

# Certainty vs. Equity: a case for reform of the duty of utmost good faith?

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I desire nothing so much as that all questions of mercantile law shall be fully settled and ascertained; and it is of much more consequence that they should be so, than which way the decision is.

- Lord Mansfield<sup>1</sup>

*Uberrimae fidei* or the duty of utmost good faith is an historic rule of marine insurance law which has permeated numerous jurisdictions in one form or another for centuries.

The duty, originally intended to balance the interests of the insurer and the assured, has become inequitable as the scales become increasingly weighted in the insurer's favour and is therefore unsustainable in its current form. The otherwise desirable objective of legal certainty should not come at the expense of fairness for assureds who pay significant premiums and who do not intend to deceive insurers.

Part I of this paper will examine the content of the duty of utmost good faith in Australia and the United Kingdom (UK) in light of the oft competing objectives of certainty and equity. Part II considers regimes in other jurisdictions (including the recent reforms in the UK) to assist in weighing up some proposals for reform. This paper will conclude with some final recommendations for reform in Australia.

Notwithstanding arguments in favour of certainty at all costs, for reasons of both equity *and* certainty, reform of the duty of utmost good faith in Australian marine insurance law is essential, both because it must keep step with the law of other nations and allow the Australian marine insurance industry to remain competitive, but also to promote harmony within the law of insurance more generally in Australia.

## 1 Content of the Duty of Utmost Good Faith

The rationale behind the duty of utmost good faith was that, as global shipping developed, insurers were not able to investigate the risk prior to taking it on. Insurers were only able to protect their interests by placing an obligation on the assured to disclose all facts material to the risk prior to entering into the contract of insurance<sup>2</sup>. This principle was expressed by Lord Mansfield in *Carter v Boehm*<sup>3</sup> when he famously stated that, due to the speculative nature of insurance, the insured's pre-contractual duty of disclosure was based upon the fact that "the special facts upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only"<sup>4</sup>.

The principle was then codified in the *Marine Insurance Act* 1906 (UK) (UK MIA) and subsequently adopted into Australian law. The UK MIA has now been amended, as discussed in further detail below. However, the Australian *Marine Insurance Act* 1909 (Cth) (MIA) still reflects the original drafting of the UK MIA with all its attendant complexities. Section 23 of the MIA provides:

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.

This seemingly straightforward legislative provision sheds little light on the complex questions which existed in common law, including: what does utmost good faith mean? Does the duty survive throughout the life of the policy? By whom, when and how must the duty be observed? What is the effect of a breach?

There is a significant body of case law which seeks to provide answers to these questions. Ironically, however, many of those authorities only serve to demonstrate the inadequacy of the duty in redressing any imbalance in the relationship between insurer and assured<sup>5</sup>.

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<sup>1</sup> In *Buller v Harrison* 98 Eng Rep 1243, 2 Cowp 565 (KB 1777).

<sup>2</sup> John Dwight Ingram, 'The Duty of an Applicant for Insurance to Voluntarily Disclose Facts' (2009) 40(1) *Journal of Maritime Law & Commerce* 125, 125 to 126.

<sup>3</sup> 97 Eng Rep 1162 (KB 1766).

<sup>4</sup> *Ibid.*, 1164.

<sup>5</sup> Tan Chaun Bing Kendall, 'Uberrimae Fides in Marine Insurance Contracts – Demarcating the Boundaries of an Insured's Continuing Duty of Utmost Good Faith' (1999) 20 *Singapore Law Review* 281

The duty imposes a requirement on the assured to make truthful representations and disclose all facts which may be material to the insurer at the time the insurer takes on the risk. These principles are embodied in sections 24 to 26 of the MIA. Importantly, section 24 provides that the assured must:

...disclose 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 or her. If the assured fails to make such disclosure, the insurer may avoid the contract.

Section 25 of the MIA places an obligation on the agent of the assured to disclose all material facts known to the assured and section 26 requires all material representations made by the assured or agent to be true.

## 1.1 Material Circumstance

A material circumstance, pursuant to section 24(2), is a circumstance which would influence the judgment of a prudent insurer in relation to either accepting the risk or determining the premium.

This section appears to reflect what has been described as the ‘mere influence’ test for materiality espoused by the UK Court of Appeal in *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd*<sup>6</sup> (CTI). In that case the majority rejected Mr Justice Lloyd’s original finding that the fact required to be disclosed would have had to have had a ‘decisive influence’<sup>7</sup> on a prudent insurer and instead agreed with the Kerr LJ’s construction of the word ‘influence’ to find that it meant “that the disclosure is one which would have had an impact on the formation of his opinion and on his decision-making process”<sup>8</sup>. In other words, a test in which the fact not disclosed would have had to have affected the actual decision made was rejected in favour of a test where the undisclosed fact would have had to have caused the underwriter to merely consider it when accepting the risk.

The CTI decision attracted significant criticism and its ‘mere influence’ test has been variously described as harsh<sup>9</sup>, impractical, removed from reality<sup>10</sup> and even “an encouragement to reckless underwriting”<sup>11</sup>.

The House of Lords reconsidered this test in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*<sup>12</sup> (**Pine Top**), but, despite fierce dissent, eventually concluded in a majority of 3:2 led by Lord Mustill that the appropriate test was something less than the ‘decisive influence’ test and decided in favour of a two stage process. Firstly, the court must consider the impact of the non-disclosure on the mind of the prudent insurer (objective element). Secondly, the court must consider whether the non-disclosure induced the underwriter to write the policy (subjective element). Thus, while it is not necessary to demonstrate that the underwriter would have made a different decision, it is necessary for him/her to have been actually induced<sup>13</sup>. In *Drake Insurance Plc v Provident Insurance Plc*<sup>14</sup>, the House of Lords hypothesised as to what the underwriter would have done had the material fact been disclosed. In that case, it was held that the underwriter would have investigated the particular matter further and concluded that it had no bearing on whether the insurer would have accepted the risk. There was therefore, no inducement and the argument failed<sup>15</sup>.

