, but just before I give the ring to her/him it is stolen. In such a case, the loss to the ring is uninsured because the insurance has not attached to the subject matter of the insurance. In other words, the thing lost or stolen did not correspond with the definition of the property insured under the policy.

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2. The doctrine of utmost good faith provided insurers with an opportunity to unfairly reject claims they ought to pay. The 2015 Act has revolutionised the law in this regard. Do you agree with this statement?

Introduction

- As with all essays, you should begin with an introduction that sets out what the question is about, why the topic is an important one, and how your essay will go about answering the question set. By providing an outline structure of the discussion to follow, your essay will be clearer and more cohesive.
- The first thing to note is that the question contains not one but two statements and you will need to deal with both before reaching a reasoned conclusion. In this essay you have been asked to discuss the duty of the assured to disclose all 'material facts' to an insurer prior to the making of the contract and the result of a failure to perform this duty both in relation to the 'old' (pre 2015) and the 'new' law. You also need to give a critical response to the questions posed - ie did the old law permit unfair rejection of claims and has the new law revolutionised the situation.
- You could also consider how the doctrine developed beyond pre-contract disclosure and in particular the issues of what constitutes a fraudulent claim and continuing duties of disclosure. However this guidance will not cover this potentially interesting avenue of approach.
- We would suggest that structurally you should deal with the old and new law separately, setting out the pre 2015 law and then showing its effects of claims before turning to the law as laid out in the 2015 Act, ending with a conclusion which directly addresses the questions posed in the essay title.
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- As the printed book makes clear, there has been a good deal of criticism of the doctrine which has resulted in legislative change so far as consumer insurance is concerned but the chapter in the substantive text of *Commercial Law* is only concerned with commercial insurance and especially marine cargo insurance and coverage of the issues raised by this essay are only touched upon. However, the on-line chapter – 'Principles of insurance law' - does refer to this debate and you are referred to that chapter as an important initial source for your answer.

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What is the doctrine of utmost good faith under the pre 2015 law?

- You should refer to Lord Mansfield's judgement in *Carter v Boehm* and explain how the doctrine, as developed during the 19th century, was encapsulated in ss17-20 of the Marine Insurance Act 1906 pointing out that the principles apply whether the insurance is marine or not.
- It is also important to explain the effect of *Pan Atlantic Insurance Co-Ltd v Pine Top Insurance Ltd* and the objective and subjective elements as to what amounts to a material fact. You also need to point out that the non-disclosure need not relate to the actual cause of loss possibly including a sensible example and include an explanation of 'moral hazard'.
- Finally, in this section you need to explain that the effect of material non-disclosure at this stage probably confined to pre-contract non/mis-disclosure and the implications of nullity *ab initio* on previous claims as well as any which are unpaid along with the need to return any premiums paid.

Did the doctrine allow unfair avoidance?

- As noted above, materials in the on-line chapter will provide you with additional sources. However there are certain points which are clear and a good strategy might be to illustrate how unfairness might be manifested by reference to these points. The principle arguments for unfairness are:
 1. The duty extended to provide information which the assured did not himself know.
 2. The duty extends to information which the assured does not know is material to the insurer. This is often particularly problematic in the case of 'moral hazards'. *Commercial Law* gives *Glicksman* as an example.
 3. There was only one 'remedy', nullity, as *Banque Financiere de la Cite v Westgate Insurance Co Ltd* establishes and 'all or nothing' outcomes are rarely satisfactory in law, especially where as points 1 and 2 make clear, there can be two innocent parties involved.
 4. The material which had not been disclosed may have no connection with the cause of the loss – yet, because of point 3, the insurer could avoid the policy and refuse to pay.
 5. Note this point is only relevant only if you decide to cover the doctrine of utmost good faith in circumstances pre-contractual disclosure. If it is true (and it is not at all

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clear that it is) that the duty of good faith applies in full force even after the stage of formation of contract, then the insurer can recover payments made even before the breach since the policy is invalidated retrospectively. This is particularly potentially unfair. However, there are only two points at which such a breach is likely to occur – at decision points during the life of the policy where there is a request to vary the risk covered and at claims stage. In the first instance it seems only the variation is invalidated while the courts seem to regard fraud confined to the claims stage as analogous to a repudiatory breach of contract resulting in only a prospective escape from contractual duties by the insurer.

Utmost good faith and the 2015 Act.

