UTMOST GOOD FAITH AND THE REINSURANCE MARKET

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It would perhaps be logical to start with a definition of reinsurance and I am sure it will not come as much of a surprise to any of you particularly after what you have already heard this morning, to learn that this brings us back to that veritable Clapham junction of English commercial law Lord Mansfield, who defined reinsurance in *Delver v Barnes* as:

> "A new insurance, effected by a new policy, on the same risk which was before insured in order to indemnify the underwriters on their previous descriptions; and both policies are in existence at the same time."

Ever since then reinsurance has been treated in the English courts as a form of insurance. It is hardly surprising, therefore, that the duty of utmost good faith has generally been applied to reinsurance in exactly the same manner as it is applied to insurance. Indeed many of the authorities cited for the existence and extent of that duty are reinsurance cases. *CTI v Oceanus* is itself a reinsurance case, to mention but one, although perhaps the best known recent example.

Let us pause here to recall the reasons given by Lord Mansfield in *Carter v Boehm* for the duty of good faith namely:

> "insurance is a contract upon speculation the special facts, upon which the contingent chance has to be computed lie most commonly in the knowledge of the insured only: the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist and to induce him to estimate the risk, as if it did not exist."

A little bit later on in his Judgment Lord Mansfield goes on to say:

> "The reason of the rule which obliges parties to disclose, is to prevent fraud, and to encourage good faith. It is adapted to such facts as vary the nature of a contract; which one privately knows and the other is ignorant of, and has no reason to suspect."

While *Delver v Barnes* was not itself a Marine case, at that time it was decided in the middle of the eighteenth century and for many years afterwards most insurance was

concerned with goods, the storage of goods and their movement by sea and leaving to one side for the moment whatever may be and is said about the application of the duty of utmost good faith to non-commercial insurance generally, the reasons Lord Mansfield gave for the existence of the duty are still valid as regards the reinsurance market.

To this day, although for how much longer is a matter for conjecture, brokers acting on behalf of their principals can still be seen trundling through the city with slips to place before subscribing underwriters. The basic methods employed have probably not changed all that much from those used in the eighteenth and nineteenth centuries to place marine insurance and, consequently, the methods and concepts employed in the placing of reinsurance business in the London market have been largely adapted from those originally devised in earlier years to deal with the insurance of a voyage.

The process usually, although not invariably, starts with the potential reinsured asking a broker to obtain a quotation. The broker in conjunction with the reinsured will then prepare the draft slip and eventually, when it has been approved by the reinsured, the slip will then be taken round the market. This process was described by Lord Diplock in *American Airlines v Hope* as follows:

> "Contracts of insurance are placed at Lloyd's by a broker acting exclusively as agent for the assured. It is he who prepares the slip in which he indicates in the customary "shorthand" the cover that the assured requires. He takes the slip in the first instance to an underwriter whom he has selected to deal with as leading underwriter, ie, one who has a reputation in the market as an expert in the kind of cover required and whose lead is likely to be followed by other insurers in the market. It is the first contract of insurance covering that risk in which a particular underwriter has acted as leading underwriter and it is treated as an original insurance. The broker and the leading underwriter go through the slip together. They agree on any amendments to the broker's draft and fix the premium. When agreement has been reached the leading underwriter initials the slip for his proportion of the cover and the broker then takes the initialled slip round the market to other insurers who initial it for such proportion of the cover as each is willing to accept."

Lord Diplock is talking about the placing of a direct aviation cover; but what he describes is equally applicable, in my experience, to the reinsurance market, although, of course, the nature and extent of the negotiations with the leading underwriter and other details may vary greatly from one instance to another.

Consequently, so far as reinsurance is concerned there is no question of anything like what are often referred to as contracts of adhesion being involved. The situation is not the same as that where an insured, who may know nothing about insurance, is faced with accepting a standard form of policy of going without or, more likely, having a very limited choice of alternatives.

I have spent some time on the historical background and the manner of placing reinsurance not simply because this conference is held under the aegis of the Chartered Insurance Institute's Historical Forum; but also to indicate the difference which exists between the way in which, what is sometimes referred to as personal lines business, that is to say non-commercial business, such as the insurance of private dwellings, is effected on the one hand and the way in which reinsurance is placed.

I do not feel I have to attempt to go into any detail about the way in which personal lines insurance is generally effected, not simply because of the nature of the audience I happen to be addressing, but also because this is something which falls within the personal experience of most people.