Former High Court of Australia Justice, Michael Kirby, wrote in 1995 that it was likely Australia would adopt the two level test set down in Pine Top for two reasons: firstly, because marine insurance “is an area of the law where judges must be willing to subordinate their own fancies to the needs of common international legal principles understood throughout a global industry”, and secondly, because the general law of misrepresentation required a level of inducement and reliance before an aggrieved party can seek redress against a wrongdoer<sup>16</sup>. It

<sup>6</sup> [1984] 1 Lloyd’s Rep 476.

<sup>7</sup> [1982] 2 Lloyd’s Rep 178, 187 to 188.

<sup>8</sup> Above n6 Ibid, 492.

<sup>9</sup> Thomas J Schoenbaum, ‘The Duty of Utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law’ (1998) 29(1) *Journal of Maritime Law and Commerce* 1, 20.

<sup>10</sup> Ann Moore, ‘Review of “Utmost Good Faith” Duty Urged’ (Oct 11, 1984) *Lloyds List*, 6.

<sup>11</sup> Patrick JS Griggs, ‘Coverage, Warranties, Concealment, Disclosure, Exclusions, Misrepresentations and Bad Faith’ (1991-1992) 66 *Tulane Law Review* 423, 447.

<sup>12</sup> [1994] 3 All ER 581.

<sup>13</sup> Ibid, 588 to 587 (Lord Goff) and 617 (Lord Mustill).

<sup>14</sup> [2004] 1 Lloyd’s Rep 268.

<sup>15</sup> Ibid, 282 to 286.

<sup>16</sup> Michael Kirby, ‘Marine Insurance: Is the Doctrine of “Utmost Good Faith” Out of Date?’ (1995) 13(1) *Australian Bar Review* 1, 7 to 8.

appears that Australian courts have since applied this test, rejecting suggestions they may be able to rely on subsequent English cases<sup>17</sup> advocating the ‘decisive influence’ test<sup>18</sup>.

While this two stage test appears to have attenuated the somewhat absurd results of the ‘mere influence’ test, there are concerns it is not reflected in the MIA and is therefore unjustified<sup>19</sup>. There is also a possibility that an assured can be required to disclose a matter which may not have any effect on the outcome of whether the risk is accepted or not and yet is expected to understand that such a fact may still be material. As Lord Lloyd pointed out in his dissenting judgment in *Pine Top*: “[w]hat the prudent insurer would have wanted to know is as nebulous and ill-defined as the alternative is precise and clear-cut”<sup>20</sup>.

It is important to note that the English decisions cited in this paper no longer necessarily reflect the state of English law due to legislative reform (see further below), however, are still relevant to the extent that they (or their reasoning) interpret the provisions of the MIA in the form which still applies in Australia.

## 1.2 Known to Assured

The knowledge of the material fact which should have been disclosed must be capable of being imputed to the person providing information to the underwriter or must be a fact of which the person ought to have been aware in the ordinary course of business<sup>21</sup>.

A broker or agent, who sources the cover on behalf of the assured, is also required to disclose every material fact within the broker’s knowledge as well as the material circumstances the assured is bound to disclose<sup>22</sup>. This not only places a significant onus on the broker, but also allows for the possibility that the assured will lose its cover because of a failure by the broker to disclose some industry knowledge of which the broker should have been aware<sup>23</sup>.

## 1.3 Duration of Duty and the Remedy of Avoidance

The duty of utmost good faith in relation to disclosure and truthful representations set out in sections 24 to 26 of the MIA is generally seen as being pre-contractual in nature as those sections place obligations of disclosure and truthful representations on the assured or agent “before the contract is concluded”<sup>24</sup>.

Section 23, however, implies a broader duty, because it requires the duty of utmost good faith be “observed” by both parties<sup>25</sup>. The word “observed” has been interpreted as requiring an ongoing obligation throughout the life of the contract of insurance<sup>26</sup>. In addition, the fact that the duty is to be observed by *both* parties indicates that that the duty does not simply impose an obligation on the assured to disclose prior to the contract being formed, but also extends to the conduct of the insurer during the life of the policy<sup>27</sup>.

The content of the broader duty articulated in section 23 is therefore more general than simply relating to disclosure. For example, insurers can argue a breach of the duty where fraudulent claims are made post contractually or where assureds use fraudulent means to support a bona fide claim. Assureds, on the other hand, can argue a breach of the general duty in circumstances where indemnity is denied due to inequitable clauses buried in the contract or where insurers failing to handle claims in a fair and expeditious manner<sup>28</sup>.

Some of these concerns are highlighted in the case of *The Mercandian Continent*<sup>29</sup> where an assured sought to substantiate a valid claim (in that the loss was properly covered by the policy and the insurer was on risk at the time of the loss) with supporting documentation which included a forged letter. The Court of Appeal considered

<sup>17</sup> See eg *St Paul Fire & Marine Insurance Co (UK) v McConnell Dowell Constructors Ltd* [1995] 2 Lloyd’s Rep 116.

<sup>18</sup> See eg *Akedian Co Ltd v Royal Insurance Australia Ltd, Sun Alliance Australia Ltd* (1997) 148 ALR 480.

<sup>19</sup> Anthony A Tarr and Julie-Anne Tarr, ‘The Insured’s Non-Disclosure in the Formation of Insurance Contracts: A Comparative Perspective’ (2001) *International and Comparative Law Quarterly* 577, 584.

<sup>20</sup> *Pine Top* above n 12, 625.

<sup>21</sup> *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd’s Rep 241, 246 to 247.

<sup>22</sup> MIA, section 25.

<sup>23</sup> See eg *Helicopter Resources Pty Ltd v Sun Alliance Insurance Ltd* Unreported, Supreme Court of Victoria, 26 March 1991 (Ormiston J).

<sup>24</sup> MIA, sections 24(1) and 26(1).

<sup>25</sup> Anthony A Tarr and Julie-Anne R Tarr, ‘Utmost Good Faith in Insurance: Reform Overdue?’ (2002) 10 *Asia Pacific Law Review* 171, 178.

