

## Non-disclosure and breach of warranty issues in the light of English Reform of the Marine Insurance Law

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London is one of the major centres of reinsurance in the world<sup>1</sup>. Many of reinsurance and insurance contracts are subject to English law. A lot of disputes are referred to English courts or arbitration tribunals. But English insurance law is currently criticised as outdated and ruthless to policyholders. Indeed, the Marine Insurance Act (English codified legislative body applicable to the contracts of marine insurance) was enacted in 1906. This statute has only been slightly amended since this date. Unless the contract otherwise provides, the Act applies as a matter of English law and is frequently made applicable by an express provision in marine or similar insurance contracts<sup>2</sup>.

English Law Commission (a body set up by statute for the purpose of promoting law reform) is currently reviewing English insurance law. It started the review in 2005 inviting different institutions involved in marine insurance market to provide its comments on the issue. In 2006 the Law Commission issued a scoping paper on areas of insurance contract law suitable for possible reform. The papers included misrepresentation, non-disclosure and breach of warranty issues. Following responses received, the Commission issued Issues Paper 1 on Misrepresentation and Non-disclosure in September 2006 and Issues Paper 2 in

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<sup>1</sup> As well as, for example, Paris, Switzerland, Unites States, "Proposed English Insurance Contract Law Review", Clyde and Co news letter 2006, p. 10.

<sup>2</sup> Julien HILL, "Marine Insurance Law", London Metropolitan University, Lloyd's Maritime Academy, 2006-2008.

November 2006 on Warranties. The Commission intends to publish a Final Report with a view to possible legislation in 2009 or 2010<sup>3</sup>.

The initial proposal of the Law Commission to reform some marine insurance issues met however a strong opposition from the insurance industry and suffered even some conservative government's reluctance<sup>4</sup>. As a result the Law Commission has excluded marine insurance issues relating to non-disclosure and warranties from the scope of its reform, arguing that the people working in this market were professionals who "operate in a market governed by long-standing and well-known rules of law and practice and can reasonably be expected to be aware of the niceties of insurance law"<sup>5</sup>. The question remains whether this exclusion is realistic reflection of the insurance market?

In fact, this exclusion only partly reflects the reality of the insurance market. If the most of the marine insurance market actors are the professionals, there are also the non professionals who can be compared in some way to consumers. It should be recalled at this regard that the current Reform aims to respond foremost to the expectations of the consumers. In marine market they are fishermen and many other small leisure businesses who are not inevitably conscious of all niceties of insurance law. Some marine insurance rules seem to be unfair to this category of assured and thus may need to be reformed.

#### *Non-disclosure issue:*

##### *Pre-contractual duty of utmost good faith*

According to general principle, the law has to reflect to reflect accepted notions of fairness. An applicant for marine policy has to disclose all material facts, regardless of whether or not he is asked the relevant questions<sup>6</sup>. He bears a positive duty to disclose, to speak about the risk and what is said must be truthful. This duty is known as duty of utmost good faith or *uberrimae fidei*. The justification of this rule lies in the inequity of knowledge between the parties to the insurance contract. This duty and the remedy for its breach derive from *Carter v.*

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<sup>3</sup> "Marine Insurance Review 2006", Clyde and Co news letter 2006, p.10.

<sup>4</sup> Notably to introduce more laws interfering with contractual relationships, Andrew HICKS, "Insurance Law Reform", Law Lectures for Practitioners, 279-307.

<sup>5</sup> The Law Commission, "Insurance Law: Non-disclosure and breach of warranty", § 2.8.

<sup>6</sup> See Marine Insurance Act 1906, Section 17-21.

*Boehm* case [1766]. If an insurance policy is issued by the non-disclosure of a material fact, insurer may set the policy aside. This is so whether the non-disclosure was innocent, negligent or fraudulent. If there is no fraud the insurer will return the premium but the claims will be not payable.

The circumstance is considered to be material if it “would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk”<sup>7</sup>. A material fact is one that would have an effect on the mind of a prudent underwriter and not on the mind of the actual underwriter. The judges will apply a so-called “prudent underwriter test”, the standard being the hypothetical “reasonable” insurer. Thus, the insurer’s behaviour will be compared to an objective standard<sup>8</sup>. It is therefore possible for an assured to act honestly and still fail to meet the required standard of disclosure.

The insurance industry advanced the argument that the law should not be changed as their Statements of Insurance Practice already provide that the insurers should not 'unreasonably' repudiate where the assured fail to disclose a material fact. But as Andrew HICKS correctly points out, these statements are only voluntary recommendations and they leave it entirely to the insurer to judge whether or not the repudiation would be unreasonable<sup>9</sup>.