Whatever may or may not be said about the duty of disclosure as regards direct personal lines insurance the fact is that the circumstances and conditions which Lord Mansfield must have had in mind when framing the rule are not dissimilar from those which exist today where reinsurance is concerned.

Consequently, his conclusion that "the special facts, upon which the contingent chance has to be computed lie most commonly in the knowledge of the insured only" and "the reason of the rule which obliges parties to disclose, is to prevent fraud, and to encourage good faith", in my opinion are still pertinent as regards reinsurance. After all just as a shipowner in the eighteenth century might be expected, under normal circumstances, to know more about his vessel and its voyage than an underwriter: in the twentieth century an insurance company might be expected to know more about the business it wishes to reinsure than any reinsurer can.

So the fact that the developed law of disclosure and misrepresentation may be considered in some quarters to be inappropriate where applied to the man in the street, and I am not concerned here with whether this is true or even significant, is largely irrelevant so far as reinsurance is concerned. After all it hardly becomes a prospective reinsured to complain that its obligation to disclose all facts that might influence the insurer is unduly burdensome. As an insurer itself, it should know better than most what is likely to influence a prospective reinsurer's judgement. This being so it might be expected that disputes arising from non-disclosure and mis-representation as

regards reinsurance would not occur to the same degree as they do in direct insurance. Unfortunately, this does not appear to be the case now and has not been so for many years. Disputes between reinsurer and reinsured seem to arise more frequently from what the reinsurer has been told about the risk before inception or renewal than perhaps from any other single cause.

It is against this background that we may turn to consider the present position as it affects the placing of reinsurance by brokers in the London market. By the present position I mean, of course, basically the duty of disclosure as formulated by Lord Mansfield and interpreted by the Court of Appeal in *CTI v Oceanus*.

It is hardly necessary for me to go into the Court of Appeal's decision in this case any further; but perhaps I should just remind you that it means:

(1) the state of mind of the underwriter relying on the defence is immaterial, as what has to be decided is the influence the fact not disclosed or misrepresented may have had on a hypothetical prudent underwriter:

(2) it is also not necessary for an underwriter to show that the misrepresentation or non-disclosure would have caused him either to refuse to insure the risk or charge a higher premium for doing so, it suffices merely to demonstrate that the prudent underwriter would have taken the matters into consideration in reaching his decision.

As practice is generally considered to account for a great deal more than theory where such matters as these are concerned we may as well start by having a look at a case in which these issues came before Mr Justice Waller last year. *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd* in which a dispute had arisen between the plaintiffs, Pan Atlantic, and the defendants, Pine Top, over what had been disclosed and what representations or misrepresentations had been made at the renewal on behalf of the defendants, by the broker, Mr Robinson of Butcher Robinson and Staples, of an excess of loss contract covering the defendants' Casualty Account in respect of losses occurring during the calendar year 1982. This contract was itself a renewal of a series of contracts, the first of which covered losses occurring from July the 1st 1977 until the 31st December 1978 and thereafter to the 31st December in each subsequent year.

The renewal was broked by Mr Robinson to the defendants' underwriter, Mr O'Keefe, who had not acted as such when the defendant had reinsured the plaintiff for the first time in respect of the 1980 year but had done so on the occasion of the renewal

of the cover in 1981. There had been two meetings between Mr Robinson and Mr O'Keefe, one on or about December the 22nd or 23rd 1981 and the other on January 13th 1982. It would appear that a quotation had been made at the first meeting and the contract was concluded and the slip initialled at a meeting on the 13th of January 1982. The wording being signed on October the 29th in the same year.

The broker had prepared two separate loss schedules, one a detailed document setting out the claims experience in respect of the years 1977-1979 and the other, a rather more summary affair referred to as the "short record", in respect of the years 1980 and 1981.

The issues Mr Justice Waller had to decide were (1) whether there was non-disclosure of a material part of the loss record on this contract, namely, that for the years 1977-79, which Mr O'Keefe denied ever having seen, on the basis it would seem that if it had been presented to him then he would have taken a copy of it, and (2) whether, in respect of the loss record for the years 1980 and 1981, there had been a failure to disclose additional losses.

Mr Justice Waller had no doubt that the record of losses for the years 1977-1979 had been prepared by the brokers for the purpose of the renewal negotiations and had been taken along by Mr Robinson to both the meetings with Pine Top. The learned Judge also had no doubt that it was there on the table and readily available for Mr O'Keefe to see if he wished to do so; but equally he had no doubt that Mr Robinson broked the risk in a way designed to concentrate Mr O'Keefe's mind, so far as was possible, on the short form record.