<sup>26</sup> *Bank of Nova Scotia v Hellenic Mutual War Risk Association* [1989] 2 Lloyd’s Rep 238.

<sup>27</sup> Robert Merkin, ‘Australia: Still a Nation of Chalmers?’ (2011) 30(2) *University of Queensland Law Journal* 189, 203

<sup>28</sup> Tarr and Tarr, above n 25, 178; *The Litsion Pride* [1985] 1 Lloyd’s Rep 437.

<sup>29</sup> [2001] 2 Lloyd’s Rep 563.

whether this breach, which had occurred post contractually and so was therefore not a factor when the insured took on the risk, was sufficiently grave to allow the insured to rely upon the remedy of avoidance. The Court of Appeal held that, in the post-contractual context, "it is by no means in every case of non-observance of good faith by the insured that the insurer can avoid the contract. It is necessary to find some principle by which it is possible to decide whether, in the event of good faith not being observed by either party, the result is that the contract can be avoided"<sup>30</sup>. The Court of Appeal then concluded that the remedy of avoidance could be appropriately invoked only where breach amounted to a repudiatory breach on the part of the insured. The Court noted as follows:

It would not be just to insured to enable the insurer to by-pass the rights and duties imposed on the parties by the contract in order to enable him to claim the disproportionate remedy of avoidance, with the result that he can avoid liability for all other claims under the policy as well as the instant claim, without requiring that the conduct relied on be as serious as conduct which would be viewed as repudiatory<sup>31</sup>

The existence of a post-contractual duty of utmost good faith gives rise to the important question of whether a remedy of damages is available. The rationale behind this assertion is that the remedy of avoidance, provided for in section 23, is disproportionate in a situation where avoidance deprives the assured of any recourse against the insurer and is more penal than remedial if applied post-contractually<sup>32</sup>. One frequently proffered solution is to imply the term into the contract for insurance, the breach of which would sound in damages. In *La Banque Financiere de la Cite SA v Westgate Insurance Co Ltd*<sup>33</sup> (**La Banque Financiere**) a broker retained a substantial amount of the money provided to him by the assured for payment of the premium. The insurer, when writing the risk, was aware of the broker's fraud. The assured bank sought to argue that damages were the only appropriate remedy as avoidance would lead to unjust results as it would leave the bank without cover. The House of Lords disagreed. Lord Templeman noted:

...I agree with the Court of Appeal that a breach of the obligation does not sound in damages. The only remedy open to the insured is to rescind the policy and recover the premium<sup>34</sup>.

In *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)*<sup>35</sup> the House of Lords sought to clarify the scope of the post-contractual duty of good faith and confined it to situations involving fraudulent claims<sup>36</sup>. Although in the *Star Sea* the insurer's defence, which argued that the insured had breached the duty of utmost good faith, failed on the facts, the House of Lords refused to create a new remedy of damages for breach of the duty of utmost good faith on the basis that the authorities did not support the existence of an implied contractual term<sup>37</sup>. The Lords did, however, criticise the disproportionate nature of the remedy of avoidance; none more so than Lord Hobhouse who noted:

Avoidance...is appropriate where the cause, the want of good faith, has preceded and been material to the making of the contract. But, where the want of good faith occurs later, it becomes anomalous and disproportionate that it should be so categorised and entitle the aggrieved party to such an outcome.... The result is effectively penal. Where a fully enforceable contract is entered into insuring the assured, say, for a period of a year, the premium has been paid, a claim for a loss covered by the insurance has arisen and been paid, but later, towards the end of the period, the assured fails in some respect fully to discharge his duty of complete good faith, 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. This cannot be reconciled with principle. No principle of this breadth is supported by any authority whether before or after the Act<sup>38</sup>.

There is, however, a distinction between fraudulent claims and claims which are supported by fraudulent devices or collateral lies. The current leading case in this area is *Versloot Dredging BV and Anor v HDI Gerling Industrie Versicherung AG and Ors (the "DC Merwestone")*<sup>39</sup>. The *Versloot* case canvassed the remedy of forfeiture or avoidance in the context of a post contractual breach of the duty of good faith extensively. In particular, the Lords had the opportunity to consider in detail the question of whether what is known as the "fraudulent claims rule" (i.e. claims which were not justified and were made fraudulently from the outset)

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<sup>30</sup> Ibid, 572

<sup>31</sup> Ibid, 573.

<sup>32</sup> Ibid.

<sup>33</sup> [1990] 2 Lloyds Rep 377.

<sup>34</sup> Ibid, 387.

<sup>35</sup> [2001] 1 Lloyd's Rep 389.

<sup>36</sup> Ibid, 413.

<sup>37</sup> Ibid, 399.

<sup>38</sup> Ibid, 400.

<sup>39</sup> [2016] 2 Lloyd's Rep 198

should apply to claims which are legitimate and justified but which are supported by "collateral lies" (e.g. a forged document or a fabricated sequence of events which is irrelevant to the risk covered).

In the *Versloot* case, the main engine of the *DC Merwestone* was damaged beyond repair by water ingress which flooded the engine room. By way of explanation for the casualty the owners' vessel manager stated in an email that the crew had informed him that the bilge alarm had sounded but, due to heavy weather, the crew had been unable to attend to the leak. There was no evidence to support this version of events (despite the Master subsequently supporting this story) and the judge at first instance found the vessel manager's story to be a "reckless untruth"<sup>40</sup>. However, given the judge's finding that the loss was caused by a peril of the sea (the fortuitous entry of water through the sea inlet), the "reckless untruth" was ultimately irrelevant to the loss and the risk covered. At first instance, Popplewell J nonetheless held that although the owners' claim was valid, such claim was lost as a result of the collateral lie. The Court of Appeal dismissed an appeal from the owners, who then appealed to the Supreme Court.

