Members may be interested to know that in connection with the Law Commission's working paper on insurance law (No. 73) your Association is interested in the present negotiations and for the benefit of members, a paper produced by Professor Hugh Cockerell is reproduced from the Post Magazine and Insurance Monitor by kind permission of the editor.

Erosions of the duty of disclosure

by Hugh Cockerell

The British Insurer has been brought up on the doctrine that a contract of insurance is a contract requiring the utmost good faith. The principal manifestation of this doctrine is the requirement that a proposer for insurance shall disclose to the insurer all material facts about the risk offered that he knows or ought to know. A fact is material if it would influence the mind of a prudent insurer in deciding whether to accept the risk and if so on what terms. This duty is admirably outlined in the Marine Insurance Act 1906, s.19, so far as marine insurance is concerned and the law there stated is generally considered to apply to all other classes of insurance with little or no modification.

Considering that the possible loss under an insurance is large in relation to the premium, the insurer can reasonably require that a proposer, who may be presumed to know all there is to be known about the risk, shall share his knowledge with the insurer. It is clearly not an attractive proposition to insure the cargo of an owner who knows that it has already been lost. In life and accident insurance a practice has grown up of requiring a proposer to warrant the truth of his statements on a proposal form which is declared to form part of the contract of insurance and to be the basis of it. This has had the effect of entitling insurers to avoid a policy where a statement on the proposal can be shown to have been untrue even though it was made innocently and was not material, in the sense that insurance would in practice have been granted on the same terms even if the proposal had been accurately completed.

Some 20th century cases illustrate the rigour with which insurers have taken advantage of the strict terms of the contract. For example, in Allen v Universal Automobile Insurance Co. Ltd. (1933) a proposer for motor insurance, in answer to a question about his car, "What was actual price paid by owner?", said £285, when in fact he had paid £271. The court held that the answer was inaccurate and as its truth had been warranted the insurers were able to repudiate liability. Similarly, in Dawsons Ltd. v. Bonnin (1922) where a lorry was proposed for insurance against third party and fire risks a question on the proposal form "State full address at which the vehicle will usually be garaged" was answered "46 Cadogan Street, Glasgow" whereas the lorry was garaged at the insured's garage at a farm on the outskirts of Glasgow. The House of Lords held that although the statement was not material, the claim against the insurers for damage by fire to the lorry failed because the proposer had warranted the truth of his statements and the policy contained a clause that they formed the basis of the contract.

The law relating to disclosure has other pitfalls for proposers. The answers on proposal forms are often filled in by an agent or employee of the insurers. This was so in Newsholme Bros. v. Road Transport and General Insurance Co. Ltd. (1929). Some of the answers on the proposal were incorrect although the proposer claimed to have told the agent the true facts. The Court of Appeal held that the proposer must accept responsibility for the mis-statements as the person filling in the form was not the insurers' agent for the purpose of so doing and could only have been acting as the proposer's agent or amanuensis. A breach of the warranty of the truth of the statements therefore enabled the insurers to decline liability.

A further difficulty for proposers is that even if they answer fully or correctly all the questions on a proposal form they may be held not to have discharged their responsibility to disclose all material facts if there was some information not called for by the form which would have influenced an underwriter had he known it. Thus in Roselodge Ltd. v. Castle (1966) a company which claimed to be indemnified for a diamond robbery failed to recover under its policy because, although there was no relevant question on the proposal form, the company had not disclosed that its sales manager had been convicted of smuggling diamonds into the USA in 1956. Similarly, in Woolcott v. Sun Alliance & London Insurance Co. Ltd. (1977) a man whose house was destroyed by fire failed to recover in respect of his loss because he did not disclose that he had been convicted of robbery in 1960 although the proposal form did not contain any questions about his moral character. In that case the insurance company indemnified the building society which had advanced money on the security of the house though denying liability to the man with a criminal record.

Misstatement of non-material facts

The law relating to the duty of disclosure may appear harsh in the case of innocent misrepresentations and its operation has been criticised by judges from time to time, but Lord Haldane said in Dawsons Ltd. v. Bonnin that hard cases must not be used to make bad law. Criticism has centred particularly on insurers' practice of requiring proposers to warrant the truth of their statements on proposals so that even a misstatement of a fact that is not material can make a policy voidable. The Law Reform Committee, in its report on 'Conditions and Exceptions in Insurance Policies' in 1957 acknowledged that often when insurers repudiate liability on a technical ground they do so because they are suspicious of a claim. The committee commented "This does not alter the fact that the ease with which a technical defence may be found means that in many cases an insurer is in a position to substitute his own judgement of the claimant's bona fides for that of a court." Accordingly the committee recommended that no defence should be maintainable by reason of any misstatement of fact by the insured where the insured could prove that the statement was true to the best of his knowledge and belief. The committee also recommended that anyone negotiating an insurance should be deemed to be the agent of the insurers for the purpose of the formation of the contract and that his knowledge should be deemed to be the knowledge of the insurers.

No legislative action has been taken on the committee's report in Britain, but there are clear signs that the full rigour of the present law will be mitigated here in the near future as it has already been in other countries. In several parts of Europe, for example, what is called the proportional rule is applied in respect of an innocent misstatement. The insurer is not allowed to avoid the policy but must pay a proportion of the claim corresponding to the proportion between the premium actually paid and the premium that would have been payable if the insurer had known the true facts. The EEC has proposed in its most recent draft of the directive relating to the contract of insurance that this principle should be adopted in the law of all EEC member countries.

