THE PRUDENT UNDERWRITER - TIME FOR CHANGE
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In recent years the number of disputes involving non-disclosure and misrepresentation appears to have increased and it is perhaps no coincidence that the decision of the Court of Appeal in *Container Transport International Incorporated v. Oceanus Mutual Underwriting Association (Bermuda) Limited*[1984] 1 LLR 476 ("*CTI*"") represents a high water mark in favour of those seeking to establish an avoidance case based on non-disclosure and/or misrepresentation. Arguably this case has generated an imbalance between the parties to an insurance or reinsurance contract giving rise to a need that the decision be reconsidered by the Courts.

I consider the position under the following headings:-

1. The general approach prior to the decision of the Court of Appeal in *CTI*.
2. The decision of the Court of Appeal in *CTI*.
3. Post *CTI*.

1. POSITION PRIOR TO CTI.

Section 18(1) of the Marine Insurance Act 1906 provides as follows:

"Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract".

Thus, the Assured is only required to disclose such circumstances are as "material". Section 18 (2) of the Act defines what is meant by material. Section 18 (2) provides as follows:

"Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk".

Although I have cited the definition in the Marine Insurance Act I should make clear that in the context of non-disclosure and mispresentation there is no difference between marine and non-marine insurance law *(Lambert v. Co-operative Insurance Society Limited)*[1975] 2LLR 485. Likewise, there is no difference between direct and reinsurance business. *Highlands Insurance Co. v. Continental Insurance Company* [1987] 1 LLR 10.

The definition of materiality has caused much controversy. In *Berger and Light Diffusers Pty Ltd -v- Pollock* [1973] 2 LLR, Mr Justice Kerr (as he then was) was faced with the interpretation of s. 18 (2). In that case, the Plaintiffs (the assured) were the owners of four large steel injection moulds being carried under a bill of lading. The fact that the bill of lading was claused stating that the goods were "unprotected", "second hand" and "insufficiently packed" was not disclosed to the underwriters. Underwriters repudiated liability on the ground that the Plaintiffs had failed to disclose material facts, namely (1) that the bills of lading were claused, (2) the history of the moulds and (3) the fact that they were over-valued. Kerr J was required to consider the materiality of these non-disclosures. In his judgement he states:

"It seems to me, as a matter of principle, that the Court's task in deciding whether or not the Defendant insurer can avoid the policy for non-disclosure must be to determine as a question of fact whether, by applying the standard of the judgement of a prudent insurer, the insurer in question would have been influenced in fixing the premium or determining whether to take the risk if he had been informed of the undisclosed circumstances before entering into the contract. ***Otherwise one could in theory reach the absurd position where the Court might be satisfied that the insurer in question would in fact not have been so influenced but that other prudent insurers would have been. It would then be a very odd result if the Defendant insurer could nevertheless avoid the policy" (my underlining).***

In rejecting the Defendant's defence, part of Kerr J's *ratio decidendi* was as follows:

"He [the Defendant] has, in my view, established no more than that one prudent underwriter would have regarded the clausing of the bill of lading as material ... but not that the underwriters on this risk would, in the particular circumstances of this case, have taken the same view.".

Kerr J went on to say:

"The effect of the non-disclosure may, of course, be so clear that the Court will require no evidence, or only little evidence, to decide in favour of the insurer. In doubtful cases, on the other hand, the Court may require evidence from the insurers themselves before being able to hold that the right to avoid the policy has been established. In my view, the underwriters concerned should have been called in the present case, and this should be the practice in all doubtful cases even if an independent underwriter or broker is called as well".