Lord Sumption, with whom Lord Clarke, Lord Hughes and Lord Toulson agreed (Lord Mance dissenting) made the following overall findings (at 208):

- (1) The insured's right to indemnity arises as soon as the loss is suffered.
- (2) There is a difference between an inflated claim and a justified claim supported by collateral lies because, in the latter scenario, the insured is trying to "obtain no more than the law regards as his entitlement and the lie is irrelevant to the existence or amount of that entitlement".
- (3) Considerations of deterrence and "informational asymmetry" with which the law has traditionally been concerned do not justify a remedy of avoidance in the context of collateral lies as the application of the remedy to those situations would only serve to "protect [the insurer] from the obligation to pay, or to pay earlier, an indemnity for which he has been liable in law ever since the loss was suffered".
- (4) Avoidance of the claim would be a wholly disproportionate response.

Lord Sumption also commented on the characterisation or categorisation of the post contractual duty of good faith as a term of the contract as follows (at 202 to 203):

Once the contract is made, the content of the duty of good faith and the consequences of its breach must be accommodated within the general principles of the law of contract. On that view of the matter, the fraudulent claims rule must be regarded as a term implied or inferred by law, or at any rate an incident of the contract...the effect...is that the whole contract is voidable ab initio upon a breach and not just the fraudulent claim. If, on the other hand, one adheres to the contractual analysis, the right to avoid the contract for breach of the duty must depend on the principles governing the repudiation of contracts, and avoidance would operate prospectively only.

This analysis was not pursued exhaustively, however, as the insurers were not seeking to avoid the contract and the question did not arise in that case. Accordingly, the full effect of this decision as concerns the contractual character of the duty and the remedies which flow from it, remains the subject of debate and it is not clear the extent to which it can be relied upon to make a claim for damages rather than avoidance<sup>41</sup>. It is also important to note that this decision was made in the United Kingdom shortly before the new *Insurance Act 2015 (UK)* (**IA UK**) came into force, which Act contains a range of statutory remedies relating to fraud (see further below).

Notwithstanding that marine insurance law in relation to the duty of utmost good faith appears to have attained a level of certainty in the case law insofar as that jurisprudence relates to the current drafting of the MIA, there is still an overwhelming sense of inequity and desire for some kind of legislative reform in Australia<sup>42</sup>. Importantly, reform in this area in Australia will serve both the interests of equity and certainty, and will also draw a line under the controversy surrounding the scope of the duty of utmost good faith and its application in a post-contractual context.

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<sup>40</sup> per Popplewell J [2013] 2 Lloyd's Rep 131 at [225]

<sup>41</sup> See e.g. Baris, Soyer 'Lies, collateral lies and insurance claims: the changing landscape in insurance law' (2018) 237 *Edinburgh Law Review*; Margaret C Hemsworth, 'The fate of "good faith" in insurance contracts' (2018) 143 *Lloyd's Maritime and Commercial Law Quarterly*; Hjalmarsson, Johanna, 'Proof of fraud: raising the standard' (2018) *Lloyd's Shipping and Trade Law*; B. Soyer and A.M Tettenborn, 'Mapping (utmost) good faith in insurance law – future conditional?' (2016) 618 *Law Quarterly Review*.

<sup>42</sup> Jeffrey B Struckhoff, 'The Irony of *Uberrimae Fidei*: Bad Faith Practices in Marine Insurance' (2004-2005) 29 *Tulane Maritime Law Journal* 287, 295-296; Michael Kirby, 'Marine Insurance: Is the Doctrine of "Utmost Good Faith" Out of Date?' (1995) 13(1) *Australian Bar Review* 1; Australian Law Reform Commission (ALRC) *Review of the Marine Insurance Act 1909* Report 91 (2001) 214 to 215 (**ALRC Report 91**).

## 2 Possible Reforms/ Alternative Regimes

This part will discuss the recommendations for reform that have been put forward and, in some jurisdictions, adopted. These recommendations range from abandoning the duty altogether, to retaining it for the sake of certainty.

### 2.1 Abandonment

Questions have been raised as to whether the duty is necessary at all in light of the two stage Pine Top test combined with a developing body of case law on waiver. Courts have found that an insurer who asks specific questions of an assured waives its right to rely on any failure by the assured to disclose facts outside of those questions, although the extent of the waiver will ordinarily be limited to the subject matter of the questions. For example, in *O’Kane v Jones (The Martin P)* an insurer argued that the assured should have disclosed non-payment of a premium to another insurer at the time of entering into a contract for insurance<sup>43</sup>. Deputy High Court Judge Siberry QC held that the non-payment was not a material fact and did not therefore need to be disclosed. However, he also opined that the detailed questionnaire completed by the assured at the time of entering into the contract of insurance “would indeed have justified a reasonable proposer in thinking that Jones did not want to be told of such matters and so gave rise to a waiver”<sup>44</sup>.

The Appellate Division of the Supreme Court of South Africa in *Mutual and Federal Insurance Co Ltd v Oudtshoorn Municipality* famously rejected the necessity for the duty of utmost good faith in its finding that:

*Uberrima fides* is an alien, vague, useless expression without any particular meaning in law... ..it cannot be used in our law for the purpose of explaining the juristic basis of the duty to disclose a material fact before the conclusion of a contract of insurance. Our law of insurance has no need for *uberrima fides* and the time has come to jettison it.<sup>45</sup>

Kirby analysed such arguments and concluded, it is submitted correctly, that notwithstanding its challenges, the duty of utmost good faith is still a necessary component of marine insurance law. This is because it is still important that insurers be provided with certain information in order to be able to properly underwrite a risk<sup>46</sup>. Ironically, he argues this is particularly so where, as originally noted by Lord Mansfield in *Carter v Boehm*, that information is exclusively in the hands of the assured<sup>47</sup>.

### 2.2 United Kingdom Reforms

As noted above, the position in the United Kingdom has changed significantly since the introduction of the IA UK which came into force on 12 August 2016. This legislation was introduced as a result of extensive review undertaken by the English and Scottish Law Commissions culminating in a report issued in July 2014<sup>48</sup> (**UK Commission Report**). The UK Commission Report identified a number of reasons for the then proposed reforms including a greater variety of the types of risks insured, the extent of information and data available to the insured and insurer and the exponential growth of the insurance market and its members (now mostly corporate entities) as well as the fact that many of the common law countries which had adopted legislation similar to the original UK MIA had subsequently taken steps to modernise and reform their respective insurance regimes<sup>49</sup>.