- It is worth noting that the doctrine of utmost good faith has not been abolished under the Act (s14 IA 2015). It is simply that what amounts meeting the duty imposed on the insured to disclose all material facts and not to make misrepresentations has been re-defined.
- The duty of the insured in relation to pre-contract disclosure is now the duty of fair presentation - s3 IA 2015. The temptation here is simply to recast the statutory wording without showing you have understood what it all means in practice. One possibility might be to take a case - we suggest *Pine Top* - and consider whether the presentation there would meet to 2015 Act requirements. An alternative might be to turn to the Law Commission Report, Law Comm 353 Insurance Contract Law: Business Disclosure, where there is a good deal of relevant material - especially in Chapters 3-8 and Chapter 11.
- You now need to deal with the reform of the remedies for breaches of the duty of fair presentation set out in s8 IA 2015. The key here is to note that the sole remedy, the right of the insurer to avoid the contract ab initio has been replaced with a range of rights from giving no remedy (for example where the breach by the insured is not fraudulent or reckless and does not contribute to the loss) through the right to reduce the sum payable in respect of a claim (possibly to zero) on normal contractual principles to avoidance of the policy in the case of fraudulent or reckless (non)disclosure.

The 2015 Act - revolution or evolution?

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- You will already have explained that the 'sole remedy' problem under the old law was problematic for the insured. However the development by the Courts of an elaborate doctrine of waiver in relation to the insurer's right to avoid the contract, as a means of reducing the draconian effect of avoidance, often resulted in insurers being forced to pay wholly unmetititious claims through minor acts which were construed as amounting to a waiver of rights.
- It seems clear that the closer alignment of insurance contract law with 'normal' contractual principles in relation to misrepresentation in relation to remedies is revolutionary. We should point out that whilst there is a temptation when writing an essay to assume that a critical approach must necessarily mean you disagree with the viewpoint to the examiner this is not so. We have here a good example of historical development in the law. If you read *Carter v Boehm* Lord Mansfield seems to be setting down the duty of utmost good faith as a general principle which applied to all contracts not merely contracts of insurance. This position did not survive the 19th century process of formalisation of the law of contract as we now know it except in relation to insurance and it is interesting to see how statute has further modified Lord Mansfield's doctrine.
- However the general view of insurance practitioners is that by the 21st century the duty of pre-contractual disclosure was best described as one of 'fair presentation'. The Act does clarify doubtful points of law in a couple of ways as the on-line chapter shows, but otherwise the Act simply makes the law more readily understandable to the non-specialist.

Conclusion

- You might decide that you need no specific conclusion and that is a perfectly legitimate but there is some material you might consider which supports the retention of the 'old' utmost good faith doctrine.
- Firstly, material non-disclosures will normally only become apparent when there is a claim. To allow any recovery is to incentivise non-disclosure. If there is no casualty the assured will have paid a low premium reflecting the risk he disclosed to the insurer – the assured 'wins' while if the penalty for being discovered is simply to have one's claim reduced by the difference between the premium paid and the premium which would have been charged means the assured does not lose. Secondly, the effect of widespread fraud is to increase premiums for all. The nullity rule provides a disincentive to fraud and, though perhaps providing short term windfalls for the insurer, these are in effect redistributed amongst the insured

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population, since the insurer will have a target rate of return on his capital employed and the windfalls will be reflected in future premium rates.

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Shippam had two containers of goods he wanted to transport by sea. He contacted Carrie Cont Ltd, a sea carrier which he knew would offer a cheap rate for carriage because a number of containers of goods carried by them had disappeared over the last few months and Carrie Cont had 'a bit of a reputation' as a result.

Carrie Cont issued a warehouse receipt to Shippam stating the two containers had been received by Carrie Cont at their dockside warehouse and were ready for loading on board the ship. Shippam insured both containers of goods with Marinsco. While the ship was at sea, Shippam sold the goods to Bayer passing over the receipt and insurance policy in return for the price.

The first container of goods were not unloaded at the port of discharge and, owing to a computer malfunction, Carrie Cont does not know whether they were loaded onto the ship or not.

When the second container was unloaded staining was discovered on the goods so they are ruined. There are three theories how this might have happened. Firstly, since the container was carried on deck sea water entered it. Secondly, that the goods had 'sweated' during the voyage causing condensation which had condensed on the roof of the container and rained on the goods, and, thirdly, that water in high pressure hoses used by Carrie Cont to wash down the container in the warehouse as required by the port health authorities had penetrated the container which was in a poor condition.