Therefore, the materiality test laid down in section 18 (2) and as interpreted in *Berger -v- Pollock* required the Court to consider the impact that the undisclosed facts would

have had on the mind of the *particular* underwriter had the facts been disclosed to him at the time of placing the risk. It was insufficient to call an independent expert underwriter to give his opinion on the materiality of any particular undisclosed fact: it was the particular underwriter involved in the contract who was required to give evidence on how he would have viewed such facts. This would appear to be the sensible approach, for if an insurance contract is to be avoided for material fact, it should be the underwriter himself who must prove that the non-disclosure in question would have had a bearing on his decision to write the risk or how to rate the premium. The reference to the "prudent underwriter" was to provide an objective limitation so that it would not be open to the underwriter to argue that a most insignificant circumstance would have been material to the formation of his judgement.

2. EFFECT OF CTI

The decision of *Berger -v- Pollock* was not followed in 1984 by the Court of Appeal in CTI. (Leave to appeal to the House of Lords was refused by the Court of Appeal. Leave was subsequently granted by the House of Lords but the case settled prior to the hearing). In that case, the underwriters were seeking to avoid the contract of insurance for the failure by the assureds to disclose their previous loss records. The Court of Appeal consisted of Lord Justice Stephenson, Lord Justice Parker and Lord Justice Kerr (the judge in *Berger v. Pollock*). It was held that an insurer is entitled to avoid a contract under section 18 if there was a failure to disclose before the contract was concluded any circumstance which a *prudent insurer* would take into account when reaching his decision whether or not to accept that risk or what premiums to charge - the emphasis now being placed solely on the hypothetical prudent insurer and not the particular insurer. Kerr L J says in his judgment:

"The duty of disclosure, as defined or circumscribed by ss. 18 and 19, is one aspect of the overriding duty of the utmost good faith mentioned in section 17. The actual insurer is thereby entitled to the disclosure to him of every fact which would influence a judgment of a prudent insurer in fixing the premium or determining whether he will take the risk..."

He went on to say:

"One must bear in mind that the issue is as to the relevance, and not as to the weight, of any evidence which may be adduced in order to show that an undisclosed circumstance was material. Such evidence may be given by the actual insurer who - ex hypothesi - has accepted the risk in ignorance of the undisclosed fact. For him, it may be relatively easy to say simply: "Had I known this, I would had declined the risk, or imposed such-and-such a term, or changed such and such a premium". But this is not

the nature of the evidence to which section 19 (2) is directed; nor is such evidence required from any witness who may be called on the question of materiality. The section is directed to what would have been the impact of the disclosure on the judgment of the risk formed by an hypothetical prudent insurer in the ordinary course of business . . . He is in an hypothetical position, and evidence to support the materiality of the undisclosed circumstance, from this point of view, is therefore often given by an independent expert witness whose evidence has to be assessed by the Court long after the event. He, or the actual insurer, or both, may then be asked: "What would have been your reaction if you had known of this undisclosed fact:"

Both would in my view give relevant evidence on materiality if they replied: "I would then have regarded the risk in a different light. I would have taken this circumstance into account. As a first step I might have asked some questions before making up my mind about the risk. What my final decision would have been, I cannot now say for certain. I might have declined the risk altogether, or increased the premium or altered the terms in some other way". And it would make no difference if the witness went on: "I might even have taken a chance, or given credit for the frankness of the disclosure, by writing the risk as I did. But I should obviously have been told about this fact before being asked to make up my mind."

The weight which the Courts would give to such evidence is then a matter for the Court".

In *CTI* , therefore, the Court of Appeal shifted the emphasis from the actual underwriter preferred by Mr. Justice Kerr in *Berger v. Pollock* to the prudent underwriter. Between 1973 and 1984, Lord Justice Kerr clearly had a dramatic change of judicial opinion. His explanation was that he had been wrong in his reasoning in *Berger v. Pollock* due, at least in part, to his apparently not have been referred during the course of the first case to the decision of the Court of Appeal in *Zurich General Accident and Liability Insurance Co. Ltd v. Morrison* [1942] 2 K. B. 53. In the *Zurich* case, the Court of Appeal drew a distinction between the position under the Road Traffic Act, 1934, which refers to a policy having been "obtained by" the non-disclosure of a material fact, and that under the Marine Insurance Act, 1906. Both Acts define "material" in the same way, but the Court of Appeal concluded that the words "obtained by" altered the test under the Road Traffic Act. Lord Justice MacKinnon held as follows:-

"Under the general law of insurance an insurer can avoid a policy if he proves that there has been misrepresentation or concealment of a material fact by the assured. What is material is that which would influence the mind of a prudent insurer in deciding whether to accept the risk or fix the premium, and if this be proved it is not

necessary to prove that the mind of the actual insurer was so affected..."