The IA UK abolishes any law which permits a party to avoid a contract on the ground that the utmost good faith has not been observed (s14(1)). This has the effect of amending the wording of s17 of the MIA UK from:

"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",

to:

"A contract of marine insurance is a contract based upon the utmost good faith."

<sup>43</sup> [2004] 1 Lloyd’s Rep 389, 434 to 437.

<sup>44</sup> Ibid, 438.

<sup>45</sup> (240/82) [1984] ZASCA 129; [1985] 1 All SA 324 (A) (16 November 1984) 34 to 35

<sup>46</sup> Kirby above n16, 18 to19.

<sup>47</sup> Ibid.

<sup>48</sup> *Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment* accessible here : <https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jxou24uy7q/uploads/2015/11/Report-Insurance-contract-law.pdf>

<sup>49</sup> Ibid, at 6 to 8. See also Yeo, HY “The morphing of good faith and disclosure: lessons for Singapore” (2018) 425 *Journal of Business Law*

An exhaustive analysis of the effect of this amendment is outside the scope of this paper, however, the significance of this reform is that it will provide scope to argue that good faith is an implied term of the overall insurance contract and a remedy of damages, not just avoidance, is therefore available<sup>50</sup>.

Section 21(2) of the IA UK effectively repeals sections 18 (disclosure by assured), 19 (disclosure by agent effecting insurance) and 20 (representations pending negotiation of contract) of the MIA UK and section 21(3) of the IA UK abolishes any rule of law to the same effect. The repealed sections of the MIA UK are the exact equivalent of sections 24 to 26 of the MIA discussed in Part I above.

The IA UK then creates a new duty of "fair presentation" of the risk insured requiring the insured to disclose every "material circumstance which the insurer knows or ought to know" (section 3(4)(a)) or disclosure sufficient to "put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances" (section 3(4)(b)). The definition and level of knowledge required of the insured, insurer and generally is set out in sections 4, 5 and 6 respectively of the IA UK.

Perhaps most importantly, section 8 of the IA UK effectively codifies the two step Pine Top test for breach of duty of "fair presentation" of the risk and incorporates a range of remedies for breaches which are then detailed in Schedule 1. The remedies for non-reckless or non-deliberate breaches include, inter alia, allowing the insurer to treat the contract of insurance as if it had been entered into on different terms, charging a higher premium and reducing the amount paid on a claim "proportionately" to the premium paid<sup>51</sup>. This change is significant as it overcomes the harshness of the remedy of avoidance in the previous section 17 of the MIA UK. It is important to note, however, that insurers can still avoid the contract where the insured has deliberately or recklessly breached<sup>52</sup> the contract or where an insured has made a fraudulent claim<sup>53</sup>.

Whilst a detailed discussion of the effect of all amendments to the IA UK is outside the scope of this paper, it suffices to note that if Australia does not implement reforms in a similar vein, it will be significantly out of step with the largest global marine insurance market in the world.

### **2.3 United States' Position**

There are those who argued that English jurisprudence prior to the enactment of the IA UK (and therefore current Australian jurisprudence where it adopts the English cases' interpretation of the MIA), had put the London insurance market at a disadvantage as it was increasingly seen as being inequitable and pro-insurer<sup>54</sup>.

The American response to what has been perceived as a harsh and unjust doctrine<sup>55</sup> was to provide, through the introduction of legislation in a number of States, that the remedy of avoidance was only available to insurers where the failure to disclose was done with intent to deceive, or was causative of the acceptance of the risk by the insurer<sup>56</sup>. American jurisprudence has also limited the scope of a post-contractual duty to specific circumstances<sup>57</sup>.

Struckhoff argues that, by including choice of law and choice of forum clauses which render disputes subject to the more insurer friendly regimes such as the UK (pre-reform) and Australia, those insurers, when seeking to enforce inequitable rules such as the duty of utmost good faith, are effectively acting in bad faith. This is made abundantly clear in his statement:

The procedural machinations used to accomplish this result, under the guise of utmost good faith, bear an uncanny resemblance to the kind of insurer bad faith that is prohibited by statute and case law in most American states.<sup>58</sup>

<sup>50</sup> See Hemsworth, above n41 at 155

<sup>51</sup> See paragraphs 4 to 6 of Schedule 1 to the IA UK.

<sup>52</sup> See paragraph 2 of Schedule 1 to the IA UK.

<sup>53</sup> See section 12(1) IA UK

<sup>54</sup> Struckhoff above n 42; Martin Davies, 'Insured's Post-Contract Duty Ubrerimae Fidei: Manifest Shipping Co. Ltd v Uni-Polaris Shipping Co. Ltd (The Star Sea), [2001] 1 All ER 743 (House of Lords)' (2001) 32(3) *Journal of Maritime Law and Commerce* 501; Schoenbaum above n9.

<sup>55</sup> See eg *Gay v United Benefit Life Insurance Co* 96 So 2d 497 (1957); *Kennison v US Letter Carriers' Mutual Benefit Association* 132 So 2d 94 (1961).

<sup>56</sup> See eg Louisiana Revised Statute 22:619; California Insurance Code section 10380; John Dwight Ingram 'The Duty of an Applicant for Insurance to Voluntarily Disclose Facts' (2009) 40(1) *Journal of Maritime Law and Commerce* 125.

<sup>57</sup> Davies above n54, 506; *Rallod Transport Co. v Continental Insurance Co.* 727 F 2d 851 (9<sup>th</sup> Cir 1957); *Windsor v Mount Joy Mutual Insurance Co. v Giragosian* 57 F 3d 55 (1<sup>st</sup> Cir, 1995).

<sup>58</sup> Struckhoff, above n42, 311.