From this it followed, in the learned Judge's opinion, that the question of whether the 1977-1979 loss record was disclosed was not a question of fact so much as a question as to whether in broking the risk in the manner in which it had been done a fair presentation of the risk was made. Mr Justice Waller considered that it was impossible to separate that question from the question of waiver saying:

> "As I have already indicated, I do not think it is possible to divide that question in this instance from the question of waiver. It is in my view a borderline case. I say that because I am not convinced that the preparation of the two records was done to assist the underwriter as suggested. It seems to me to have been done in the hope that the underwriter would concentrate on one record rather than the other. But I have come to the view that it is either on the right side of the borderline, or the doctrine of waiver in this instance should defeat any reliance on the non-disclosure."

For the same reason Mr Justice Waller concluded there had been no misrepresentation because the underwriter appreciated that the full record was available and therefore he was not entitled to understand that any representation was being made to him by virtue of the short record, other than that the figures contained therein represented the losses and premium as at September the 30th 1981 for the 1980-1981 year.

As regards the failure to disclose additional losses affecting the years 1980 and 1981 it was asserted by the defendants that:

"(i) that the short record when shown on December 23rd, 1981 with figures as at September 30th, 1981 was inaccurate because two losses were not included in the record relating to the 1981 year;

(ii) that by January 13, 1981 losses were known to the insured to have occurred both prior to September 30th, 1981 ie the losses in (i) above and between September 30th, 1981 and December 31st, 1981, ie in the fourth quarter, which materially altered the presentation of the business and which thus should have been disclosed; and

(iii) that if Mr Robinson was right, he showed Mr O'Keefe a document summarizing the losses for the respective years as at December 31st, 1981 and that, if that were so, he thereby represented the losses for the 1981 year were still $235,768 whereas they were in fact $464,168."

After having held that the errors and omissions clause was not applicable to precontractual non-disclosure and misrepresentation Mr Justice Waller went on to consider whether the losses materially altered the presentation made to Mr O'Keefe.

That is to say whether the losses which were known to the plaintiffs in the ordinary course of business as having occurred prior to January 13th 1982 were losses which a prudent underwriter, in considering the figures as at September 13th 1982, would assume were likely to occur in the normal course of events as part of the development of those figures or whether the figures relating to those losses showed a difference which would impact on the underwriting judgment of a prudent underwriter.

It would appear that the brokers BRS did not know of the additional losses; but Mr Justice Waller held that it was clear that due diligence was required on the part of an insured or reinsured to communicate material facts to his agent. In any event it seems from Mr Robinson's evidence that this was what he understood should be done and thought he had done.

The learned Judge then went on to conclude that the additional losses should have been known to the plaintiffs in the ordinary course of business and should have been communicated to BRS prior to January 13 1982 and that the additional losses materially altered the presentation saying:

> "It seems to me that the evidence demonstrates that a prudent underwriter in fact would want the information in relation to the 1981 year, even if he had the full record, because it would confirm that the 1979 year was not some rogue year. It furthermore makes clear that any underwriter who is looking purely at the 1980 and 1981 years would certainly want that information. Accordingly, in my view, the additional losses for the 1981 year were material to the contract, and should have been disclosed on January 13, 1982 when the final presentation took place."

As regards the question of whether the loss position had been misrepresented to Mr O'Keefe at the meeting on January 13th 1982 Mr Justice Waller concluded that the document summarizing the loss position as at 31st of December 1981 would have been in existence and taken along by Mr Robinson to the meeting on January 13th 1982 and he then went on to remark:

> "It would be used by Mr Robinson, not as a document which would be likely to have been copied by Mr O'Keefe but simply as something to support his assertion that having done a quick update there was little movement in the figures. In particular, Mr O'Keefe would have taken in the figures in relation to the years 1980 and 1981, and the representation to him would have been clear that for the year 1981 there had been no deterioration in the position since September 30th, 1981. That might well be contrary to his expectations as an underwriter, but nevertheless there is no reason why he should not rely on the fact that there has been no material deterioration since he put down his original quote. The effect of the representation, both to him and to any prudent underwriter, as it seems to me, would have been to influence him not to reconsider any quotation previously *put down.*
>
> So far as the test laid down in *CTI v Oceanus* is concerned, it seems to me that on the same basis as I have found that the additional losses figures would have been material to have been disclosed, a misrepresentation as to those figures would amount to a material misrepresentation."

