Drake Insurance Plc v. Provident Insurance Plc

by Alison Green LL.M

What are the implications of this decision on insurers' right to avoid insurance for material non-disclosure or misrepresentation?

For BILA members who have been following judicial comments on the duty of good faith, the views expressed by the Court of Appeal in this case ([2004] QB 601) have proved fascinating. The leading judgment was given by Lord Justice Rix, who made a thought provoking address entitled "Good Faith: to be or not to be" at the BILA's President's lunch in December 2001. In that talk (published in the BILA Journal, Issue no. 108, 2002), he spoke of a *"modern awakening to the underlying doctrine of good faith" and referred to recent cases showing a "realisation that a proper doctrine of good faith requires remedies for breach to become more thoughtful, focused, proportionate and flexible."* He made further reflections on this in his judgment in Drake v Provident.

Introduction

At the start of Lord Justice Rix's judgment he stated:

> *"The facts of this appeal might have been set by a committee of law professors with the express design of giving rise to points of interest and difficulty".*

Before looking at the implications of this case on insurers' right to avoid, I will outline the facts below.

The facts

Why this was a case between two insurance companies

Mrs Kaur was driving a car belonging to her husband, Dr Singh, when she collided with a motor cyclist, Mr Beach, who was seriously injured. Mrs Kaur was a named driver under Dr Singh's policy with Provident. She also owned a car which was insured in her name under a policy issued by Drake, which covered her against liability to third parties when driving another vehicle with the owner's permission. Mr Beach sought compensation for his injuries. Dr Singh claimed on his policy but Provident declined the claim and sought to avoid the policy because of his non-disclosure of a speeding conviction. Mrs Kaur therefore made a claim under her policy with Drake, which settled Mr Beach's claim. Drake then issued proceedings seeking to recover a contribution from Provident on the grounds that it had no right to avoid its policy, that both companies were liable to indemnify Mrs Kaur and Provident should contribute to the settlement.

How the insurance contract was entered into

Dr Singh had telephoned brokers in February 1995 to arrange insurance for his car, asking for his wife to be named as an additional driver. He disclosed that she had been involved in an accident in 1994. The broker completed a proposal form, entering the answer 'Yes' to the question of "fault" relating to this accident, and Dr Singh subsequently signed the form. Under Provident's system, this accident had to be recorded as a "fault" accident until the matter had been settled by the third party in Mrs Kaur's favour. Prior to renewal of his policy in February 1996 Dr Singh was convicted of speeding, but failed to disclose the conviction to his insurers, Provident, nor did he mention that the 1994 accident had been settled satisfactorily. In July 1996 he made the claim in respect of his wife's accident with Mr. Beach. Provident asked Dr Singh to supply his driving licence. This disclosed Dr. Singh's conviction. On 2 August 1996 Provident wrote to him stating that they were avoiding the policy for material non-disclosure, namely his failure to disclose the speeding conviction. Insurers' avoidance was on the basis that if there had been disclosure of that conviction at renewal, the insurance would have been written on different terms; Dr Singh would have been charged a higher premium due to the way in which Provident's underwriting system worked.

Provident's system of writing motor insurance

Under Provident's system for writing motor insurance, neither a recent "fault" accident, nor a speeding conviction on its own would result in an increased premium, although together they would. Provident operated an automated service, under which approved brokers could accept proposals and fix the premium themselves. Such brokers were provided with detailed underwriting criteria. The acceptability of a proposal and the rating of the premium were calculated by a rigid points system. Under this system a conviction for speeding carried 10 points and a "fault" accident carried 15 points. A "no fault" accident would be ignored. Below 17 points the proposer was charged a normal premium, at 17 to 25 points his premium would be increased by 25%, and so on. At 60 points or more the risk would be declined. On the basis of the information given at renewal, Dr. Singh was charged a normal premium. When Provident gave notice to avoid Dr Singh's policy, it was under the impression that there had been an earlier "fault" accident. Dr Singh challenged the avoidance and then produced evidence to show that in fact the 1994 accident was a "no fault" one and that he and his wife had received compensation from the other driver.

Arbitration

Dr Singh commenced arbitration proceedings against Provident. The arbitrator decided that Provident's avoidance was valid. It was accepted that this arbitration was binding only between Dr Singh and Provident, so any issue as to whether the policy had been properly avoided for the purposes of a contribution claim by Drake could be determined by a Court.

