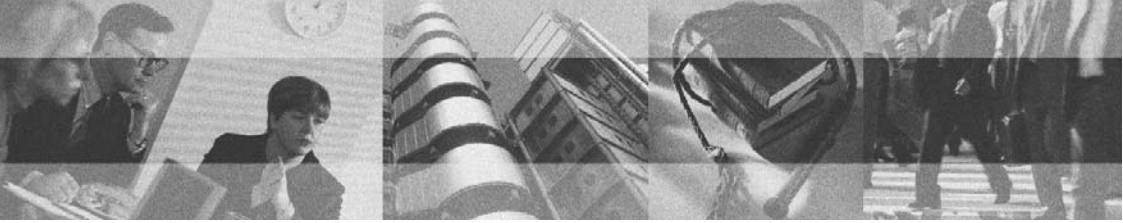


THE POST CONTRACT DUTY OF GOOD FAITH IN INSURANCE CONTRACTS: IS THERE A PROBLEM THAT NEEDS A SOLUTION?[1]

by The Right Honourable Lord Justice Aikens

It has become fashionable to head prefaces to books or chapters of them with snappy quotations. Many of the quotations are learned and, of course, all are apposite to the subject being covered. As this talk is about the duty of good faith in insurance and as I will have to consider what the consequences might be for failing to observe it, I could not resist two favourite snippets which appear at the head of a chapter in Terry O'Neill and Jan Wolonieki's excellent book on Reinsurance, now in its second edition. The relevant chapter deals with "The reinsurer's grounds for denying liability". The quotations show that things do not change. I will give you the 20th century one first, which is attributed to a solicitor:

An underwriter at Lloyd's
Who wants to be "one of the boys"
Will scratch without thought
Any risk that he's brought,
But when there's a loss, he avoids.

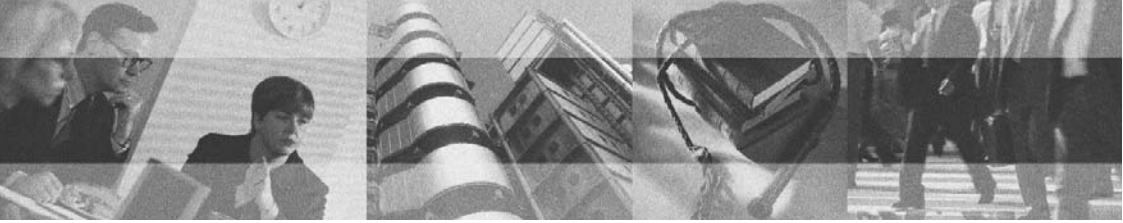
The second one is from the 14th century, and is by Francesco Datini, a celebrated and successful merchant of the Tuscan city of Prato, where he left all his fortune to the city's poor. The saying is from Datini's correspondence and is quoted in Iris Origo's biography of him: *The Merchant of Prato*. Datini says:

> *"For when they insure, it is sweet to them to take the monies; but when disaster comes, it is otherwise and each man draws his rump back and strives not to pay".*

The reason for giving a talk on the topic of post contractual good faith in insurance contracts, which some may feel is "old hat", is that the Law Commission recently announced that it intended to produce an "Issues Paper" on the question of: "the insured's post contractual duty of good faith" in the context of business insurance – not consumer insurance where the Law Commission has already produced a draft Bill. You will note the wording of the title: the *insured's post contractual duty of good faith*. Here may be two problems that need a solution: is there a difference between "good faith" and "utmost good faith"; or to adapt the aphorism of Willes J about "gross negligence"[2] is the latter just good faith with a superlative epithet? Secondly, is there actually mutuality in whatever duties of good faith there are after the conclusion of a contract of insurance and in the consequences of a breach? (I will not keep on saying "in a business context" that is assumed for the purposes of this talk).

In order to see whether there is a problem that needs any solution I must try and ascertain where the law stands at the moment. This is not so easy and that itself may be the reason why there are problems!

We start with the Marine Insurance Act 1906, which everyone has recognised since it was passed represents (so far as it goes) the law for both marine and non-marine insurance. We



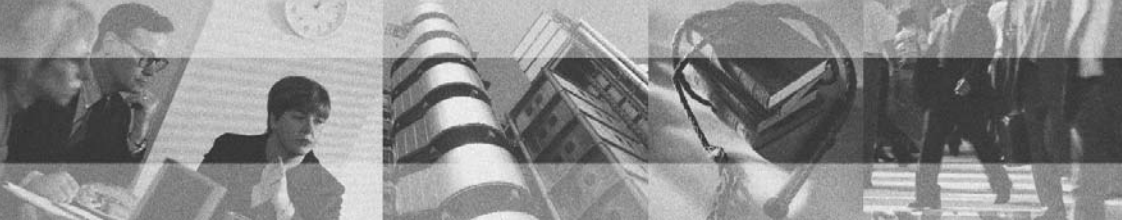
virtually know section 17 by heart by now, I expect: *"A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party".*

Does this mean that there is a post-contractual duty of good faith at all; and if there is, what is its content? There are cases which consider the post-contractual duty of good faith before the 1980s, but it was not a topic much discussed, save perhaps in relation to the question of "ship's papers", a recondite issue which we need not consider. The first comparatively recent case to give the issue prominence was *Piermay Shipping Co SSA v Chester "The Michael",*[3] which was decided in the late 1970s. You may recall that was the case where a vessel sank in calm water – they all do – and all the crew was rescued – they always are. Coming up the gangplank from the rescuing ship, almost into the arms of the underwriter's solicitor, Mike Baker Harber of Ince, was an engineer, Mr Komiseris, who had been third engineer on board another ship that had sunk in calm water and sunshine: the *Gold Sky***.**[4] The owners of *The Michael* alleged loss by perils of the seas; the underwriters alleged scuttling, then the owners responded (after a pause) by alleging that Mr Komiseris had committed barratry, also an insured peril. That prompted the underwriters to allege that the owners had maintained a false claim of perils of the seas when they knew Mr Komiseris had sunk the vessel. The Court of Appeal found that there was no fraud by the owners but left open the issue of whether a fraudulent perils of the seas claim, even if subsequently abjured, would have been a defence to the barratry claim.[5]

The case that really got the debate going was, of course, *Black Sea Shipping Corp v Massie: "The Litsion Pride",*[6] a decision of Hirst J. The fate of tanker casualties in the Gulf during the Iran-Iraq war prompted more marine insurance decisions than any other event since the Suez crisis in 1956, including the 1967 Arab-Israeli war. In the *Litsion Pride* case the owners lied about the vessel's entry into the excluded zone, where she was hit by an Exocet guided missile and sank. The judge found for the underwriters on several bases. The important statement of principle by him, subsequently disapproved, was that an insured had a duty of good faith, post contract, not to make a "culpable" non disclosure or misrepresentation.[7]

The other case I should mention as part of the history is *Royal Boskalis Westminster BV v Mountain,*[8] which I argued for the claimants before Rix J. It was a most extraordinary case and, I think, the most taxing case on the law I ever did at the Bar. It raised issues on constructive total loss, the doctrine of sue and labour, the doctrine of post-contract good faith and fraudulent claims, and illegality. And that was just the English law. We also had to deal with Dutch, Swiss and Iraqi law.