The Australian Law Reform Commission (ALRC) in its Review of the Marine Insurance Act 1909 (see further below) does not appear to have given a great deal of consideration to the American position<sup>59</sup>, whether for reasons of uncertainty in US law<sup>60</sup> or a lack of uniformity between Federal and State law is unclear<sup>61</sup>. Indeed, some authors had suggested, prior to the legislative reforms in the IA UK, that the certainty offered by the English legal position was preferable to the perhaps more equitable, yet conflicting and controversial, American jurisprudence<sup>62</sup>. This position is now clearly untenable in light of the reforms brought about by the IA UK.

## 2.4 Doctrine of Proportionality

Many civil law countries have attempted to attenuate the harsh effects of the duty of utmost good faith by applying a doctrine of proportionality<sup>63</sup>. The doctrine can manifest itself in two ways: either, by proportionately reducing the amount of the claim, or by increasing the amount of the premium in proportion to the loss claimed<sup>64</sup>. Thus, the insurer remains liable but is not obliged to pay amounts which it would not have paid had the assured disclosed certain material facts.

Schoenbaum concedes the conceptual appeal of the doctrine, however, argues that it is inappropriate and impractical. The first stumbling block he identifies is that the nature of the marine insurance business has operated on the basis of a duty of good faith for over 200 years. Secondly he notes a number of practical challenges including complex calculations and an increase in litigation to apportion liability<sup>65</sup>.

It is submitted that while the first observation is akin to a ‘certainty for the sake of certainty’ argument and is not sufficient to justify denying the need for reform, the practical challenges posed by the doctrine are more legitimately dissuasive.

## 2.5 Unification with Insurance Contracts Act

In 1982, the ALRC examined the common law duty of disclosure in a non-marine insurance law context and recommended a number of reforms<sup>66</sup> which were effected in the *Insurance Contracts Act 1984 (Cth) (ICA)*. That report and the ICA did not apply to policies for marine insurance, except in relation to pleasure craft (following an amendment to the MIA in 1998)<sup>67</sup>.

Many of the recommendations implemented into the general insurance regime in Australia address the concerns raised in this paper in relation to the inequitable outcomes of the application of the duty of utmost good faith and the closely-related duty of disclosure. Further amendments in the form of the *Insurance Contracts Amendment Act 2013 (ICA Amendments)*<sup>68</sup> have further refined and clarified the ICA. Some of the relevant sections and subsequent amendments are as follows:

- (1) Sections 13 and 14 of the ICA relate expressly to the duty of utmost good faith. Section 13 provides:

A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.

(emphasis added)

This provision has done away with ‘avoidance’ as the sole remedy for a breach of the duty of good faith and expressly implies that duty into the contract of insurance, the breach of which by either party could sound in damages. In addition, as the duty is an implied term in the

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<sup>59</sup> ALRC Report 91.

<sup>60</sup> Davies, above n54.

<sup>61</sup> Christopher W Nicoll, ‘Uberrimae Fidei: The Doctrine That’s on Everyone’s Lips’ (2008-2009) 21 *U.S.F Maritime Law Journal* 1

<sup>62</sup> Warren J Marwedel and Stephanie A Espinoza, ‘Dagger, Shield, or Double-Edged Sword?: The Reciprocal Nature of the Doctrine of *Uberrimae Fidei*’ (2009) 83(5&6) *Tulane Law Review* 1163.

<sup>63</sup> ALRC Report 91, 217.

<sup>64</sup> Schoenbaum, above n9, 36.

<sup>65</sup> *Ibid.*

<sup>66</sup> In ALRC, *Report on Insurance Contracts* Report 20 (1982).

<sup>67</sup> ICA, sections 9(d) and 9A; *Insurance Laws Amendment Act 1998 (Cth)*, section 3.

<sup>68</sup> The original *Insurance Contracts Act Amendment Bill 2010*, to which the 2013 Bill made only minor adjustments, was proposed following a review of the ICA by Alan Cameron and Nancy Milne in 2004.



contract relating to “any matter arising *under*” that contract, it lasts for the duration of the contract<sup>69</sup>.

One of the criticisms levelled at section 13 has been that it does not clarify whether the insurer’s duty of good faith extends to third party beneficiaries<sup>70</sup>. This lacuna has been remedied by the ICA Amendments which now expand the application of section 13 to third party beneficiaries<sup>71</sup>.

Section 14 then states that a party may not rely on a provision of the contract where to do so would “be to fail to act with the utmost good faith”. This provision gives legislative force to Struckhoff’s argument raised in the American context, where he suggested that, in various States of the United States, relying on a choice of law clause to seek to oust an American court’s jurisdiction in favour of the current Australian (in marine insurance) or former UK regime may itself amount to a breach of the duty of utmost good faith<sup>72</sup>.

- (2) Section 21 of the ICA contains the assured’s *pre-contractual* duty of disclosure. The assured is required to disclose all matters:
- (a) the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms; or
  - (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant.<sup>73</sup>

Since the ICA Amendments have come into force sub-section (b) above has been amended so that a reasonable person will be required to have regard to the following non-exhaustive factors in deciding whether a matter is relevant for the purposes of disclosure:

- (i) the nature and extent of the insurance cover to be provided under the relevant contract of insurance; and
- (ii) the class of persons who would ordinarily be expected to apply for insurance cover of that kind.<sup>74</sup>

It is submitted that the inclusion of these factors would allow the decision maker to take into account the more sophisticated commercial relationship between the parties in an international marine context were the ICA to be amended to cover marine insurance.

In addition, section 21(3) of the ICA provides that where the assured fails to provide an answer or gives an incomplete answer to a question posed by an insured pre-contract and the insurer does not make additional inquiries, the insured is deemed to have waived any reliance on the duty of disclosure in relation to that particular matter. Deputy High Court Judge Siberry QC’s obiter statement in *The Martin P* in relation to the legal effect of a questionnaire as a waiver appears to reflect what has been an accepted position in non-marine insurance law for some time<sup>75</sup> (see also sections 21A(3), (4) and (5) of the ICA).

- (3) Section 21A of the ICA further expands upon the concept of waiver and prescribes specific situations in which the insurer may not rely upon the assured’s non-disclosure<sup>76</sup>. Further, where the assured complies with the requirements set out in that section, the assured is deemed to have complied with its duty of disclosure<sup>77</sup>.