First instance decision

Mr. Justice Moore-Bick dismissed Drake's claim against Provident for contribution, (his decision is reported at [2003] Lloyd's Rep. I.R. 781). He held that Provident had the right to avoid the policy for material non-disclosure. The issue of breach of the duty of utmost good faith had to be assessed at the time of renewal in February 1996. At that date it appeared that the policy would have attracted 25 points. This was material as it would have resulted in different terms by way of an increased premium and there was also inducement given Provident's underwriting practice. When Provident avoided the policy in August 1996, there was nothing to alert it to the fact that 15 of those points should be disregarded and it was not open to the court to overturn the avoidance. He stated at p.788:

> *"If grounds exist to justify avoidance, the insurer's duty once communicated to the insured, is effective immediately. The insurer does not need to invoke the assistance of the court, nor does the court have jurisdiction to declare that his right to avoid has been lost retrospectively by reason of subsequent events."*

In his view, Provident was not under any duty to reconsider its position once the situation had been clarified. He went on to hold that Provident had not waived its right to avoid the policy.

The Court of Appeal

The Court of Appeal considered four main issues in this case:

1. Whether, irrespective of any argument that can be raised as a matter of good faith, Provident was entitled to avoid the policy;
2. Whether Provident's right to avoid the policy was limited by the doctrine of good faith;
3. Whether Provident waived its right to avoid Dr Singh's policy;
4. Whether Drake's payment was voluntary;

I do not propose to consider the last two issues in this article; indeed they could form the subject of further articles themselves. However, for the sake of completeness, the answer given to (3) was that if Provident had been entitled to avoid the policy, its subsequent actions amounted to waiver of that right. In answer to (4) the Court of Appeal held that Drake was not a "volunteer" and could recover a contribution from Provident.

Issue 1: whether, irrespective of any argument that can be raised as a matter of good faith, Provident was entitled to avoid the policy?

In deciding this issue the Court had to consider whether there had been material non-disclosure by the insured. It was accepted that the non-disclosure of the speeding conviction was material. Their Lordships had to consider whether knowledge of the information withheld would have induced the actual underwriter to act differently (see *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co Ltd) ([1995] I.A.C.501)*.

All three Lord Justices held that Provident was not entitled to avoid the policy. The majority (Lord Justices Rix and Clarke) decided this on the basis that it had not been shown on the facts that Provident was induced to enter into the contract by Dr Singh's non-disclosure of his speeding conviction. It was necessary to consider what would have happened if the speeding conviction had been disclosed at renewal. They found that it was wrong of the judge to say that there was nothing in the evidence 'that points either way'. In their view if Dr Singh had disclosed the speeding conviction, he would have been told that the premium would be increased, he would have queried it and probably the reason for the increase would have been discussed. In those circumstances Dr Singh would have been able to persuade Provident to treat the previous accident as a "no fault" accident, which would have meant that it would have continued to insure Dr Singh without any increase in premium.

Mr. Justice Moore-Bick had decided that there was no evidence pointing either way as to what would have occurred at renewal if Dr Singh had disclosed his conviction. His view was that one simply did not know what Dr Singh's reaction would have been to an increase in premium; he might have questioned it or he might not; if he had questioned it, and if he had simply been told that it was due to his recent speeding conviction, he might have left it at that, or he might not. The majority of the Court of Appeal regarded the trial judge's approach as misguided; he had erred in applying the burden of proof and in his speculation. Lord Justice Rix stated at paragraph 64 that it was not Dr Singh or Drake who bore the legal burden of

proving that the non-disclosure of the speeding conviction induced the contract. The burden of proof was on Provident and Provident had failed to discharge its burden.

Thus, failure to show that Provident had been induced, was enough to invalidate Provident's avoidance of the policy. That provides the ratio of the decision and was sufficient to dispose of the appeal, save for the issue of contribution. However, as we shall see, all three Lord Justices looked at the matter from a wider perspective.

Lord Justice Pill disagreed with the views of the other Lord Justices on Issue 1. He accepted that the trial judge should not have speculated as to what might have happened had the conviction been disclosed, but took the view that the Court of Appeal should not engage in the selfsame exercise. The burden was on Drake to show that events would have taken a different course, and the trial judge had held that Drake had not done so: hence the Court of Appeal should not interfere.

Issue 2: whether Provident's right to avoid the policy was limited by the doctrine of good faith?