The Australian Insurance Contracts Act 1984 replaces the prudent underwriter test by a prudent assured test. One advantage of this approach is that it removes the Common law difficulty that the insurer’s own method of assessing the premium had no parallel elsewhere in the market and accordingly could not be subjected to an objective materiality test<sup>10</sup>. But Australian Insurance Contracts Act 1984, aimed at consumers, does not apply these changes to the marine insurance.

Regarding all said here above, it can be proposed to distinguish inside marine insurance on one side “non professional” and, on the other, “business” contracts, in order to apply the prudent assured test to the former. But this would not lead to simplify the law and may increase legal disputes. Expecting a different standard of disclosure from different classes of person means that it will be difficult for legal

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<sup>7</sup> Marine Insurance Act 1906, Section 18 (2).

<sup>8</sup> See, for example, *CTI v Oceanus Mutual Underwriting Association (Bermuda)* [1984] 1 Lloyd’s Rep. 492.

<sup>9</sup> Andrew HICKS, “Insurance Law Reform”, Law Lectures for Practitioners, 279-307.

<sup>10</sup> Robert Merkin, “Reforming insurance law: is there a case for reverse transportation?”, report for the English and Scottish law commissions on the Australian experience of insurance law reform.

advisers to predict whether that particular proposer should have disclosed the particular fact which he failed to disclose. Andrew HICKS suggests an alternative approach which is to abolish the general duty of disclosure so that the proposer is merely expected to answer the questions in the proposal form. He points out however that there is a risk that insurers will raise general questions which will re-impose the obligation to disclose<sup>11</sup>.

Another grievance made to the Marine Insurance Act 1906 was the one regarding the causality. But since "*the Pan Atlantic Insurance Co*"<sup>12</sup> the actual position is that the remedy of avoidance depends on the material non-disclosure being causative to the contract: "there was to be implied in the Marine Insurance Act, 1906, a requirement that a material misrepresentation would only entitle the insurer to avoid the policy if it induced the making of the contract; and a similar conclusion was to be reached in the case of non-disclosure; the decisive influence test would be rejected". This is known as an "actual inducement test". This position seems to reflect the accepted notions of fairness and to respond better to the expectations of the actual insurance market.

#### *Post-contractual duty of utmost good faith*

It should be mentioned that the insured also bears a post-contractual duty to disclose all material facts. The scope of this duty, and precisely, the remedy for its breach is however different. This has been recently considered in the following cases: *The Star Sea* [2001], *Agapitos v Agnew* [2002], *The Mercandian Continent* [2002]. In the case of a breach of a post-contractual duty of utmost good faith the remedy would be "the damages to compensate the injured party for its actual proved loss, with avoidance only in respect of a material fraudulent act"<sup>13</sup>. It has been decided in *The Star Sea* that in the post contract context the avoidance of the contract *ab initio* will only be granted if the breach of this duty is at least as serious as a repudiatory breach of the contract. So, the wide-ranging interpretation of *The Litsion Pride* case is not followed any more.

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<sup>11</sup> Andrew HICKS, "Insurance Law Reform", Law Lectures for Practitioners, 279-307.

<sup>12</sup> See *Pan Atlantic Insurance Co v Pine Top Insurance Co* [1994] 2 Lloyd's Rep. 427.

<sup>13</sup> Comments of Susan HAWKER, "Marine Insurance Law", London Metropolitan University, Lloyd's Maritime Academy, 2006-2008, p. 37.

### Warranties issue:

The English courts construe warranties<sup>14</sup> more strictly in marine cases than in other forms of insurance.

In its 1980 Report The Law Commission recognised that the law of warranties was unsatisfactory for following reasons: “cover could be lost for failure to comply with a term immaterial to the risk; there was no need for a causal link between the breach and the loss; warranties ... were not readily accessible to the assured; and basis of the contract clauses ... deemed all statements to be warranties, whether or not they were material to the risk and without drawing the assured’s attention to them”<sup>15</sup>.

In English law insurers can rely on a breach of warranty by way of defence even though the loss is completely unrelated to the breach. Even the fact that the insured may have remedied the breach before the loss occurred is irrelevant<sup>16</sup>.

The Law Commission’s solution proposed to require insurers to pay despite a breach of warranty if the assured could show that the breach of warranty was immaterial to the risk and that there was no causal connection between the breach and the loss. It was also of the view that whether or not the insurers were required to pay, they could give notice terminating the policy for the future.

Warranties are designed to delimit the risk that insurers accept to run. Indeed, it is important that insurers should be able to define the risks they insure and that they should not face liability for any other risk<sup>17</sup>. However, the original conception has been abused, as it has become common practice for insurers to demand warranties of all manner of matters, many of which would have even had no impact on the underwriting decision. Such as, for example, the marine premium payment warranty which guaranteed payment of premium instalments on given days.

