



FACULTY OF LAW  
Lund University

Bilal Ahmad

**The Pre-Contractual Duty of Good  
Faith** — A Comparative Analysis of the Duty of Utmost  
Good Faith in the Marine Insurance Contract Law with the Duty  
of Good Faith in the General Contract Law

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Professor Lars-Göran Malmberg

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# Summary

The duty of utmost good faith in the marine insurance contract law and the duty of good faith in the general contract law are quite similar in nature. Former recognises that the parties must make true representation and must disclose all material information while latter recognises the duty of representation only and does not at all recognise the duty of disclosure.

The parties in the marine insurance contract are required to observe the duty of utmost good faith. Nevertheless, it is mainly the duty of the prospective assured to observe the duty of utmost good faith. The prospective assured is required to fully disclose and truly represent the facts about the subject matter to be insured to the insurer, so he could take informed decision about risk taking and premium. The expression 'utmost good faith' in the marine insurance contract law indicates that strict duty of good faith is required to be observed by the parties. Although word 'utmost' is used to highlight the significance of good faith in a particular contract, the duty of good faith is essential part of every contract but degree of good faith may vary in each case. Likewise, no insurance contract can be made in bad faith.

The common impression that the general law of contract does not recognize the duty of good faith is well founded but not entirely true, as it recognizes the duty of true representation, which is one element of the duty of good faith. In the general contract law, parties are not under any obligation to disclose information because each party is free to protect his own interest. Nevertheless, they are not allowed to induce the other party to enter into the contract by misrepresentation because that is deceit.

If one party fails to observe the duty of good faith, the other party may avoid the contract. This means that contract is not void automatically, and if the innocent party wants to continue with the contract, this is his own free will. Furthermore, avoidance is not the only remedy; the innocent party may claim damages in case of negligent or fraudulent misrepresentation.

# Preface

I have had the great privilege to learn under the kind supervision of Professor Lars-Göran Malmberg, Faculty of Law, Lund University, Sweden, who has been very supportive at every stage of writing this Thesis. I am also grateful to him for his patience in listening my indistinct ideas and refine them with in no time to make me understand and analyse the complex issues of the marine insurance contract law and the general contract law.

I am also highly thankful to Professor P.K. Mukherjee, World Maritime University, Malmö, Sweden, who guided me with great ideas, which were extremely helpful in shaping my analysis in this Thesis.

Finally, many thanks go to my 8 years old daughter, who did not overload me at all with her miscellaneous questions when I was busy writing this Thesis.

# Abbreviations

ALRC	Australian Law Reform Commission
CPA 1987	Consumer Protection Act 1987
CPR 2000	Consumer Protection (Distance Selling)
CRA 1979	The Contractual Remedies Act 1979
FTA 1986	Fair Trading Act 1986
ICA	Insurance Act 1984
MIA 1906	The Marine Insurance Act 1906
MIA 1908	Marine Insurance Act 1908
MIA 1909	Marine Insurance Act 1909
MIA 1993	Marine Insurance Act 1993
MA 1967	Misrepresentation Act 1967
RSC 1981	The Restatement (Second) of Contracts 1981 Regulations 2000
ROA 1974	Rehabilitation of Offenders Act 1974
TPA 1974	Trade Practices Act 1974
TDA 1968	Trade Description Act 1968
UCC	Uniform Commercial Code
US	the United States of America
UNIDROIT Principles	UNIDROIT Principles of International Commercial Contracts
UTCCR 1999	Unfair Terms in Consumer Contracts Regulations 1999

# 1 Introduction

The duty of Good faith is considered a controversial subject in the modern marine insurance contract law and the general contract law because there is no general concept of the duty of good faith, according to the circumstances in each case, the courts develop a variety of good faith related principles. However, with the increasing significance of transnational law, the impact of good faith on common law in both fields is likely to increase in the future.<sup>1</sup> This seems highly probable because of the growing recognition of the duty of good faith in international conventions and principles.<sup>2</sup> Where possible, comparison with the different common law jurisdictions will be helpful in making an extended comparative analysis of the duty of utmost good faith in the marine insurance contract law with the duty of good faith in the general contract law. The reason for this is of course that the material is easily accessible in common law jurisdictions, and there is no language problem. Another reason is that the legislation in UK has been adopted approximately unaltered in several other common law countries, such as Australia, New Zealand, Canada, and the United States of America (US), just to name few. Nevertheless, focus of analysis will remain on English law.

The basic moral notion of honesty or fair dealing may be used for understanding the duty of good faith in the general contract law. However, the recognition of the general principle of the duty of good faith in the general contract law may lead to some uncertainty, so we may understand that the concept of the duty of good faith should be solid enough to be certain, but should be flexible enough to be fair.<sup>3</sup>

Definition of the duty of good faith is not available in any of the statutes in any of the common law jurisdictions. The courts define the duty

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<sup>1</sup> Vanessa Sims, Good faith in English Contract Law: Of Triggers and Concentric Circles, p.213, Vol. I No. 2, Ankara Law Review, Winter 2004.