The claim was for the CTL of dredgers that had been seized by Saddam Hussain in his invasion of Kuwait in 1990 – another fruitful provider of case law in the English courts. The dredgers were eventually released after the assureds had paid a ransom to the Iraqis. One issue was the fact that the assureds had been forbidden, literally on pain of death, to tell anyone of the terms of the settlement. So they had not told underwriters until after the claims were presented: which Rix J found was a deliberate and culpable misrepresentation and non-disclosure. Rix J rejected the CTL claim but found that the sue and labour claim was good in principle, subject to the allegation by underwriters that they could resist it because of the



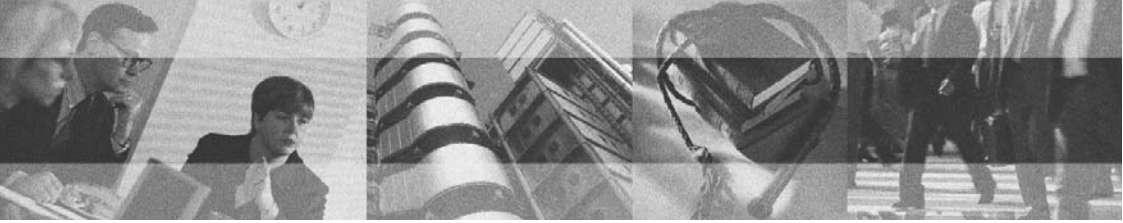
misrepresentation and non-disclosure. Underwriters had not avoided the insurance. Rix J held that the defences of misrepresentation and non-disclosure could not succeed. He decided: first, at its widest, the post contract duty of good faith was not to make deliberate or culpable misrepresentations or non-disclosures of facts that were "material", i.e. which had ultimate legal relevance to a defence under the policy. Secondly, an underwriter had to be induced by the material misrepresentation or non-disclosure. Thirdly, the only remedy available for breach of this duty was avoidance of the contract of insurance, which the underwriters had not attempted.[9] Rix J found that the claim itself was not fraudulent; so he rejected all those defences. We won, but unfortunately lost in the Court of Appeal on another ground not relevant to us today.

Central to any discussion of this issue is the House of Lords' decision in *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd: "The Star Sea"*,[10] which I had argued in the Court of Appeal for the shipowners but bequeathed the brief in the House of Lords to Jonathan Sumption QC because I had taken the Queen's shilling and become a judge. You will recall that the insurers' argument was that a failure to disclose an expert's report which was, arguably, contrary to the shipowners' interests because it might have helped the underwriters prove their section 39(5) defence,[11] was "culpable" non-disclosure. It was argued that this gave the underwriters the right to avoid the policy, which was on the whole of the claimants' fleet. The insurers also claimed that they were entitled to avoid because of the fact that one witness of fact had given evidence of fact which the trial judge disbelieved. It was said that this also constituted a breach of insured's duty of utmost good faith. Both these so called breaches had occurred after litigation between the parties had started.

In the House of Lords separate speeches were given by Lord Clyde, Lord Hobhouse and Lord Scott of Foscote.

Lord Clyde stated[12] that section 17 of the Marine Insurance Act appeared to be unlimited in scope. He said that the notion of "the utmost good faith" was apparently based on the concept embraced by the Latin words *"uberrimae fidei"*– literally, I think, "the most copious of trust". Lord Clyde, speaking as a Scottish and therefore civil lawyer, said he had not been able to trace the origins of the phrase and that it did not appear to derive from civil law and had been regarded as unnecessary in civilian systems. He noted that in the case which started all the trouble, *Carter v Boehm,*[13] Lord Mansfield referred simply to "good faith". Lord Clyde said the breadth of the wording of section 17 had to be cut down somehow. But he rejected the suggestion that it should be restricted to pre-contractual matters, saying, in a memorable phrase: "that solution now appears to be past praying for".[14] He then accepted that a degree of "good faith" was needed in insurance contracts after their formation, because they required a degree of openness. But that, he thought, would vary depending on the stage of the parties' relationships. So good faith, on this basis, would be rather like the Cheshire Cat, which never disappears entirely, but at certain times you can only see its smile.

The late and very much lamented Lord Hobhouse of Woodborough gave the main speech. Lord Hobhouse traced the introduction of the word "utmost" into the phrase "good faith" in the insurance law context.[15] It was, he concluded, a nineteenth century invention. He said that the sense of the words was "the most extensive" as opposed to the greatest, or



deepest, one might say, good faith. He confirmed that (on his researches) the phrase was unknown in Roman law and the phrase was first used by Lord Commissioner Rolfe, later Lord Cranworth LC, in a mid nineteenth century case: *Dalglish v Jarvie,*[16] which was not about insurance at all.

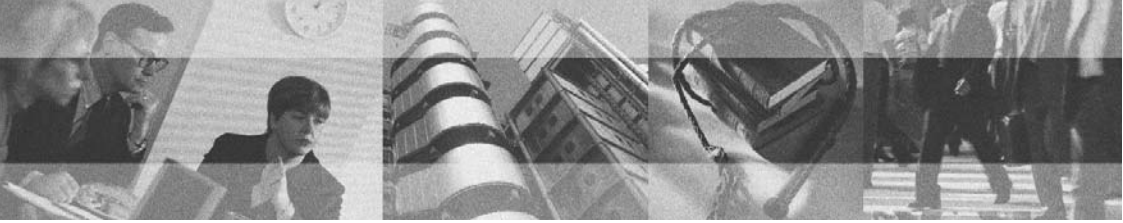
Lord Hobhouse then stated some general propositions about the duty of good faith and its application after a contract of insurance has been concluded. First, the duty arises from the general law, not from a term of the contract. I will examine that idea later. Secondly, although it might have been said that the duty imposed by section 17 did not extend post-contract, there was a weight of dicta that the principle had a continuing relevance to the parties' conduct after the contract had been made. Thirdly, and I think most importantly, he said that there was no remedy in damages available to the innocent party if the other party had failed to observe good faith: the only remedy was avoidance of the contract.