The ICA Amendments to section 21A have sought to simplify the requirements of that section and have imposed similar requirements, via an additional section 21B, relating to the duty of disclosure prior to renewal of insurance contracts.

<sup>69</sup> Robert Merkin, Scottish Law Commission, *Reforming Insurance Law: is there a case for reverse transportation?* (2006), 12-13.

<sup>70</sup> *Ibid.*

<sup>71</sup> ICA Amendments, sections 13(3) and (4).

<sup>72</sup> Struckhoff, above n 42.

<sup>73</sup> ICA, section 21(1)(a) and (b).

<sup>74</sup> ICA Amendments, section 21(1)(b). Note that a third factor recommended by the panel in earlier drafts of the Bill has been removed from the 2013 Bill. That factor was as follows:

“The circumstances in which the contract of insurance is entered into including the nature and extent of any questions asked by the insurer”.

<sup>75</sup> Above n 43.

<sup>76</sup> ICA, sections 21A(3) and (4).

<sup>77</sup> ICA, sections 21A(6) and (7).

- (4) Section 22 requires the insurer to inform the assured, in writing, of the nature and effect of the duty of disclosure as well as the nature and effect of section 21A if that section applies. Failure to do so will, except in cases of fraud, deprive the insurer of the ability to rely upon any non-disclosure by the assured<sup>78</sup>.

The ICA Amendments have expanded the application of section 22 to require the insured to inform the assured of the nature and effect of section 21B (in relation to renewal of insurance contracts)<sup>79</sup> and also to place the onus on the insurer to reiterate that advice in writing where counter-offers take place between the parties more than 2 months after the first written advice was provided to the assured<sup>80</sup>.

- (5) Finally for present purposes, it is important to note that remedies for a failure to comply with a duty of disclosure (or misrepresentation by the assured) are not, under the ICA, limited to avoidance. Section 28 provides that unless the failure to comply with the duty of disclosure was fraudulent<sup>81</sup>, rather than having an immediate right to avoid the contract, the insurer will instead be able to reduce its liability “to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred... ..”<sup>82</sup>. This compromise position appears to have incorporated the civil law concept of proportionate liability noted above.

The remedies in section 28 will not apply where the insurer would have entered into insurance contract on the same terms and for the same premium notwithstanding any failure by the assured to disclose a fact, or any misrepresentation of fact made by the assured (or, presumably, its agent)<sup>83</sup>. This effectively removes the need for a two-staged inducement test as set out in *Pine Top*.

Because of the comprehensive nature of the ICA and its apparent redressing of many of the concerns relating to inequity raised throughout this paper, many authors continue to advocate for either the abolition of the MIA altogether in favour of broadening the ICA to cover all insurance contracts in Australia<sup>84</sup> or the adoption of identical or similar recommendations into the MIA<sup>85</sup>.

## 2.6 Amendment/Reform of the MIA

The ALRC, in 2001, again examined these issues in the marine insurance law context and made the following recommendations, relevant to the above discussion, in its Report 91 (**ALRC Report 91**):

- (1) Section 23 of the MIA should be amended to incorporate the concepts provided for in sections 13 and 14 of the ICA<sup>86</sup>. This would render the duty of utmost good faith undeniably reciprocal and, most importantly, makes section 23 an implied term of the insurance contract. The effect of this is that the breach of an implied term allows the non-breaching party to seek damages<sup>87</sup>. As noted above, such an amendment would go a significant way toward attenuating the harsh effects of the remedy of avoidance.
- (2) The MIA should clarify that the duty extends throughout the life of the contract of insurance up to the point where litigation is commenced<sup>88</sup>. Whilst the ALRC asserts that this is the position reflected in *The Star Sea*, it does not expressly articulate whether this recommendation is intended to extend to the pre-contractual duties of disclosure<sup>89</sup>. It is submitted that, in light of the further recommendations detailed below, the ALRC can only

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<sup>78</sup> ICA, section 22(3).

<sup>79</sup> ICA Amendments, section 22(1)(b).

<sup>80</sup> ICA Amendments, section 22(3).

<sup>81</sup> ICA, section 28(2).

<sup>82</sup> ICA, section 28(3).

<sup>83</sup> ICA, section 28(1).

<sup>84</sup> Robert Merkin, ‘Australia: Still a Nation of Chalmers?’ (2011) 30(2) *University of Queensland Law Journal* 189.

<sup>85</sup> Tarr and Tarr, above n19.

<sup>86</sup> ALRC Report 91, Recommendation 20.

<sup>87</sup> Cf *La Banque Financiere* above n 33.

<sup>88</sup> ALRC Report 91, Recommendation 21.

<sup>89</sup> *Ibid*, 228.

have intended for this recommendation to relate to the broader duty of good faith and not simply a pre-contractual duty of disclosure.

- (3) The sections relating to non-disclosure and misrepresentation (sections 24 and 26) of the MIA should be amended such that the assured (or his/her agent) is only required to disclose facts which he/she *knows* or a reasonable person in his/her position would know, are material<sup>90</sup>. Again, this effectively does away with the need for the problematic inducement test set out in *Pine Top*<sup>91</sup>.
- (4) The sections relating to non-disclosure and misrepresentation (sections 24 and 26) of the MIA should be further amended to set out situations where the insurer may and may not avoid the contract and/or reimburse the premium depending upon the existence or otherwise of fraud and the reliance it placed on the material fact (including whether the liability to reimburse the loss was caused by the non-disclosure)<sup>92</sup>.
- (5) The MIA should be amended so that the duty of pre-contractual disclosure is limited to sections 24 to 26<sup>93</sup>. This recommendation states that the insurance contract should not be able to impose greater duties on the assured, but then goes on to say that the parties should be free to include a post-contractual duty in the contract. It would appear from the discussion within the report that what is intended by this is that the parties be permitted to lengthen the period to which the duty applies, but not to broaden its scope or limit any remedies for breach (to say, avoidance)<sup>94</sup>.