This was, obviously, the statement which influenced Kerr L.J. in *CTI*. Mackinnon L.J. continued:

"But under the provisions of the Road Traffic Act 1934, I think this general Rule of insurance law is modified. The section requires the insurer to establish that the policy was "obtained" by non-disclosure or misrepresentation . In such a case as this, therefore, I think the plaintiffs must establish two propositions (1) that the manner relied on was "material" in the sense that the mind of a prudent insurer would be affected by it, and (2) that in fact their underwriter's mind was so affected, and the policy was thereby obtained."

Given the difficulties that I will highlight below, I must doubt whether that distinction even if legally correct can be justified as a matter of principle. To the contrary, it seems to me that there is much to be said for the test as to what is material being the same in relation to all insurance policies.

3. POST CTI

In my view, the approach to assessing materiality under the general law of insurance adopted in CTI opens the door to possible abuse and makes it extremely difficult for a broker to place business with any real certainty that he will have properly fulfilled the duty to disclose all facts that a prudent underwriter would consider material in the context of that particular placing. The reason simply is that what an assured or broker may believe to be reasonable is not a factor in the question. Nor is it sufficient to disclose those facts which the actual underwriter himself would wish to know. The broker and the assured must go further and disclose those facts that the prudent underwriter (who at the time of placing is obviously a mythical character) would wish to know and requires the broker, in effect, to form a view whether each particular underwriter he sees meets the standard of the mythical prudent underwriter, with the consequent effect upon the manner in which the risk is broked to each underwriter. Take the following examples:-

1. An underwriter establishes himself as something of a leader in a particular new class, in which few others participate. The broker provides him with the same information for every placing. Years later, that class having proved unprofitable, an expert underwriter, who never wrote that class, testifies that the broker ought to have provided some item of information which the original underwriter had never requested.

2. A broker puts together a complicated reinsurance package which may include

certain underwriters agreeing to front for elements of the risk. Because they are fronting little or not enough attention is paid by them to the package. One of those for whom they are fronting (who knew all the material facts) then goes into liquidation.

In circumstances such as these can it be right that some years later when losses occur the Underwriter is entitled to avoid because a prudent underwriter would have been influenced by different commercial considerations, or would have reviewed the information more thoroughly, and would consequently have found the presentation to be incomplete? It seems to me that at present the Court considers the test of materiality in something of a commercial vacuum with the consequent risk that bad underwriting may prevail at the expense of the assured and/or reassured.

CONCLUSION

The views expressed by Mr. Justice Kerr in *Berger v. Pollock* are to be preferred over the views later expressed by Lord Justice Kerr in CTI. Frankly I doubt whether Lord Justice Kerr (or for that matter his colleagues in the Court of Appeal) intended their decision in CTI to be taken quite as far as it now has. It is absurd to have a situation where the law, as it currently stands, holds that the view of the actual underwriter about materiality is so irrelevant that one might legitimately object to him being cross-examined about it.

Short of legislation, which seems unlikely, the only way forward is for the matter to be considered by the House of Lords in the hope that a more balanced approach will prevail and that the views of the actual underwriter, in addition to those of the prudent underwriter, will be taken into account to establish materiality. The uncertainty generated by the present state of the law and consequential ability of insurers (especially those in run-off with no ongoing commercial interests) to seek to avoid policies for non-disclosure or misrepresentation (whether or not they ultimately succeed) is not in the best interests of the London Insurance Market and needs to be resolved in a fashion which makes better business sense.