In Lord Justice Pill's view it was so limited. He found that Provident was sufficiently put on notice of the true facts to make it a breach of its duty of good faith to avoid the policy without making what would have been a simple enquiry as to the true position so far as the earlier accident was concerned, namely whether it was really a "fault" accident. Lord Justices Rix and Clarke considered issue 2 as being one they did not wish to decide. They did not think it was open to them to go behind the finding of the judge that Provident had acted in good faith in avoiding the contract (cf Lord Justice Pill). However, as we shall see, both of them considered that the doctrine of good faith should be capable of limiting insurers' right to avoid.

Implications of this decision on insurers' right to avoid

Prior to this decision there had been two judicial approaches to whether an insured who had failed to disclose a material fact should be given the opportunity at a later stage to argue that such disclosure would have made no difference to the insurer on the basis that the insured may be able to demonstrate that the matters underlying the "non disclosed" fact were unfounded or inconsequential.

The hindsight test – reopening avoidance

This is the approach that was favoured by Mr. Justice Colman in *Strive Shipping Corporation v. Hellenic Mutual War Risks Association, "The Grecia Express"*, ([2002] 2 Lloyd's Rep. 88). He held that that the insured was normally under a duty to disclose to the insurer allegations of dishonesty or criminal conduct

since these are material. In that case the ship owner had failed to make disclosure of such allegations and insurers purported to avoid for non-disclosure of matters going to moral hazard. The judge went on to hold that the insured should be given the opportunity to establish at trial that such allegations were unfounded. If he succeeded in establishing that the allegations were untrue, then it would be a breach of the insurer's duty of utmost good faith to persist in the avoidance of the contract.

Assessing the facts at the time the risk was written – no hindsight test

This approach is the one favoured by Mr. Justice Moore-Bick in this case and in the case of *Brotherton v. Aseguradora Colseguros SA* ([2003] Lloyd's Rep I.R. 746), where the Court of Appeal endorsed the judgment of Mr. Justice Moore-Bick. This approach involves looking at the circumstances when the risk was being accepted; if there was non-disclosure and good grounds existed to avoid and the right to avoid has been exercised, then the insurer is not precluded from maintaining that position by the subsequent receipt of further information. To enable an insured at trial to defeat an insurer's right to avoid, after it has been exercised, by establishing facts of which the insurer was not aware when the insurer wrote the risk, would alter the basis of the underwriting exercise and introduce unwelcome uncertainty and additional costs (see Mr. Justice Moore-Bick J in *Drake v. Provident (supra) p.788*). Lord Justice Mance, who gave the leading judgment in *Brotherton* in the Court of Appeal, was critical of Mr. Justice Colman's reasoning in *The Grecian Express*.

Court of Appeal's approach in Brotherton

In *Brotherton* insurers gave banker's bond and professional indemnity cover to a Colombian bank and obtained reinsurance. At the time the reinsurance was being placed the insurers failed to disclose that allegations of serious impropriety had been made in the Colombian media against the president and other senior officials of the bank nor of rumours regarding possible impropriety. The reinsurers claimed to be entitled to avoid the reinsurance for non-disclosure. The insurers submitted that they were entitled to prove that the allegations were entirely without foundation. The Court of Appeal held that proof at trial that the allegations were unfounded based on information that only came to light after the contract was made could not affect the materiality of the non-disclosure. The only proper questions for decision at trial were whether there had been non-disclosure which was material and which had induced the reinsurance. The Court of Appeal emphasised that materiality had to be judged in the context of the circumstances that existed at the time of acceptance of

the risk and the reaction of the reinsurers had to be judged at the time of placement. Both Lord Justice Mance (see p.758) and Lord Justice Buxton (see p. 760) pointed out the difficulties that a Court could have in investigating the truth of the *allegations* at a later date.

Court of Appeal's approach in Drake

In *Drake* the majority in a differently constituted Court of Appeal was prepared to countenance a position where an insured could seek to show, subsequent to avoidance having been invoked, that the matter which had not been disclosed was not material and was not something which would have induced the insurers in the circumstances of the case.

How does one reconcile the judicial approaches in Brotherton and Drake?

One can reconcile the decisions by pointing out the factual differences between the two cases. In Brotherton the insurers wished to rely on matters that *occurred after* the contract of reinsurance had been written and on *evidence that was not available* at the time the reinsurance was placed with a view to proving that the allegations were without foundation. However, this was not the situation in *Drake*; by the time of the renewal in question the 1994 accident had been settled favourably and was known to Dr. Singh even if Provident did not know of the outcome of that accident. Had the outcome been known to the insurers via the broker, it would have rendered the non-disclosure of the speeding conviction of no significance. If it mattered that Provident needed to see evidence of the settlement of that accident, that could have been supplied and did not depend on any further report nor evaluation at trial. The non-disclosure of the speeding conviction could not have been material because it could not have induced a re-rating.