The Maritime Law Association of Australia and New Zealand (**MLAANZ**) has also prepared a draft Bill<sup>95</sup> (**MLAANZ Draft Bill**) proposing reforms to the MIA which closely reflect the draft Bill annexed to the ALRC Report 91 (**ALRC Draft Bill**) and, in 2016, ran a series of presentations around Australia to its members and interested persons advocating reform in light of the impending coming into force of the IA UK. As noted in the MLAANZ explanatory memorandum which accompanied the MLAANZ Draft Bill (**MLAANZ Explanatory Memorandum**), the implementation of the IA UK would leave Australia:

In the invidious position of retaining provisions over a century old which have now been discarded in "mother" legislation in the UK. As the UKIA (like the ALRC draft Bill) adopts a more pro-insured approach it would seem probable that this will place the Australian marine insurance market at a competitive disadvantage and at real risk of losing business. It will also mean that Australian marine insurance law will become obsolete in relation to the changes to English marine insurance law under the UKIA.<sup>96</sup>

Interestingly, however, the MLAANZ Explanatory Memorandum, whilst acknowledging that the MLAANZ Draft Bill and ALRC Draft Bill closely reflected the provisions in the ICA, it did not provide any justification or explanation as to why the ICA could not simply be amended to extend to marine insurance contracts rather than pushing for comprehensive reform of the MIA. One possible explanation for this is that the MLAANZ Draft Bill proposes other amendments including extending the operation of the MIA to inland waterways and incidental air risk<sup>97</sup>, ships under repair (not just under construction)<sup>98</sup>, seeks to repeal the 12 month limit on time policies<sup>99</sup> and expands the floating policy provisions in section 35 of the MIA to apply to "open and annual" policies<sup>100</sup>. These are not, however, amendments which are particularly controversial and could be incorporated into any reform proposal for extension of the ICA to marine insurance contracts.

It is submitted that, rather than seeking to amend the MIA to effectively reflect the ICA as suggested in the ALRC's Report 91, it is preferable to simply repeal the MIA and extend the application of the ICA to marine insurance contracts (with some carve outs, for example in relation to voiding choice of law and jurisdiction

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<sup>90</sup> ALRC Report 91, Recommendation 22.

<sup>91</sup> Tarr and Tarr, above n19, 581.

<sup>92</sup> ALRC Report 91, Recommendations 23 and 25.

<sup>93</sup> *Ibid*, Recommendation 26.

<sup>94</sup> *Ibid*, 226.

<sup>95</sup> available at <http://www.mlaanz.org/Page-Preview/0,2788,18832,00.html>

<sup>96</sup> See paragraph 6 of the Explanatory Memorandum available at <http://www.mlaanz.org/Page-Preview/0,2788,18832,00.html>

<sup>97</sup> See proposed amendments to section 8(1) at paragraph 2 of the MLAANZ Draft Bill

<sup>98</sup> See proposed amendments to section 8(2) at paragraph 3 of the MLAANZ Draft Bill

<sup>99</sup> See proposed amendments to section 31(2) at paragraph 10 of the MLAANZ Draft Bill

<sup>100</sup> See proposed amendments to section 35(1) at paragraph 11 of the MLAANZ Draft Bill

clauses<sup>101</sup>). This would not only promote uniformity within Australian law and bring it into line with international standards including the IA UK, it would also dispense with the need to push complicated amendments to the MIA through both houses of Parliament which have effectively already passed in the form of the ICA. In particular, extending the ICA to marine insurance in Australia would clarify that the duty of good faith is an implied term of the insurance contract the breach of which sounds in damages (as opposed to avoidance) and, accordingly, is preferable to an amended MIA based on the IA UK which still leaves the role of the duty (including whether it is an implied term of the contract) open to judicial discretion and interpretation<sup>102</sup>.

In addition, as demonstrated by the relatively recent passing of the ICA Amendments, the Parliament has shown a willingness to implement amendments where required to alleviate industry concerns relating to the ICA. Much needed reform to the MIA, on the other hand, has progressed at a glacial pace. Repealing the MIA in favour of a single regime would significantly decrease the burden of progressing law reform in the insurance industry on the advocate groups and legislators alike, perhaps increasing the likelihood of achieving the desired outcome within a more expedient timeframe.

### **3 Conclusion**

The law of marine insurance, in its current form and despite judicial efforts to rectify some of the more glaring inequities, remains heavily skewed in favour of the insurer in Australia.

A demanding duty of pre-contractual disclosure on assureds, combined with a disproportionately harsh penalty for its breach, reinforces the perception of injustice for assureds. Further, where the post-contractual duty of good faith appears to be forever expanding it is important that courts and legislative bodies begin to recognise that a remedy of damages is essential, particularly in circumstances where it is the insurer who has breached the duty.

For these reasons, no matter how desirable certainty is in the law (which certainty is now in doubt given the IA UK reforms), it is even more critical to recognise the importance of fairness, particularly in the context of an industry that relies on good public opinion. Happily, in this situation, legislative reform is well placed to achieve both policy goals as there is a pre-existing body of case law on the ICA which formed the conceptual basis for many of the ALRC's recommendations for reform of the MIA<sup>103</sup>.

The Federal Government should repeal the MIA and amend the ICA so that it applies to all contracts of insurance (with appropriate distinctions between commercial and consumer contracts), including marine insurance.

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<sup>101</sup> For more detail on this issue see Rob Merkin, 'Australia: Still a Nation of Chalmers?' (2011) *University of Queensland Law Journal* 189 – 224, at 222; see also ALRC 91 Report, Chapter 14

<sup>102</sup> See Hemsworth's discussion of implied terms and good faith wherein she draws a distinction between implying a term of 'good faith' and employing principles of good faith when considering the way in which an express or implied term is construed in a contract of insurance. Hemsworth's article also provides an exhaustive discussion and analysis of the reviews undertaken by the English and Scottish Law Commissions which led to the passing of the IA UK. Above n 41, 155 to 160.

<sup>103</sup> Tarr and Tarr, above n 19.