But Lord Hobhouse then showed how a duty of good faith which derived from the general law, not contract, which only gave a right to avoid, not to damages, and which duty applied to the parties post contract, could also lead to absurdities. So, he imagined[17] this situation: a valid annual contract of insurance, on a fleet say, has been made and the premium paid; then a loss has occurred and been paid. Then, towards the end of the year the insured fails to discharge his duty of complete good faith. It seems, he said, that "…the insurer is able not only to treat himself as discharged from further liability but can also undo all that has perfectly properly gone before". That, Lord Hobhouse says, quite rightly, cannot be reconciled with principle or the cases before or since the 1906 Act, with the possible exception of what must now be regarded as the rogue decision of Hirst J in *The Litsion Pride***.**[18]

Lord Hobhouse recoils from the proposition that a failure to disclose information, post contract, could give the insurer the right to avoid a contract; it would give him a disproportionate benefit. And, as he rightly points out, the remedy of avoidance is no good to an insured if it is the underwriter who has acted in bad faith, as had the insurers in *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd*.[19]

Lord Hobhouse then turns to analyse the law on fraudulent insurance claims. He notes that, since the mid nineteenth century, the law has held that if an insured makes a fraudulent claim then he loses the right to recover altogether; he cannot recover even that part of a claim which was honest. Lord Hobhouse describes this as a "rule of law" equivalent to that which states that a wrongdoer cannot profit from his/its own crime, citing *Beresford v Royal Insurance Co Ltd***.**[20] It is a kind of legal penalty.

Is this "rule of law" derived from an implied term in the contract? Lord Hobhouse had to tackle the contradictions between the well known nineteenth century cases of *Goulstone v Royal Insurance Co*[21] and *Britton v Royal Insurance Co,*[22] which treat the matter as a rule of law outside the contract terms and *Orakpo v Barclays Insurance Services***,**[23] where two members of the Court of Appeal (Hoffmann and Staughton LJJ) analysed the matter in terms of breach of an implied term of the contract of insurance. The third judge in *Orakpo,* Sir Roger Parker, seems to have treated it as a rule of law unconnected to the contract terms. But the Court of Appeal in *Orakpo* did not grapple with the question of whether the consequence of a finding that the claim was fraudulent was that the claimant forfeited his claim in its entirety



or whether the insurer was thereby entitled to avoid the whole contract of insurance from start to finish.

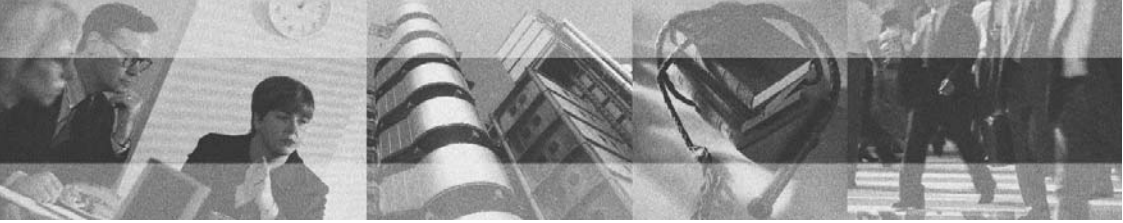
Equally, as Lord Hobhouse noted, in the case of *Galloway v Guardian Royal Exchange (UK) Ltd,*[24] which had followed *Orakpo,* the Court of Appeal held that the consequence of putting forward a fraudulent claim was that the insured forfeited his whole claim, as a matter of law. But that case did not focus on whether that was the limit of the consequence or whether the insurer had the right to avoid the policy as well.

Two last points about Lord Hobhouse's wide ranging speech should be made. First, he said[25] that *The Litsion Pride* should not any longer be treated as a sound statement of the law. By that he was referring to Hirst J's statement that a non fraudulent but "culpable" failure to act in good faith post contract gave rise to the right to avoid. Secondly, Lord Hobhouse confirmed that once litigation had taken over, the duties of the parties were governed by the Rules of Court, not the general duties of good faith or contractual terms.

Lord Scott, with whom Lords Steyn and Hoffmann agreed, said,[26] seemingly in contradiction to the more tentative view of Lord Hobhouse, that a dishonest claim constituted a breach by the assured of section 17 and entitled the insurer to avoid the insurance contract.[27] Lord Scott posed the issues in terms of the content and duration of the insured's duty of utmost good faith "at the claim stage and thereafter".[28] Lord Scott held that the duty of utmost good faith owed by an insured post contract was not the same as that pre-contract. But it was, at least, a duty of "honest in the presentation of a claim".[29]

Having reviewed a number of cases, Lord Scott stated the proposition that the "presentation of a dishonest or fraudulent claim constitutes a breach of duty that entitles the insurer to repudiate any liability for the claim and prospectively at least, to avoid any liability under the policy".[30] He regarded the question of whether the presentation of a fraudulent claim should be treated as a breach of a continuing duty under section 17, thus entitling the insurer to avoid the policy with retrospective effect, and also obliging the insured to repay valid claims, as "more debatable". He contented himself with the general statement that an insured owes a duty to the insurer to be honest in relation to a claim. He did not decide whether or not this derived from section 17.[31]

So *The Star Sea* decides some points, leans towards a view on others, but leaves yet other questions in the air. I think it decides that the section 17 duty of utmost good faith on both insurer and insured carries on after the conclusion of the contract. It affirms that the only remedy available for a breach of the duty of utmost good faith is avoidance, not damages. I suppose this must mean that it rejected as wrong the statement (in 1995) of Sir Thomas Bingham MR in *Cox v Bankside*[32] that he could not accept the suggestion that a breach of the duty of good faith on the part of an insurer once a policy was in force gave the assured no right other than rescission. The House of Lords' decision in *The Star Sea* holds that an insured has a duty to be honest in presenting a claim, but seems equivocal whether that duty is derived from section 17 or some other principle of general law. It appears to decide that this principle of general law is not itself derived from the contract terms, but is, like the duty not to be negligent towards one's neighbour, in "the legal ether". The case holds that if an



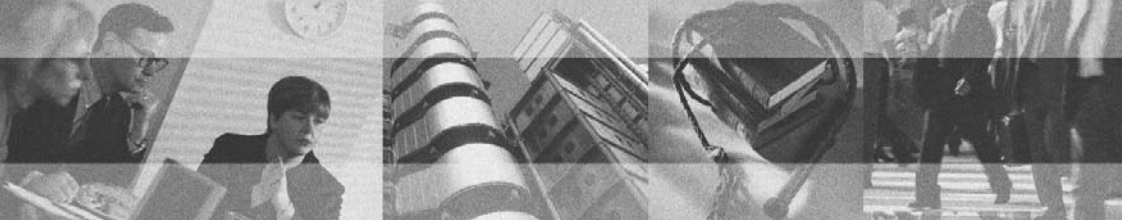
insured presents a dishonest claim, he will forfeit the claim entirely. It accepts that an insurer will, in such circumstances, be entitled to terminate any future liability on that contract of insurance. It leaves open, I think, the issue of whether the insurer is entitled to avoid the policy *ab initio* if presented with a fraudulent claim.