In other English-speaking countries, too, the law had been modified by legislation. In some states of the USA all warranties are deemed to be representations only, while in others the insured is allowed to recover if a breach of warranty did not lead to the loss. Alternatively, as in New Hampshire, the proportional rule is applied. In Ontario since 1914 no policy can be avoided by reason merely of any misrepresentation or inaccuracy in a statement made on a proposal; any misrepresentation which might avoid the contract must be a misrepresentation of a material fact. In South Africa, by the Insurance Amendment Act 1969, an insurer cannot rely on a misrepresentation of fact unless it was likely to affect materially the assessment of the risk.

Statement of practice

In Britain insurers are anxious to preserve the principle of the utmost good faith while conceding that insurers should not make unreasonable use of their right to avoid an insurance in cases of innocent misstatement or non-disclosure. The Law Commission recommended that, so far as individual consumers were concerned, insurance contracts should be subjected to the proposed Unfair Contract Terms Act 1977 which might have had the effect that the courts could have considered in respect of any policy whether a term such as a warranty of truth was reasonable in the circumstances of any case. In the event, the Government agreed to exclude insurance contracts from the scope of the Act, upon insurers agreeing to statements of practice to show that they did not intend to exercise their powers unreasonably.

The statement of practice relating to non-life insurances of private policyholders resident in the UK said that declarations on proposal forms would be restricted to completion according to the proposer's knowledge and belief and that matters which insurers have found generally to be material would be the subject of clear questions on the forms. The statement also said that except where fraud, deception or negligence was involved, the insurer would not unreasonably repudiate liability to indemnify a policyholder on the grounds of non-disclosure or misrepresentation of a material fact where knowledge of the fact would not materially have influenced the insurer's judgement in the acceptance or the assessment of the insurance. Nor would insurers unreasonably repudiate on the grounds of a breach of warranty or condition where the circumstances of the loss were unconnected with the breach. Insurers have undertaken to draw the attention of the insured on proposal forms and in renewal notices to the duty of disclosure both at inception and on renewal. Insurers in agreeing to the statement have pointed out that there would sometimes be exceptional

circumstances which would require exceptional treatment. Comparable undertakings have been given in respect of life insurance.

Proposals completed by the agent

There remains the question of responsibility for incorrect statements in proposals that have been completed by an employee or other agent of an insurance company. It has been seen that in Newsholme Bros. v. Road Transport the insurer's agent can be held to be the agent of the insured for the purpose of filling in the proposal form and indeed some insurers here sought to make this always the case. In Stone v. Reliance Mutual Insurance Society Ltd. (1972) the declaration contained the words "in so far as any part of this proposal is not written by me the person who has written same has done so by my instructions and as my agent for that purpose". In that case, the proposal form was filled in by an employee of the insurers who inserted wrong answers by mistake. The Court of Appeal held that as he had authority from his employers to fill in the form and represented to the insured that the form had been correctly filled in the insurers could not rely on the declaration in the proposal form and must pay the claim. It is possible however to conceive of circumstances in which the declaration quoted would have been effective. If the recommendation of the Law Reform Committee in 1957 had been implemented the insurers would always be responsible for a mistake on the part of their agent in filling up the form. In the Green Paper of January 1977 the Government expressed the belief that insurers should be fully responsible for an agent's conduct in carrying out the terms of his agency agreement. The Paper said somewhat ambiguously that this suggestion "for making insurers fully responsible for the conduct of their agents provides a useful opportunity for giving effect to the Law Reform Committee's recommendation. But it is not the Government's intention that the proposer should be relieved of responsibility for the accuracy of statements made by him in response to questions expressly put to him in the proposal form". If a proposer signs without checking a form on which incorrect information has been inserted by the company's agent one is left wondering who is intended to be held legally responsible for an inaccurate statement in it.

It remains as important as ever that insurers should be told all they need to know for underwriting any risk that is proposed to them. But the days have gone when they could exercise a free hand in repudiating a claim for a merely technical breach of the duty of disclosure. Future cases of apparent hardships are likely to be rare indeed. The dust will settle on the old cases.

Meanwhile the Government last year asked the Law Commission to look at the subject matter of the 1977 EEC draft directive on insurance contract law which deals not only with the effects of non-disclosure, misrepresentation and breach of warranty but with other aspects such as the effect of an increase or a decrease in the risk covered by insurance. The Law Commission after nine months of deliberation has produced a working paper for discussion, stating its provisional conclusions.

The Commission considers the law should be changed as it fails to strike a fair balance between the insured and the insurer. It suggests that where no proposal form is used the insured should be under a duty to disclose those facts which a reasonable man in his circumstances would consider material in the sense that they would influence the judgement of a prudent insurer in accepting the risk or fixing the premium. The test would therefore no longer be what a prudent underwriter would need to know but what the insured if acting reasonably in his circumstances thinks the underwriter would need to know. The test would thus vary from policyholder to policyholder and would be expected to weigh more heavily on the experienced businessman than on the young housewife.

Waiving the duty

Where a proposal form is used the Commission thinks that in general the insurer should be taken to have waived the insured's duty to disclose any fact outside the scope of the questions asked. While it would be a presumption that the questions and answers on a proposal were material the insured should be able to rebut this by proving that they would not have influenced the mind of a prudent underwriter. Catch-all questions such as "Are there any other facts....?" should not be allowed. Answers to questions need only be true to the extent of the insured's knowledge and belief, provided the insured had carried out reasonable enquiries. Warranties would only be effective if material to the risk and if the loss falls within the commercial purpose of the warranty. If the insured can prove that the breach could have had no connection with the actual loss, the insurer should not be entitled to reject a claim.

The Commission provisionally rejects the proportional rule embodied in the EEC directive and makes a good many other criticisms of the draft. Whatever one may think of the Commission's own proposals it can be questioned whether Britain would be wise to alter its law at this stage in a direction that did not necessarily commend itself to our European partners. To do so would open the way to further years of negotiation in the EEC with a consequent postponement in practice of insurers' freedom to offer their services across frontiers.