<sup>2</sup> See, for example, Article 7, United Nations Convention on Contracts for the International Sale of Goods, 1980 (CISG), Article 1.7, UNIDROIT Principles of International Commercial Contracts, 2004, and Article 2, UN Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea, 2008, 'the Rotterdam Rules'.

<sup>3</sup> *Ibid.*, Foot Note 1.

of good faith in each case differently, but the duty of good faith mainly consists of two duties: duty to disclose and to make true representation. Although the agent of the prospective assured has almost the same duty of disclosure as the prospective assured (hereinafter 'the assured') must observe, however, in this thesis we will examine the duty of disclosure with reference to the assured only. Interesting point is that the marine insurance contract law recognizes the duties of disclosure whereas the general contract law does not recognize the duty of disclosure at all, as it follows the philosophical *caveat emptor* or let the buyers know.<sup>4</sup> This thesis will examine the reasons for not recognising the duty of disclosure in contract law. Since the marine insurance contract law recognizes the duty of disclosure, we will examine the available remedies in marine insurance law in case of non-disclosure as well as misrepresentation.

Similar to the marine insurance contract law, the modern law of contract recognises misrepresentation that may vitiate the approval of the receiver of the statement to a consequential contract, and provides option to that party to rescind the contract.<sup>5</sup> Nevertheless, unlike the marine insurance contract law, the general contract law provides remedy for damages. Since the representation can be fraudulent, negligent or innocent, the courts may award damages in addition to the option of rescinding the contract in case of negligent and fraudulent misrepresentation. In this Thesis, we will examine when courts may award damages in addition to rescinding the contract in case of misrepresentation. In addition, we will examine whether option of damages available in case of misrepresentation in the marine insurance contract or not? At this point, we should realize that strict action against misrepresentation, in both marine insurance contract law and the general contract law, is important in order to place the innocent party at the same position as he was before the contract and in order to deter misrepresentation.

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<sup>4</sup> *Smith v. Hughes (1871) LR 6 QB 597.*

<sup>5</sup> F.D. Rose, *Marine Insurance: Law and Practice*, p. 65, LLP, London, 2004.

## **1.1 Purpose, Method and Material**

The purpose of this thesis is to describe and analyse the pre-contractual duty of utmost good faith in the marine insurance contract law and compare it with the pre-contractual duty of good faith in the general contract law. The topic of this Thesis is, without any doubt, a little unusual and so the method adopted. However, the comparative analysis of the duty of good faith in both, the marine insurance contract law and the general contract law fields, will certainly help to understand why both law fields developed in different directions on this particular subject. This is also the purpose of this thesis to analyse why the duty of utmost good faith in the marine insurance contract law has different connotation while the duty of good faith in contract law has different meaning and why breach of both have dissimilar consequences.

Old and relatively recent cases will be used to analyse the topic and issues related to the topic. Besides, books, scholarly articles and internet sources will be used to analyse the general duty of good faith in the marine insurance contract law and the general contract law.

## **1.2 Delimitation**

Realizing the fact that the size of the topic, the duty of good faith, is extremely vast, the focus will remain on the pre-contractual duty of good faith and the elements of the duty of good faith, namely, non-disclosure and misrepresentation at pre-contractual stage. Comparison of the duty of utmost good faith in the marine insurance contract law with the duty of good faith in the general contract law will be presented with a special focus on examining section 17, 18 and 20 of the Marine Insurance Act 1906 and Misrepresentation Act 1967 with the help of new and old case law. It is not the purpose of this Thesis to describe the circumstances of the case law, and, therefore, the main points of the court decisions will be quoted.

# 2 The Duty of Good Faith

## 2.1 Historical Background of the Duty of Good Faith

Good faith has ancient philosophical roots and is referred to in the writings of Aristotle and Thomas Aquinas. They were concerned with the problems of buying/selling and faced the dilemma of lack of fairness and disputes in trade.<sup>6</sup> Nevertheless, the origin of good faith can be traced in Roman law. The concept of *bona fides* in Roman law can be translated to the principle of good faith.<sup>7</sup> The word '*fides*' was originally understood as that a man should remain faithful to his words and should own his undertakings.<sup>8</sup> On the other hand, *Bona fides* was used to ascertain the substance of a contract. It required the contracting parties to act sincerely and consequently influenced the approach in which a contract was required to be performed.<sup>9</sup> This ancient concept in the revived form and in the shape of good faith went around the world like wildfire at the end of the 18th century.<sup>10</sup> In, *Carter v. Boehm* (1766) 3 Burr 1905, Lord Mansfield described good faith as the governing principle applicable to all contracts and dealings. Lord Mansfield introduced this new principle to insurance law in particular and other contracts in general. He introduced that insurance is a contract based upon speculation, involving reliance and confidence, particularly of the insurer upon the assured, but applicable to both. He stressed that insurance contract demands disclosure of circumstances and if any party fail to disclose, even by mistake, this is fraud. The policy will be void because of this fraud.