There are some subsequent cases that I want to refer to in order to see if the law has been further clarified; then I want to see what the problems are, if any, for which we may need solutions from legislation, which would be proposed by the Law Commission, or, perhaps, solutions from the Supreme Court, as it now is.

The first case is the Court of Appeal's decision in *The Mercandian Continent,*[33] which was an appeal from a decision of mine. I was upheld, but the reasoning of Longmore LJ is somewhat different. A shipowner had put his ship into the insured ship repairer's yard in Trinidad for repair. The repair was negligently done and the vessel's engine exploded as a result. The ship repair yard had liability insurance and it notified its London insurers, who took over conduct of the claim. The shipowner sued the insured repair yard and tried to get leave to serve the proceedings out of the jurisdiction. The insured was wrongly advised that his limit of liability to the shipowner would be lower in the Trinidadian courts and so he forged a signature, designed to rebut the shipowner's claim that London law and jurisdiction had been agreed. That forgery then came to light, but before the issue of jurisdiction had been determined by the English Court. The insurers purported to avoid liability under the policy on the ground that this forgery was a breach of the insured's duty of utmost good faith to the insurer. The shipowner subsequently obtained a judgment against the insured, wound up the insured and then proceeded against the insurers under the Third Parties Rights Against Insurers Act 1930.

The case was argued before me in advance of the *Star Sea* going to the House of Lords. I held that the insurers were not entitled to avoid the policy because: (a) the fraudulent action of the insured was in relation to a collateral matter which made no difference to liability under the policy; therefore no duty of utmost good faith arose at all; (b) in any event the deliberate and culpable misrepresentation (that the signature was genuine) was immaterial, because it had no legal relevance to the insured's claim on the policy; and (c) there was no evidence that the insurers had been induced to do anything as a result of the forged signature.

By the time the Court of Appeal hearing came on,[34] *The Star Sea* decision had been handed down by the House of Lords. Longmore LJ gave the leading judgment. He started from the proposition that there was clearly a duty not to make a fraudulent claim. But he noted that the pre-1906 Act cases on fraudulent claims had not expressed themselves in terms of avoidance of the policy. He also doubted whether Sir Mackenzie Chalmers, the draftsman of the 1906 Act , had in mind the fraudulent claims cases such as *Britton* and *Goulstone,* when composing section 17.[35] Longmore LJ came to the general conclusion that an insurer can only avoid a contract of insurance for a breach of the duty of good faith post contract if: (a) the quality or seriousness of the breach is such that it would entitle the insurer to repudiate the contract; (b) the breach was material to some action of the insurer; and (c) the insurer was induced to take some action as a result of the breach of good faith by the insured.[36] He



summarised the position by saying that the right to avoid for breach of good faith was co-extensive with the right to terminate for breach of that duty.[37]

In his judgment Longmore LJ pays tribute to Professor Malcolm Clarke's book on *Insurance Contracts*, saying that it is the most perceptive on the continuing duty of good faith. I would like to take this opportunity to say that Malcolm Clarke's work on insurance law generally has been most valuable to practitioners and judges alike. I hope that when he retires from his professorial chair this summer, he will still continue for many years on what Lord Goff once described as the pilgrims' journey to "unattainable perfection" that is made by all lawyers, whether jurists or practitioners.[38]

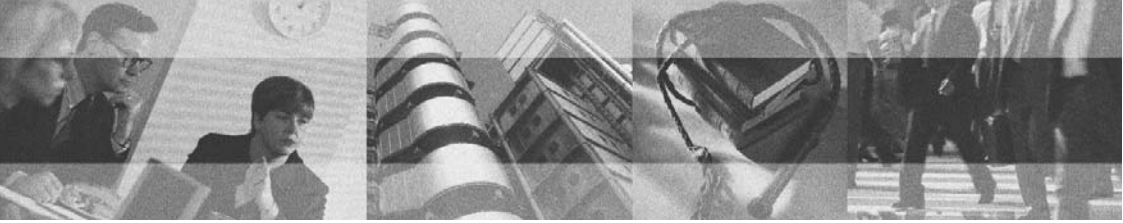
The next post *Star Sea* decision I wish to consider is *Agapitos v Agnew,*[39] decided by the Court of Appeal in 2002. It was an interlocutory decision on whether to permit the insurers to amend their defence to a claim on a marine policy, where a ship had been destroyed by fire when undergoing hot work in a Greek harbour. There was a warranty in the policy against hot work. After the litigation had begun the insureds disclosed sworn statements from workers that hot work had been carried out from a certain date. The underwriters wished to plead that the insureds must have known all along that this work was going on and had fraudulently concealed the fact from the insurers. The insurers wished to allege that the shipowners were (a) in breach of a common law duty not to present a fraudulent claim or (b) they were in breach of the continuing duty of good faith under section 17. Toulson J refused to allow the amendment and his judgment was upheld by the Court of Appeal.

Mance LJ used the case for a wide ranging review of what he plainly sees as the problems of the interaction between the post contract duty of good faith enshrined in section 17 and the common law rule that an insured must not present a fraudulent claim. He expressed the hope that the House of Lords, either judicially or legislatively, might look again at the scope of the duty set out in section 17.[40] Well, the House of Lords has missed the chance sitting as a judicial body. Maybe it will have it legislatively. But Lord Mance will not now be able to take part in that process because, like all members of the Supreme Court who are peers, he has signed a self-denying ordinance barring his participation in the House of Lord's legislative functions.