Now Mr Justice Waller had been asked on behalf of the plaintiffs to make findings as to what the particular underwriter in question, Mr O'Keefe, as opposed to a hypothetical prudent underwriter, might or might not have done so as to enable the

plaintiffs to challenge the test laid down in *CTI v. Oceanus* in another court and as there had been no objection Mr Justice Waller had consented to do so.

On the basis that the plaintiffs wished to challenge both aspects of the test of materiality, that is to say the impact on formation of opinion as opposed to influence on the final decision, as well as, whether the particular underwriter must be shown to have been influenced, Mr Justice Waller expressed the view that the non-disclosure of the additional losses or the misrepresentation of them was material, in the sense of tending to induce a prudent underwriter or Mr O'Keefe not to reconsider the quotation given.

The learned Judge observed that outside the test laid down in *CTI v Oceanus* the law seemed to be that there is a presumption that where a material misrepresentation had been made the person to whom the misrepresentation has been made acted upon it and had been misled by it. The onus was on the person making the misrepresentation to demonstrate that this was not the case.

Consequently, the onus was on the plaintiffs to establish that Mr O'Keefe did not rely on any misrepresentation they had made and this they failed to do. Consequently, whether applying the test laid down in *CTI v. Oceanus* or a test relevant to the particular underwriter himself, the defendants had established a material misrepresentation and an entitlement to avoid the contract.

Mr Justice Waller concluded by saying:

> "I have to say that I have at times felt some unease about finding that a failure to disclose these additional losses on the 1981 year, even though they were substantial, should entitle the defendants to avoid all liability, when their underwriter appears simply not to have been concerned to look at or take account of the most material part of the record in considering this risk. But, if the eye of an underwriter is successfully taken off the ball, it must be expected that a detailed enquiry will be made in relation to how a risk was presented. That sometimes does throw up points of non-disclosure or misrepresentation which would not otherwise have been taken. If the non-disclosure or misrepresentation relates to a matter which is material, then there is no choice but to allow the contract to be avoided and that accordingly is the position in this case."

Here then is an example of the way in which it would appear some reinsurance negotiations at least are carried out. It may strike some people that there is a fair share of gamesmanship about it all and the process bears more than a fleeting resemblance

to a game of poker. Human nature being what it is this may well be inevitable, but all the same I do not think it is something which needs to be encouraged.

It may be recalled that one of the reasons advanced by Lord Mansfield for the rule was "to prevent fraud, and to encourage good faith."

THE BILA CHARITABLE TRUST - DONATIONS PLEASE!
by Hugh Cockerell

The BILA Charitable Trust was registered in 1986. Its main object is the advancement (in any charitable manner) of the public knowledge and understanding of law and insurance including the study of law in its inter-relation with insurance and for the study of insurance in its inter-relation with law. The original (and still serving) Trustees are Sir Maurice Bathurst, Hugh Cockerell and Pat Saxton. The Trust Fund, donated by BILA out of monies provided by British Insurers for the 1982 World Congress of Insurance Law held in London, at present consists of about £11,000. The Trustees have power to spend the capital but so far have confined themselves to making grants out of income. This means that they dispose of about £1,000 per year, a pretty modest sum.

Up until now half the income has gone in awarding an annual prize of £500 for a published work making a notable contribution to literature in the field of law as it affects insurance. Notable winners include Malcolm Clarke's "The Law of Insurance Contracts" and "Construction Insurance and UK Insurance Contracts" by Marshall Levine and Jeremy Ward, the 1991 winners. People concerned with both law and insurance are increasingly well catered for by authors and publishers.

The Trustees have also spent small sums from time to time in facilitating the attendance of needy people, notably students at Insurance Law Conferences but it is obvious that a few hundred pounds a year cannot do much in this respect. In 1994 the Quadrennial World Conference of Insurance Law is to be held in Australia. The Trust, with no more than its current resources, will be powerless to help any would-be attenders however desirable their presence might be.

Has the time come to consider building up the Trust's resources so that it may in future years better fulfil its object? No public appeal for money has ever been made on behalf of the Trust. Such an Appeal would only be successful if it identifies the pressing need. Meanwhile, if any far-sighted firm or individual with charitable intentions can