Bayer claimed on the policy for both losses. In respect of the first claim, Marinsco asked for proof of the cause of loss. Bayer argued that it is obvious that he has a claim but the insurer persists. Bayer contacted Shippam and Shippam in order to help Bayer, forged a letter from the Carrie Cont stating that the goods had been loaded on the ship and must be presumed to have been off loaded at the wrong port and have since been lost. Shippam forwarded this letter to the Marinsco who then decided to pay the claim.

Marinsco has now discovered all of the facts – though no-one knows what caused the staining in the second container. They want to know whether they can recover the money they paid to Bayer in respect of the first container and resist his claim in respect of the second container.

Introduction

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- Many students think that only essay questions require an introduction, but this is not so. Answers to problem questions should also begin with a lucid and well-structured introduction that clearly highlights the area (or areas) of law to which the question relates. By doing this, you demonstrate immediately that you have understood the question and have clearly identified the relevant legal topics.

- The question is best tackled by dealing with each container in turn after pointing out:

1. That Bayer, although not the original contracting party with the insurer, nevertheless has all of the rights of the insured under the policy by virtue of the fact that delivery of a policy of marine insurance can affect an assignment of the benefit of the insurance to the recipient – s 50(3) Marine Insurance Act 1906. It is accepted that no endorsement of the policy is necessary in a Cif sale but this may not be such a sale. In that event, whether the policy will require endorsement for the assignment to take place will depend on whether it is customary for assignment to be effected in this type of trade without endorsement.

2. That Bayer does have an insurable interest under the policy even if (which is unknown) the losses occurred before he bought the goods by virtue of s50 MIA 1906.

- In this question, the issues are principally whether the claimant can prove that the cause of the loss was covered by the policy, whether the policy can be avoided for breach of the duty of utmost good faith, the effect of such an avoidance and if not what rights the insurer has.

- 1st Container

Cover. In order to succeed, B must show it is more likely than not that the goods suffered loss through an insured risk. We do not know what risks are covered by the policy but, if it is on an Institute Cargo Clauses B or C basis, there will be no cover since perhaps the most plausible reason for the disappearance is theft and neither covers loss or theft of the goods. However, there could be a claim if B can show that the cause of the loss was jettison (B or C cover) or, washing overboard or total loss overboard on loading/unloading (B cover only), though it would seem unlikely that such losses would not have been known to the carrier. However, ICC A covers all risks, including theft, and the very fact that the location of the goods is not known suggests loss by carrier or theft, both of which are covered under an all-risks policy. However, there is the possibility that the goods were never received by the carrier and, as *Fuerst Day Lawson Ltd v Orion Insurance Co Ltd* demonstrates, ICC A does

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not cover an inevitable loss like this, but only covers 'fortuities'. Indeed, since under ICC Clause 8, cover under the policy commences when the goods are first moved in the warehouse for the purpose of immediate loading at the commencement of the transit, if the goods were never delivered to the carrier or indeed were stolen or lost before being moved to the ship, the goods were never actually insured under the policy. *Gaunt* suggests that the insured must eliminate the likelihood of non-fortuitous loss (like non-delivery), but otherwise it is for the insurer to show that the cause of the loss was not covered by the policy. Here, since the carrier has issued a receipt for the goods it should be straightforward for the insured to show that the likely cause of loss is loss or theft in transit.

There remains the theoretical possibility of the insurer showing that the cause of loss is excepted under ICC 4-7. Though this is unlikely, it is at least possible that the insurer might pursue an argument that the price negotiation, knowing the carrier was suspect, amounts to wilful default. The burden of proof is high – see the principles discussed in *Papadimitriou* but the issue is worth mentioning.

Can the policy be avoided ab initio for material non-disclosure? There are two issues here. Firstly has there been a breach of the duty of fair disclosure by the insured and secondly, if yes the remedy available. There is a possibility that there has been a breach of the duty of fair disclosure since there are known problems with the reliability of the carrier. It was established in *Pan Atlantic* that any fact that may 'influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk' must be disclosed. This position is retained by s7 IA 2015 with a slight amplification. *Pine Top* established that this involves a two-part test and this too is carried through to the 2015 Act. Objectively, would a prudent insurer have taken the circumstance into account and subjectively was the insurer actually induced to enter into the contract through the non disclosure? It is certainly plausible that the carrier's unreliability was disclosable. Should the insurer have known the reputation anyway (see ss3(5)(b) and 5(3)(b)? Also was he actually induced to enter into the contract because of the non-disclosure? These issues are ones of fact and so in the absence of more information we can go no further. The fact that B is an innocent assignee does not matter if there was material non-disclosure; B is still bound by S's fault.