Mance LJ first concentrates on the common law rule. He says it applies not only to fraudulent claims but also to "fraudulent devices" to advance a claim. In the former, the whole claim, even if some of it is good, is forfeit. But in the latter case, the question is whether the mere use of a fraudulent device to advance a claim which is otherwise good can end in the forfeit of the claim or not? [41]

Mance LJ states that the *Mercandian Continent* affords no guidance as to the appropriate approach to use in the case of a fraudulent device to promote a claim under a policy.[42] Strictly speaking this must be right. Although it was a case where the insured had used a fraudulent device, at the time, as Longmore LJ pointed out, there could in fact be no claim under the liability policy because liability of the insured had not been determined at the stage that the insured had tried to use the fraudulent device.[43]

Mance LJ considered the question of what relationship there had to be between the fraud



on the part of the insured, whether in presenting a claim or in using a fraudulent device to promote a claim and the claim itself. In the first case, the knowing presentation of a non-existent or exaggerated claim is enough: the whole claim is automatically forfeit.[44]

In the second case, Mance LJ made important statements on two points. First, on whether the fraudulent device should have induced underwriters into any course of action, he said "he saw no reason for requiring proof of actual inducement here",[45] which seems contrary to indications given by Rix J in *Boskalis* and by Longmore LJ in the *Mercandian Continent*

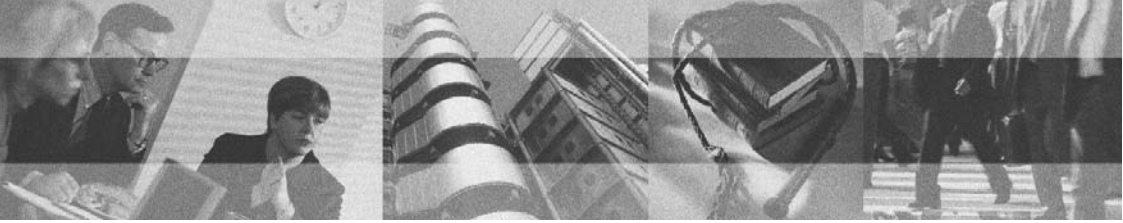
Secondly, on the issue of how "material" the use of the fraudulent device had to be, he said that the fraud must be "directly related" to and intended to promote the claim. If it is "directly related", then the fraudulent device will be material if it is intended to induce a different appreciation of the facts or the prospects in the minds of the insurer. The fact that the lie or fraud might be discovered later or be irrelevant to the underlying claim or the insurers' defence is not a relevant consideration.[46] This again seems contrary to the view expressed by Rix J in *Boskalis,* which was endorsed by Longmore LJ in *Mercandian Continent*.[47]

Mance LJ sums up the law[48] on the use of a fraudulent device to promote a claim under an insurance contract as follows. First, he says that the law is in an imperfect state on this topic, because it is "fettered" by section 17. Secondly, he says the use of a fraudulent device should be treated as a "sub species" of making a fraudulent claim, at least in relation to the consequence, which will be forfeiture of the claim in respect of which the fraudulent device was used. Thirdly, any "lie" which is directly related to the claim to which the fraudulent device relates and which is intended to improve the insured's prospects of obtaining a settlement or winning the case and which would (if believed) yield a "not insignificant improvement in the insured's prospects on the claim", is a relevant lie. Fourthly, the common law rule as to fraudulent claims including the use of fraudulent devices, falls outside the scope of section 17. Accordingly, no question of avoidance *ab initio* can arise.

Mance LJ went on to say that the common law rule on the effect of a fraudulent claim or device did not apply once litigation had started, by analogy with the termination of the section 17 duty.[49] For that reason, the amendment was refused because it raised a hopeless plea.

I should mention two subsequent cases in the Court of Appeal. In the first, *Axa General Insurance Ltd v Gottlieb,*[50] the leading judgment was again given by Mance LJ. It was a case concerning a fraudulent claim on a buildings policy. Four claims on the policy had been paid. The insurers said two of them were fraudulent and claimed reimbursement of all four. Mance LJ held that the common law rule relating to fraudulent claims applied, not section 17. There was no rule of law that permitted retrospective recovery of genuine claims paid before any fraud occurred.

Mance LJ makes two particularly interesting remarks. First, he says that the rule relating to fraudulent claims does not act just prospectively.[51] He says that there is a retrospective element in that the cause of action on an insurance contract arises from the moment when the insurer fails to keep the insured harmless from his loss.[52] The effect of a fraudulent claim,



including the use of a fraudulent device to promote an otherwise valid claim, is to remove or bar the insured's pre-existing cause of action. I follow the analysis, although I would have thought that if the claim is actually fraudulent, no cause of action could have accrued in the first place.

Secondly, he points out that the principle that a person cannot profit from his wrong, as stated in the *Beresford* case, does not account for the rule in insurance law, apparently adopted as a matter of policy, that once fraud is introduced in relation to a claim then the insured loses even a genuine part of the claim. Mance LJ describes this as a "special common law rule", although he also accepts that there was no binding authority about its limits. He says there are two parts to the rule, which are: no recovery of any claim to which the fraud was related; but retention of all other claims which are not related to the fraud.[53]

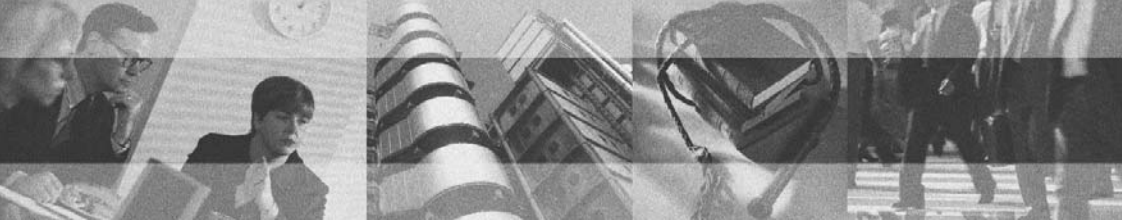
The second Court of Appeal case I note is that of *Shah v Ulhaq*.[54] This was not a claim on an insurance policy, but a claim for damages for personal injury arising out of a road accident. It was alleged that the claim of one of the three claimants was fraudulent because she was not in the car that was hit in the accident. It was argued that the claims of the other two claimants should be struck out, even if they were genuine, because of their fraud in supporting the third person's claim. The Court of Appeal rejected that argument and refused to apply any kind of analogy with fraudulent claims on insurance policies.[55]

So, having reviewed these cases, what are the problems with the law on the insured's or indeed the insurer's post contractual duty of good faith to which we need solutions? I suggest that there are at least four possible problems. The first must be: is there, or should there be, such a duty at all? The second is: if there is such a duty, when does it manifest itself in the post-contractual landscape. Does it, like the Cheshire Cat, appear and disappear? Thirdly, if there is to be such a duty, what should be the consequences of a breach of it? Fourthly, what should the legal relationship be between this duty and what now appears to be an established common law rule relating to fraudulent claims and the use of fraudulent devices to promote claims, which may or may not otherwise be genuine?

I make no excuses about the fact that I am now going to be argumentative. That is what talks like this are for!