Drake can be distinguished from *Brotherton* on the facts and also from *Lynch v. Hamilton* ([1810] 3 Taunt 15, *Lynch v. Dunsford* [1811] 14 East 494), the authority on which the Court of Appeal relied in Brotherton). In Lynch, at placement of insurance, a cargo owner failed to disclose a report that the ship carrying his cargo was unseaworthy. The cargo owner did not know at the time of placement whether that report was correct or not. The report turned out afterwards to be untrue. Insurers were held entitled to avoid.

The views of the Court of Appeal in *Brotherton* demonstrated a judicial approach concerned with certainty, not burdening courts (or insurers) with what could be a lengthy "trial within a trial" involving extra costs in an effort to discover what was the true position at the time of placement. Insurers should not have to bear this

additional risk, at least in a case involving allegations. In *Drake* the same considerations were not to the fore; there was no doubt about the facts of the "no fault" accident or Provident's underwriting criteria; there was no problem in proving these matters.

Should insurers' right to avoid be judged according to the information provided to the insurer at the time of contract or according to what turns out to have been the true facts as at that time?

Though cautious on the subject, it was Lord Justice Rix's opinion in *Drake* that the insurers' entitlement to avoid should be determined by the true facts as they were at the time the contract was made (see paragraphs 70 to 78). Lord Justice Clarke found it unnecessary to decide the point as he had held that the non-disclosure did not induce the contract on the facts in this case. Nevertheless, he stated that he was inclined to agree with Lord Justice Rix's views (see paragraph 138). Lord Justice Rix was prepared for the insurers, rather than the insured, to take the risk (see paragraph 69):

> *"Ultimately the issue seems to be: who takes the risk that the true facts as of the time of contract, conclusively established by the time of contract, do not support the right to avoid? I do not see why, subject to estoppel or other such defences, the answer should not be in favour of the insured."*

The way to reconcile these cases appears to be that, if, at the time of contract, anyone had investigated the position in *Drake*, it would have been clear that the earlier accident had been settled favourably and the speeding conviction would have been of no consequence. The same could not be said about the allegations in *Brotherton*.

Should insurers' right to avoid be subject to the requirement of good faith on their part?

It has long been accepted that the duty of good faith in insurance is mutual and binds the insurer as well as the insured. Section 17 of the Marine Insurance Act 1906 states that *"if the utmost good faith be not observed by either party, the contract may be avoided by the other party."* Lord Mansfield in *Carter v. Boehm* ([1766] 3 Burr.1905) recognised that there may be circumstances in which an insurer by asserting a right to avoid for non-disclosure, would himself be guilty of want of good faith. However, whilst the law reports are littered with cases where insurers have avoided insurance for lack of good faith on the insured's part, there are very few authorities on the consequences of lack of good faith on the insurers' part (see *Banque Keyser Ullmann S.A. v. Skandia (UK) Ins Co Ltd* [1990] 1Q.B. 665 and [1991] 2 A.C. 249).

Once again there are the two different schools of judicial thought on this question:

Right to avoid should not be subject to a requirement of good faith

The Court of Appeal in *Brotherton* expressed the view that insurers' right to avoid should not be qualified, as Mr. Justice Colman suggested in *The Grecia Express*, by a stipulation that it should be subject to a requirement of good faith or conscionability on the part of insurers. Lord Justice Mance gave two reasons why avoidance should not be subject to a requirement of good faith. These were that:

1. Rescission under English law was not generally subject to any requirement of good faith or conscionability; the mere fact that a right to rescind had an equitable origin did not mean that its exercise was only possible if that was consistent with good faith;

2. Recent cases on good faith had in any event tended to limit the scope of any post-contractual duty of good faith to circumstances of repudiatory breach or fraudulent intent (see *Manifest Shipping Co Ltd v. Uni-Polaris Shipping Co Ltd ("The Star Sea") [2001] 2 W.L.R. 170; K/S Merc-Scandia XXXXII v. Certain Lloyd's Underwriters ("The Mercandian Continent")* [2001] 2 Lloyd's Rep.563 and *Agapitos v. Agnew* [2002] 2 Lloyd's Rep.42).