However, even if the insurer can overcome these problems there is the issue of his remedy. Under the old law he could avoid and thus refuse to meet any claims assuming he is prepared to return the premiums paid. However under the 2015 Act only fraudulent or reckless mis-disclosure permits the insurer to avoid. (Sch 1(2)). Again the state of the insured's mind is a matter of fact to which we have no access

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but it is worth pointing out that the duty to show fraud or recklessness is on the insurer (s8(6)) and although proof is on the normal civil basis of the balance of probabilities fraud or recklessness is a less likely explanation for the mis-disclosure than negligence and so the insurer will usually need to bring compelling evidence to prove its case.¹

Assuming that the failure to disclose the carrier's reputation was mis-disclosed but Marinsco cannot prove fraud/recklessness then what is its remedy?. You need to refer to S8 and Sch1 IA 2015 for this material.

- Turning to the fraud by Shipham the issue is whether the claim be avoided for fraud. In *Agapitos v Agnew* [2002] the Court of Appeal held that if an insured was involved in 'fraudulent devices' in the course of a claim that claim was forfeit. Clear examples would be making a fraudulent claim or fraudulently inflating the amount of a valid claim. The *Mercandian Continent* has facts very similar to ours and here the court treated aducing fraudulent evidence to support an otherwise valid claim fell within the definition of fraudulent devices. However In *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG* [2016] UKSC 45 the Supreme Court held that fraudulent devices did not include cases 'where the insured is trying to obtain no more than the law regards as his entitlement and the lie is irrelevant to the existence or amount of that entitlement...'. Therefore Marinsco can recover the money it paid on the basis of a restitutionary claim for money paid in the mistaken belief that Bayer had proved its case but the policy remains in force and if Bayer can prove the loss was covered by the policy it is entitled to make a claim.

- Second container.

Cover. Whichever of the three possible causes applies, prima facie ICC A will cover the cause of loss, being all-risks cover. ICC(B) only provides cover if the loss is caused by sea water entry, but not if through condensation or through pressure washing, since neither is on the list of insured risks listed in the respective policies. ICC(C) provides cover for none of the possible causes. Consequently, the assured has little difficulty under ICC A and has no chance under ICC C. However, if he has ICC B it can

¹ See Lord Hoffmann in *Secretary of State for the Home Department v Rehman* [2001] UKHL 47 who said, "it would need more cogent evidence to satisfy [a judge] that the creature seen walking in Regent's Park was more likely than not to have been a lioness than to be satisfied to the same standard of probability that it was an Alsatian."

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be appreciated that although theoretically covered, Bayer will have to show which of the three possible causes of loss was actually responsible – the burden is on him to show on the balance of probabilities that the cause of loss is covered under the policy. In this instance it may not be difficult, since presumably the stains will contain a residue of salt if the staining is caused by sea water, but often it is actually impossible to prove a cause of loss at sea definitively. Previously, the claim that the loss was caused by an ‘unknown peril of the sea’ was of benefit to such a claimant since the insuring clause in the old SG policy was until 1982 insurance against perils of the sea. That clause has now gone and the assured must prove loss caused by an event listed in the policy.

Can the policy be avoided for material non-disclosure? In respect of the carrier's reputation the issues are exactly as with the first container. However there is another problem with the second container since it was carried on deck and this is probably a disclosable material fact which, if not disclosed means consideration of the same issues as with the other non - disclosures..

It should be noted that there is a problem with attachment under ICC if the loss was caused through the hoses in the warehouse before loading. In such a case there would be no attachment (though there would if the insurance is like in *Wünsche Handelsgesellschaft*). If the hosing was in the warehouse after discharge, then the policy will no longer be attached to the policy if this warehouse is named in the policy as ‘the final warehouse or place of storage’ by virtue of the operation of ICC clause 8.

Was the cause of loss excluded? There are two potential problems:

1. Inherent vice if caused by condensation. *Noten v Harding* does suggest that the condensation would be inherent vice and nothing in the *Cendor Mopu* casts obvious doubt on the decision. That said, the heating and cooling in the container was caused by the voyage, so presumably the goods would not have been damaged but for exposure to marine perils. So did they really damage themselves? 2. Unsuitability of container – a potential problem if the loss was caused either by the pressure hoses or seawater penetration. However, note the protection afforded to the insured by ICC 4(3).

- Conclusion. Only a short conclusion is needed – perhaps pointing out the advantages of all risks insurance.