Should there be a post contractual duty of good faith on the insured and insurer at all? In the *Agapitos* case, Mance LJ obviously thought, despite Lord Clyde's view in *The Star Sea,* that it was open to the House of Lord to pronounce that a section 17 application of good faith, imposed by the general law, not contract, did not extend beyond the formation of the contract and to analogous situations, e.g. renewals, variations, cases where insurers were contractually entitled to information and where an insured wishes to rely on a "held covered" clause.

There is a lot to be said for this aspiration. There were no relevant cases prior to the Marine Insurance Act which stated, in terms, that there was a continuing duty of good faith post contract. (The one possible exception, *Boulton v Holder Bros*[56] in 1903, was a ship's papers case). In the *Mercandian Continent,* Longmore LJ said that Sir Mackenzie Chalmers was not referring to the fraudulent claims cases (all fire policy cases) when drafting what has become



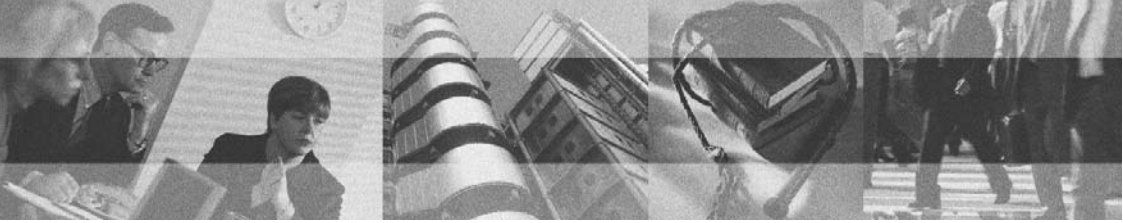
section 17, in a consolidating Act. In his own book on the Act, published in 1907, Chalmers refers to section 17 simply as being "a general principle" which was stated because the sections following were not exhaustive.[57] The first part of the section refers to *the contract* being "*based* on the utmost good faith", which suggests it is focusing on the pre-contract stage. In my view, all section 17 is doing is saying that the duty extends beyond the specific ones placed on the insured in sections 18-20 and it also places duties on the insurer as well.

But would the Supreme Court take that line now, in the light of all the statements in cases that have said that the scope of section 17 extends beyond formation of the insurance contract and analogous situations? We know that the House of Lords was prepared to put a judicial gloss on section 18, as it did in relation to the question of inducement in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Ltd.*[58] Lord Mance, like Lord Mustill who led the way in that case, is highly authoritative and knowledgeable on insurance law. So he might persuade his colleagues; but I am not sure he would. The problem is this: what could the Supreme Court fashion in its place and how could that be done in one case? The Supreme Court would be legislating, pure and simple.

That leads then to the question: if we are currently stuck with post contractual duties of good faith, then should it be based on a contractual implied term, or should it be something which derives from the general law and what sort of duties should there be? We can all agree that there is a duty not to present a fraudulent claim or to use a fraudulent device to promote a claim, whether good or bad. That does not need section 17, as is now clear, at least at Court of Appeal level, since *Agapitos.* In my view, this principle is nothing more than the most basic one that everyone must act honestly towards others with whom one deals. So an insured and an insurer must not act in bad faith. That principle is of universal application in the common law. It does not depend on an implied term of a contract, although if there is a contract, it seems to me to make sense to frame the duty in terms of an implied agreement between the parties to it.

Do we need more than that? What about the badly behaved insurer, as in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd: "The Good Luck".*[59] That was the case where the insuring P&I Club failed to tell the mortgagee bank, before it increased its loans to the shipowner, that it knew that the shipowner was deliberately sending its ships into the prohibited zone in the Gulf during the Iran-Iraq war without informing the Club or the bank. The *Good Luck* had a reversal of fortune and was struck by an excocet and sank. The P&I Club inevitably rejected the claim and the bank, now without security, sued the Club on all sorts of bases, including breach of a duty of utmost good faith.

The utmost good faith claim failed before Hobhouse J and the CA, first and foremost because the bank was found not to be a party to the contract of insurance, merely the assignee of the assured's financial interest in it. But we can all imagine cases where an insurer should owe a duty, particularly in the way it handles claims. What if it deliberately prevaricates and takes points which it knows are wrong or cannot honestly believe them to be good? That must be bad faith. It would also probably be a repudiatory breach of contract: see the remarks of Lord Lloyd in *Pan Atlantic*[60] and the Court of Appeal in *Drake Insurance plc v Provident Insurance plc.*[61] Do we need a duty of good faith to deal with that? If we do,



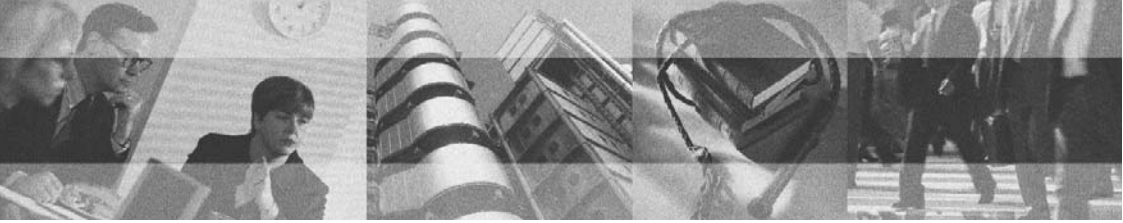
then an insured needs more than a right to avoid, as Sir Thomas Bingham MR pointed out in *Cox v Bankside.*

But this brings to the forefront the most perplexing problem with the post contractual duty of good faith, at least as it is apparently framed in section 17. The problem is the apparent limitation on the remedies for its breach. It derives from the fact that the courts have said that the post contract section 17 duty is not derived from an implied term in the contract, but the general law. In *The Good Luck,* the Court of Appeal followed its earlier decision in the *Banque Kayser Ullman v Skandia* case[62] which had concluded that a breach of the pre-contract obligation of good faith by reason of non-disclosure by an insurer did not give rise to a right to the insured to claim damages in tort. In *The Good Luck* the court said that the reasons for rejecting the right in relation to pre-contract breaches of good faith were equally persuasive against regarding post contractual breaches of good faith as being based on an implied term and so capable of supporting a claim for damages. But, as Sir Thomas Bingham MR, who was a party to the CA decision in *The Good Luck* effectively said in *Cox v Bankside,* surely it ought to give rise to such a right if loss has resulted?