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<sup>14</sup> It is important to distinguish a warranty in the English law of contract and a warranty in English insurance law. In contract law, a warranty is a term or promise in a contract, breach of which will entitle the innocent party to damages but not to treat the contract as discharged by breach. In insurance law a warranty is a contractual promise by the insured, breach of which will entitle the insurer to treat the contract as discharged by breach. The word therefore has the same meaning as “condition” in the general law of contract, *A Dictionary of Law*, Edited by E. A. Martin, J. Law, Oxford, Sixth Edition, 2006, 573.

<sup>15</sup> Law Commission Issues Paper 2, « Warranties », published 28/11/06.

<sup>16</sup> “Marine Insurance Review 2006”, Clyde and Co news letter 2006, 1.

<sup>17</sup> Robert Merkin, “Reforming insurance law: is there a case for reverse transportation?”, report for the English and Scottish law commissions on the Australian experience of insurance law reform.

Moreover the reality of the insurance market has changed. The doctrine that marine warranties should be strictly construed comes from 18 century. It has been developed by Lord Mansfield. This principle has been upheld in the modern time in *The Good Luck* [1991]. The difficulty, however, is that the breach is usually only discovered after a loss has occurred. This doctrine is understandable where the loss is related to breach, but where the breach relates to a different risk, and is immaterial to the loss, the remedy can seem excessive nowadays, because the amount of information available to insurers has changed.

The aim of the MIA enacted in 1906 was to address the inherent imbalances of knowledge between the assured and the insurer<sup>18</sup>. However, in the 21 century the legal requirements and modern technologies have rendered some MIA requests a little bit outdated. Today the insurer seems to be in most favourable position, although the initial goal of the MIA is to counterbalance the position of the contractors. Nowadays, for example, the ISM and ISPS Codes require a large body of records to be kept, including records of training, security threats, internal audits and reviews. This means that marine risks today resemble more the other risks in the market. Insurers are less reliant on the good faith of the assured. They can verify the information through a variety of surveys and audits. In this context, the strict construction of warranties seems to be no longer justified. It seems that these rules on marine warranties do not really meet the needs of actual international market. Moreover the drafters of the Insurance Reform did not find any commentators outside the common law sphere who consider it is fair for an insurer to fail to pay a claim for a breach which is not connected to the loss<sup>19</sup>. Following complaints from the fishing industry, Australia reviewed its marine insurance law in 2001. It recommended that a breach of warranty should justify avoiding a claim only if it is linked to the loss. Within jurisdictions that share the legacy of the Marine Insurance Act, the courts do not usually accept arguments that a claim unlinked to a breach should not be paid (see, for example, US Supreme Court in *Wilburn Boat*; Supreme Court of Canada in *Bamcell II*).

For these reasons, and for the considerations of fairness and legal simplicity, we think that the causal connection test should apply both to express and implied marine warranties. Regarding Seaworthiness, Portworthiness and

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<sup>18</sup> Marine Insurance Review 2006", Clyde and Co news letter 2006, p.10.

<sup>19</sup> Law Commission Issues Paper 2, « Warranties », published 28/11/06.

Cargoworthiness, it seems more beneficial to lessen the difference between the time and voyage policies. In time policies the insurer has already to prove that the breach was dominant cause of the loss. If it works in time policies, it would work in voyage policies. The warranty of legality, subject to the general doctrine of illegality, which prohibits the insurer to enforce an illegal contract even if the loss was unconnected to the risks, corresponds to the public policy and the realities of the actual marine market.

The UK Law Commission thought undesirable to disturb the basis of legal certainty in this very competitive international market. But this argument is not really persuasive. The Institute clauses<sup>20</sup> are reviewed regularly to replace the old non-adapted principles by the new clear ones. Moreover, some authors<sup>21</sup> note that it would obviously be simpler and would avoid “boundary disputes” if the same rules were applied to all types of insurance. However, the particulars of different fields can not be ignored.

In conclusion, it should be mentioned that if these issues are not subject of the current English Insurance Reform, the European Union (EU) legislation promoting the coherence in the EU countries may incite the changes in this field in the future. The European Commission published an Action Plan in 2003 calling for the improvement of the coherence of the UE legislation and promoting the UE-wide standards terms. The development of a Common Frame of Reference is being established. This would contribute to set out common fundamental principles of contract law in European Union.

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<sup>20</sup> The Institute clauses are standardised clauses for the use of marine insurance. Their drafting and use are maintained since the 19th century when Lloyd's and the Institute of London Underwriters (a grouping of London company insurers) developed them for the first time. These are known as the Institute Clauses because the Institute covered the cost of their publication.

<sup>21</sup> “Reform of Insurance Contract Law, are there problems with English insurance contract law? If so, what areas should be the subject of reform?“, Report of a joint seminar held by the British Insurance Law Association and the Law Commission on 19th January 2006 in the Old Library at Lloyd's, Report prepared by Marcus Mander.

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