Waiver: Implications for Underwriter Conduct

by Derrick Cole and Geoffrey Lloyd

The recent case of *Wise (Underwriting Agency) Ltd v. Grupo Nacional Provincial SA [2004] 2 Lloyd's Rep 483)* heard in the Court of Appeal is significant not on the basis of the actual judgment which was decided on "affirmation" of the contract but in the different approach by two of the learned law lords to the subject of "waiver" of material facts by the underwriter.

Longmore and Rix LJJ, being very distinguished Court of Appeal judges, well versed in insurance disputes, nevertheless failed to agree on the duties of an underwriter at the time a risk is presented. No proposal form was used in this case. Longmore LJ relied on the helpful case of *Marc Rich & Co AG v. Portman [1996] 1 Lloyd's Rep. 430* where he (then as Mr Justice Longmore) had defined waiver. He held that the question is whether:

> *"a fair presentation of the risk was made to the underwriter and whether such a presentation would put a reasonable underwriter on notice of the existence of other (non-disclosed) material circumstances"*

This meant, therefore, that there were two limbs to the waiver:

1. *a fair presentation which puts the insurer on notice of possible risks; and*
2. *a failure by the insurer to follow the matter up*

Longmore J also observed that:

> *"it is no part of an assured's duty, if he has otherwise complied with his duties, to tell an underwriter how he is to do his job"*

Whilst we can go along with that comment we have profound reservations about another of the learned judge's comments when he said:

> *"it was not incumbent upon an insurer to ask express questions"*

Good market practice over our very many years in the insurance business would indicate otherwise.

The *Marc Rich* case was a clear ruling in 1996 of the duties of the underwriter during the presentation of the risk but we have been uneasy about parts of that judgment. In the *Wise* case, Rix LJ on the other hand, did not accept what he describes as the two stage approach, arguing that the underwriter has a duty to ask "obvious" questions. He seems to be implying that the underwriter has a duty to ask

obvious questions irrespective of whether he had been put on enquiry. We see this as a welcome development.

It would be remarkable if, when a proposal for fire and other catastrophe perils insurance is being made to an underwriter and the broker fails to reveal the construction of the building, the underwriter does not bother to ask questions about the construction. That is obvious to anyone experienced in the practice of underwriting. However, if the broker mentions that the proposer has a poor loss experience – perhaps even attempts to gloss over it – and the underwriter fails to ask for comprehensive details concerning dates, circumstances and amounts of loss, he cannot at a later date avoid the contract for material non-disclosure, assuming that it was materially significant. Poor claims experience invariably is significant to an underwriter; indeed, claims experience is usually the starting point in any discussion about a new risk between underwriter and insurance broker.

Similarly, if the broker is unable, in the above example, to give an unqualified assurance that the building is of standard construction, good practice in the market would require the underwriter to probe the broker for full details e.g. if there is perhaps reason to believe that part of the roof is flat, what is the extent of it? What are the materials? In recent years there has been a growing use of polystyrene which is admirable for insulation purposes in certain industries but can present a poor fire risk. Good market practice has always expected the prudent underwriter to be alive to common fire hazards.

In the field of liability (product) risk it behoves an underwriter to ask detailed questions of the broker if it emerges that the proposer/manufacturer exports. Does he export to the United States? To whom does he sell there? What are the methods of distribution in the chain of supply to the final customer? These are key questions which the underwriter must ask if the broker is not forthcoming. There are many professionally qualified and well experienced insurance brokers who are as knowledgeable about underwriting factors as a good underwriter; but ultimately the underwriter is the risk taker. An experienced underwriter adhering to good practice would take it for granted that not only had he a duty to probe but that he would regard the absence of probing as the height of folly. The risks of underwriting product risk in the United States are enormous and any proposition for cover to that country needs careful analysis involving questioning by the underwriter and research by the broker.

It would not be difficult to think of examples in other classes of business where close questioning by the underwriter would be normal.

The insurance broker, of course, has a duty to make a fair presentation of the risk. He is entitled to present his client's case in the best possible light. After all, he is primarily the agent of the proposer. He must not, however, conceal material facts known to him which would induce the underwriter into a contract he would not otherwise have entered.

If material facts have been concealed or misrepresented and the underwriters are entitled to avoid paying the claim then, having regard to the strong hand an underwriter has in the insurer/proposer relationship, bearing in mind the draconian remedy he has to void the contract *ab initio* for any non-disclosure, however minor, it seems to us that it is not at all unreasonable to expect there to be an implicit duty on the underwriter to do much more during a presentation than sit passively and say nothing. Good practice among the reputable insurance companies over the years has involved a dialogue between the parties which was underpinned by a wide ranging and detailed examination of the risk by the insurance company's surveyor or, in the case of Lloyd's, one instructed by them, with the broker's own surveyor often being present. A good surveyor – as the eyes and ears of the desk bound underwriter – would probe not just the Managing Director or other senior executive; he would seek out the Production Manager or other manager in charge of the shop floor in order that the underwriter may have a comprehensive appraisal of manufacturing processes, chemicals and other hazardous materials.

In the British Insurance Law Association (BILA) Report to the Law Commission, we suggested that:

> *"As part of the mutual duty of utmost good faith, the insurers should have a duty to ask 'reasonable' questions concerning each risk presented to them insofar as the insured's presentation does not provide information or sufficient information on a topic which the insurers regard as material. Best practice in the modern market involves both the insured, with the help of his broker (if any), and the insurers, co-operating to ensure that the risk is fairly presented"*

Clearly, these questions would concern matters about which the underwriter would not be expected to be aware or matters as defined in section 18(3)(c) of the Marine Insurance Act 1906 (MIA) such as "matters of common knowledge". We do not think there is any significant difference in the meaning of the words "obvious" or "reasonable" in this context – there is probably no reason why both could not be used. This would be a matter for the draughtsmen of any future legislation or, perhaps preferably, a precedent emerging from case law which lawyers and the insurance industry supported. The use of either or both words would, we suggest,

require the underwriter to ask the typical type of questions used on a proposal form for the type of risk being presented.

Both Longmore and Rix LJJ are in favour of reform as they indicated in their papers attached to the BILA Report of 2002. Market practice has changed dramatically since the MIA: underwriters are better educated, better trained and have access to considerable sources of information, e.g. the Building Research Establishment Limited (BRE), and consequently are expected to be more knowledgeable.

As Professor Rob Merkin states in his comments made in Insurance Law Monthly (October 2004 edition) when reviewing the above case:

> *"If Rix LJ is right in Wise, underwriters will in future be required to play a positive role in the disclosure process, no longer able to rely upon the assured's presentation but being required to ask obvious questions".*

We believe that this should be the law so that it is made clear that in any presentation of the risk by a proposer, or an insurance broker on his behalf, there should be a full disclosure of all material facts to the underwriter who, for his part, has a duty to satisfy himself that he has, by asking reasonable and obvious questions, elicited all the information which could be obtained by question and answer to enable him to make a proper risk assessment for underwriting purposes.

Underwriters who fail to ask reasonable and obvious questions may well find themselves held responsible if they are not thorough.

In this paper we have made numerous references to good practice. This is because it is our belief that the law should reflect the best practice in the insurance industry. Until insurance contract law is reformed we hope that the judiciary will be constantly mindful of this and make judgments that reflect this. The law should be the servant of commerce, not its master.

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Both were members of the BILA sub-committee on insurance contract law reform whose recommendations were submitted to the Law Commission in September 2002.

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