Can the common law find a way, via the Supreme Court, to fashion this right or do we need legislation that will set out the parties' post contractual duties and say what the consequences of breach can be or might be, in the manner of the Misrepresentation Act 1967? You will recall that in *Banque Keyser Ullman,* the Court of Appeal advanced four reasons why a court should not create a tort out of a breach of a pre-contract duty of disclosure in a contract based on utmost good faith. The second, that there need be no actual inducement, I never understood, but is now irrelevant since *Pan Atlantic.* The third, that Parliament did not intend by section 17 of the Marine Insurance Act to give a right to damages for breach of the obligation of good faith seems rather feeble. The section says nothing about excluding a right to damages. The last, that a breach of the duty, whether innocent, negligent or fraudulent, would cause hardship if in each case it was a tort, seems to forget that both causation and actual damage, necessary ingredients in tort, must be established.

But I am concentrating on the post-contractual position, where one assumes a duty of good faith, i.e. not to act in bad faith, which is a general duty under the law: and asking why that should not give rise to a right in damages if broken in that contractual situation, provided causation and damage are proved. There are only two plausible reasons against it. The first one, raised in *Banque Keyser Ullman,* is based on legal archaeology. The Court of Appeal said that the power of the court to grant relief when there had been a non-disclosure of a material fact in the case of a contract *uberrimae fidei* stemmed from the jurisdiction of the courts in Equity to prevent imposition.[63] The second is the more general one that because the duty arises by virtue of the general law, not an implied term in the contract, therefore there is no question of a breach giving rise to a right to damages.

My tentative answers to that are as follows. First, the duty to exercise good faith before and after entering a contract of insurance do not originate in the courts of Equity. Lord Mansfield was sitting as Justice of the KB in *Carter v Boehm* and pronouncing the common law and the law merchant incorporated into it.[64] Second, if the contract was validly concluded, but there is then a breach of the obligation of good faith, which is, admittedly a



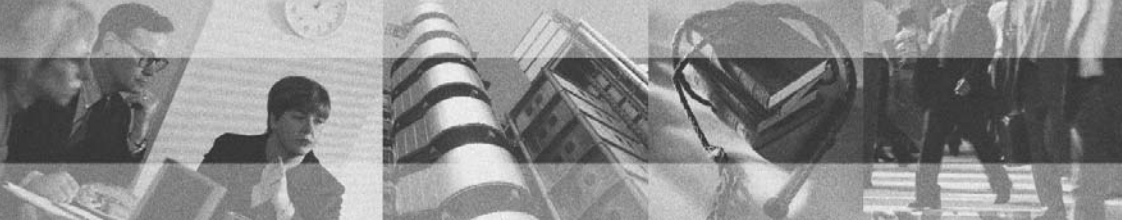
breach of a general duty in law, why cannot that be characterised also as thereby a breach of a term that is to be implied by law, the breach of which gives a right to damages? Contrary to the argument of Professor Bennett in his powerful article on the doctrine of utmost good faith published in 1999,[65] the implied term would be promissory: "I promise not to act in bad faith in the conduct of the contract of insurance just concluded".

Judges seem to have assumed that one must have the same analysis both pre and post contract, but they are, as Charles 1 said of a subject and his sovereign, "clean different things". As Lord Hobhouse himself pointed out in *The Star Sea,*[66] once the parties have entered a contract the source of their obligations one to the other is contract. The concept of good faith during the performance of the contract can derive from the express or implied terms of the contract itself. Intuitively, I side with Lord Bingham on this one. There ought to be such a remedy and I cannot see why the ingenuity of the common law cannot provide it. I also note, as Malcolm Clarke points out in his loose-leaf version of *The Law of Insurance Contracts,*[67] that Rix LJ has said, in terms, albeit in a non-insurance case, that there is a "general requirement of good faith and rationality" in contractual dealing and that "commercial contracts assume such good faith" which is why it is rarely expressly stated.[68]

Should there ever be a right to avoid for breach of the obligation of good faith post contract? It may be disproportionate in many cases. Lord Mustill said in *Pan Atlantic*[69] that there is no place for a "disciplinary element" in the law of marine insurance: the courts are not Misses Whiplash! (My expression, not his.) If avoidance is an equitable remedy, then perhaps the court should be entitled to say whether one side or the other is entitled to avoid, again by analogy with the Misrepresentation Act 1967.

Lastly, then, if there is to be a post-contractual duty of good faith and it is to give rise to a right to damages in certain cases, what is the relationship to be between that right and the common law rules on fraudulent claims and fraudulent devices? As Rix LJ has said on more than one occasion in the cases, fraud is a thing apart; or to put it in Latin: *fraus omnia corrumpit*. So, if the correct analysis relating to fraudulent claims and devices is that it is unconnected with section 17 and gives rise to a right to forfeit claims that are directly affected by the fraud concerned, I do not see a problem. Those rules will carry on. They seem fair and just enough to me. But would it not be better to recognise, as the majority did in *Orakpo*, that the correct analysis is a contractual one?

Now, where does this leave us? First, there are problems with the state of the law regarding the scope of section 17, looking at the cases as they stand at present. Secondly, there is scope for the Supreme Court to rule authoritatively on the scope of section 17 post contract. I do not repent of the view I expressed in the *Mercandian Merchant* that there has to be some trigger, whether it be a contractual obligation or a duty under the general law, that gives rise to an obligation to act in good faith such that, if you do not, it has legal consequences. But how long will we have to wait for the right case to get to the Supreme Court and even then, will it bite the bullet? Thirdly, there is a major and probably insuperable problem over the available remedies for breach of the duty of good faith. The Court of Appeal's view in *The Good Luck* was approved by Lord Templeman in the House of Lords.[70] It would be a bold Supreme Court that now introduced a right to damages for breach of that duty. Lastly, if the



law stays as it is, then the relationship between the common law rules relating to fraudulent claims and devices and the duty under section 17 and the consequences of breach will remain opaque and, in my view, logically irreconcilable.

I am not a fan of reform for the sake of tidiness. I am not a fan of legislation. But I do fear the Behemoth called "Europe" and those beavering away in Brussels on proposals which might deprive us of our English law on commercial insurance that has, by and large, served the United Kingdom and the international business community well for a long time. After all, London remains a world centre for marine and general business insurance and the contracts are, for the most part, governed by English law, so the UK law of insurance cannot be too bad!

Therefore, with great reluctance, I would concede that the Law Commission ought to consider these issues and, with the help of the market practitioners, the lawyers and the judges, produce some solutions. Maybe the simplest would be that proposed by the Australian Law Commission in 2001[71] which suggested one change to its Marine Insurance Act 1909, which is in identical terms to the 1906 Act. Its solution is a new provision which states (rather like the Sale of Goods and Services Act) that there would be implied by law a term in a contract of marine insurance that each party should act towards each other with the utmost good faith. I gather, however, that this proposal has yet to be enacted. Whatever the Supreme Court or the Law Commission comes up with, they must do their best to ensure that London remains the world centre for commercial insurance and particularly marine insurance, as it has been now for at least two centuries.