Lord Justice Mance stated that even if there was any scope in any circumstances for such a development, it could not be in a case like the one before them where reinsurers did not at the time of avoidance accept or know for certain of the incorrectness of the intelligence constituting the basis for their avoidance.

The right to avoid should be subject to a requirement of good faith

In *Drake* all three Lord Justices considered that a duty of good faith could affect the insurer's right of avoidance.

When would an insurer be in breach of a duty of good faith in avoiding according to Drake?

The majority's views on this were expressed obiter. Lord Justice Rix considered that:

"...the doctrine of good faith should be capable of limiting the insurer's right to avoid in circumstances where that remedy, which has been described in recent years as draconian, would operate unfairly" (paragraph 87)

"If, however, the point were a live one, I would hazard the opinion that knowledge or shut-eye knowledge of the fact that the accident was a no fault accident would have made it a matter of bad faith to avoid the policy." (paragraph 91).

Lord Justice Clarke stated at paragraph 144 that he was inclined to agree with Lord Justice Rix:

> *"It does seem to me that if, at the time of avoidance, Provident knew or turned a blind eye to the fact that the earlier accident was a no fault collision, it would not be acting in good faith if it avoided the policy because such avoidance would not be "fair dealing"... However, there is no suggestion that Provident in fact knew the true position."*

Could an insurer be in breach of a duty of good faith by not making enquiries in certain circumstances?

Different answers are given by the Court of Appeal in *Drake*:

Lord Justice Rix's view was that if an insurer was put on notice that its ground for avoidance had been disproved by later events then it would not be in good faith for the insurer to avoid the policy *"without first giving the insured an opportunity to address the reason for which the insurer is minded to avoid the policy."*

Lord Justice Clarke was inclined to agree with Rix LJ's views, but did not wish to rest his decision on this point because of the difficulty of knowing where to draw the line. He stated at paragraph 145:

> *"Indeed , in the absence of a general principle that insurers must always give the insured an opportunity to address the reason why they are considering avoidance, it is difficult to know what amounts to notice in the absence either of knowledge of the critical facts or of the insurers' turning a blind eye. There is at present ... 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."*

Lord Justice Pill went much further and found 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"*

Unlike his fellow judges in the case he found that Provident had not, when avoiding the policy, acted in good faith in treating the 1994 accident as a "fault" accident. He found that Provident, knowing what it did (plus the fact that an insured was unlikely to be aware of the significance attributed by Provident to the word "fault"), was required by the duty of good faith:

"at least to tell the insured what they had in mind and give him an opportunity to update them on the January 1994 accident. All that was required was a simple enquiry as to what had happened in relation to that accident. If more than lip service is to be paid to the principle that an insurer shall show the utmost good faith, the principle in my judgment required that enquiry to be made before the "wholly one-sided" remedy of avoidance was exercised."

This was the basis on which Lord Justice Pill held that Provident was not entitled to avoid the policy.

"Remoulding" of the remedy of avoidance?

What emerges from the judgments of the Court of Appeal in *Drake* is judicial readiness to rein in avoidance where that draconian remedy may operate unfairly (see Rix L.J. paragraph 87, Clarke L.J. paragraph 145). There is a realisation that the law as embodied in the Marine Insurance Act 1906 developed in an era when most insurance contracts were made by those involved in trade or commerce. The judges acknowledged that insurance law may need to reflect the imbalance that there may be between a consumer and an insurance company when an insurance contract is being entered into (see Lord Justice Pill at paragraphs 161 and 171). As Lord Justice Rix remarked at paragraph 89:

"The existence of widespread insurance contracts of a consumer nature presents new problems. It may be necessary to give wider effect to the doctrine of good faith and recognise that its impact may demand that ultimately regard must be had to a concept of proportionality implicit in fair dealing."

It was hoped that the House of Lords might have taken the opportunity to look again at this area of law, to resolve the differences between *Brotherton* and *Drake* and give guidance on how far "good faith" may restrict the insurers' remedy of avoidance. However, leave to appeal was refused by their Lordships. In 2002 BILA presented its Report on Insurance Contract Law to the Law Commission and made various recommendations for reform, particularly so far as avoidance for material non-disclosure and misrepresentation was concerned. The Law Commission has been considering whether this is a project that they might pursue. We await their deliberations. In the interim, there is plenty of scope for lawyers for both insureds and insurers to argue about the scope of the duty of good faith.

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