Endnotes

1 My thanks to Mr Stephen Fuller, a Judicial Assistant for the Court of Appeal, who has assisted with research and getting texts together. The errors and omissions remain mine alone.

2 See *Grill v General Iron Screw Collier Co* (1866) LR 1CP 600 at 612**:** "…gross negligence is ordinary negligence with a vituperative epithet".

3 [1979] 2 Lloyd's Rep 1 (CA)

4 See: *Astrovlanis compania Naviera SA v Linard: The "Gold Sky"* [1972] 2 Lloyd's Rep 187.

5 [1979] 2 Lloyd's Rep 1 at 22.

6 [1985] 1 Lloyd's Rep 437.

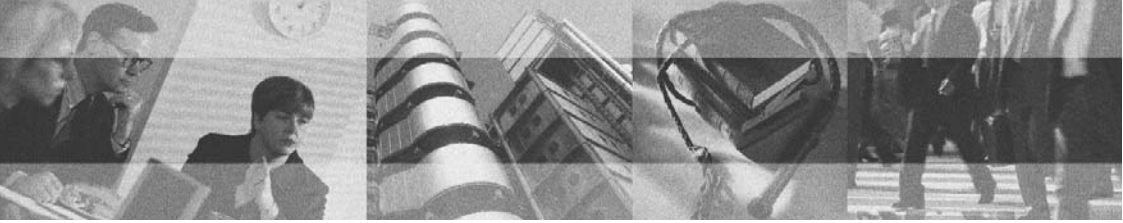
7 At page 512.

8 [1997] LRLR 523.

9 See pages 598-601.

10 [2003] 1 AC 469.

11 The underwriters had alleged that the shipowners had sent the vessel to sea in an unseaworthy state with their privity. If that had been proved then, in accordance with section 39(5) of the Marine Insurance Act 1906, it would have provided a defence to the claim which was made under a time policy for marine risks. The expert's report was on the cause of a fire in another ship owned by the shipowners. The underwriters asserted that the shipowners regularly sent their ships to sea in an unseaworthy state.



12 Para 5.

13 (1766) 3 Burr 1905 at 1910

14 *Star Sea* at para 6.

15 See para 44.

16 (1850) 2 Mac & G 231 at 243.

17 Para 51.

18 [1985] 1 Lloyd's Rep 437.

18 [1990] 1 QB 665; [1991] 2 AC 249.

20 [1937] 2 KB 197 at 212-213.

21 (1858) 1 F&F 276.

22 (1866) 4 F&F 905.

23 [1995} LRLR 443.

24 [1999] Lloyd's Rep 1R 209.

25 Para 71.

26 Para 71.

27 However, Lord Scott said, at para 120, that he agreed with Lord Hobhouse's opinion.

28 Para 85.

29 Para 102.

30 Para 110.

31 Para 111.

32 [1995] 2 Lloyd's Rep 437 at 462.

33 [2001] 2 Lloyd's Rep 563.

34 It is a nice touch of history that the *Mercandian Continent* was argued for the insurers in the Court of Appeal by Jonathan Hirst QC, whose father had given judgment in *The Litsion Pride*.

35 Paras 11 and 22.

36 Para 26.

37 Para 36.

38 Spiliada Maritime Corporation v Cansulex Ltd "The Spiliada" [1987] AC 460 at 488.

39 [2003] QB 556.

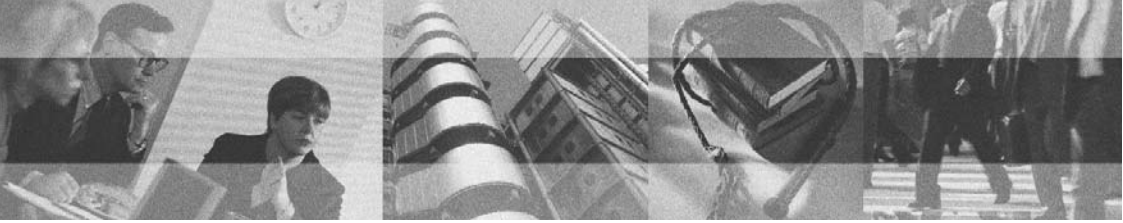
40 Para 13.

41 Para 20.

42 Para 24.

43 Longmore LJ relied on the principle confirmed by he House of Lords in *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957; see 966 per Lord Brandon of Oakbrook.

44 Para 36.



45 Para 37

46 Para 38.

47 In *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30, Lord Mance gave a concurring judgment on one aspect of the case which would only have arisen if the PC had allowed the appeal on the first part. Lord Mance noted (at para 35) that counsel for the appellant did not question the statements of principle of Mance LJ in *Agapetos.*

48 Para 45.

49 Para 52.

50 [2005] 1 All ER (Comm) 445.

51 Para 26

52 See: *Firma C-Trade SA v Newcastle P&I Indemnity Association: "The Fanti"* [1991] 2 AC 1 at 35-36 per Lord Goff of Chieveley.

53 Paras 29 – 31.

54 [2009] EWCA Civ 542.

55 See paras 16-20 per Smith LJ and 34-36 per Toulson LJ. Moses LJ agreed with Smith LJ.

56 [1904] 1 KB 784 at 791-2.

57 See: The Marine Insurance Act 1906 by MacKenzie Chalmers (1907) at page 25, quoted by Lord Hobhouse at para 48 in *The Star Sea.*

58 [1995] 1 AC 501.

59 [1990] 1 QB 818.

60 At page 456.

61 [2004] 1 Lloyd's Rep 268 at paras 86 -90 per Rix LJ.

62 [1990] QB 665.

63 *Banque Keyser Ullman* at page 780D.

64 This is demonstrated convincingly in the broad ranging and immensely learned article by Professor Howard N Bennett: *"Mapping the doctrine of utmost good faith in insurance contract law"* [1999] LMCLQ 165; see particularly at pages 185 – 192. But Professor Bennett argues that, even if the post – contractual duty of good faith is based on an implied term in the contract, it does not follow that breach of it gives rise to a right to damages: see pages 211 – 213.

65 See previous footnote.

66 At paras 50 – 52.

67 Para 27-1A

68 See: *Socimer v Standard Chartered Bank London* [2008] 1 Lloyd's Rep 558 at para 116.

69 At 549B-D

70 [1991] 2 AC 249 at 280B. The other Law Lords agreed with him on this.

71 Report 91 of April 2001, "Review of the Marine Insurance Act 1909".