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<sup>6</sup> Jim Mason, Contracting in Good Faith – Giving the Parties what they want, Article available on: <http://www.bear2008.org/post/199.pdf> (16 Feb 2010).

<sup>7</sup> Martin Josef Schermaier, *Bona fides in Roman Contract Law*, Edited by Reinhard Zimmermann and Simon Whittaker, p.65, Cambridge University Press, 2000.

<sup>8</sup> C C Turpin, 'Bonae Fidei Iudicia' [1965] Cambridge Law Journal at p. 260. Quoted at p. 7, J Edward Bayley, *A Doctrine of Good Faith in New Zealand Contractual Relationships* available at: [http://ir.canterbury.ac.nz/bitstream/10092/2862/1/Thesis\\_fulltext.pdf](http://ir.canterbury.ac.nz/bitstream/10092/2862/1/Thesis_fulltext.pdf) (24 March 2010).

<sup>9</sup> *Supra*, Foot Note 7.

<sup>10</sup> *Supra*, Foot Note 6.

This principle later became known as the principle of utmost good faith or *uberrimae fidei* in the marine insurance contract law and principle of good faith in the general contract law. The case law of nineteenth century discussed and adopted this principle. When the Sir Mackenzie Chalmers was drafting the marine insurance act in the early 1890, he had ignored a number of distinct rules. Only the assured and his broker were under duty, throughout the contract, to disclose all material facts and not to make material misrepresentations. The insurer's duty to disclose any material facts and not to make any misrepresentations terminated as soon as the contract was made.<sup>11</sup> Perhaps because of commonly believed notion that this is only the responsibility of the assured to disclose all material facts and the insurer has nothing to disclose. The effect of this unbalance duty of good faith is evident, as there has been more protection for the assured in litigation. The duties were stringent, it was not required to show intent to mislead and the carelessness and even the real knowledge of the assured or his broker were evenly immaterial considerations. The remedy was that the insurer might avoid the contract. These rules were carefully enacted as section 18 to 20 of the Marine Insurance Act 1906 (MIA 1906). However, perhaps only for the sake of completeness or may be to observe equality, Mackenzie Chalmers also included an enactment of Lord Mansfield's original principle, in the form of section 17.<sup>12</sup> This section attracted little attention until 1985, when Hirst J in *The Litsion Pride*<sup>13</sup> held that the insurer might have a defence to the claim based upon lack of good faith.

In reality, the courts in the last almost 20 years have lost tolerance with insurers taking technical defences based on absence of good faith, especially because of non-disclosure. The courts have acted so far as is consistent with the judicial role to contain the avoidance of policies by the insurer because the consequential legal regime is too favourable in practice to the insurer. Significantly, the requirement of disclosure has been included

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<sup>11</sup> Professor Robert Grime, *The Duty of the Utmost Good Faith, The Modern Law of Marine Insurance*, Edited by D. Rhidian Thomas, Volume Two, p. 267, LLP, London, 2002.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Black King Shipping Corporation and Wayang (Panama) S.A. v. Mark Ranald Massie* [1985] 1 Lloyd's Rep. 437 (*The Litsion Pride*).

in MIA 1906 considering the fact that the prudent insurer will do his inquiry about the risk. On the other hand, it is equally stringent from the perspective of the assured, as it is irrelevant that non-disclosure arose innocently or by mistake. Furthermore, remedial consequence is very harsh; insurer can avoid the contract.<sup>14</sup> As a result, non-disclosure in insurance law is perhaps most criticised doctrine in English commercial law. The assured does not have the assistance of sophisticated brokers. It is, therefore, significant for the assured that the law of non-disclosure should be fair and balanced.<sup>15</sup> A relatively recently, *Lord Hobhouse* in *The Star Sea* case<sup>16</sup> said: “It is a striking feature of this branch of the law that other legal systems are increasingly discarding the more extreme features of the English law which allow an insurer to avoid liability on grounds which do not relate to the occurrence of the loss.”

This must be interesting to know that Marine Insurance Act 1908 of New Zealand (MIA 1908), Marine Insurance Act 1909 of Australia (MIA 1909) and Marine Insurance Act 1993 of Canada (MIA 1993) have corresponding provisions to MIA 1906. Only there is no corresponding section in MIA 1908 for section 17 of MIA 1906. This is not understandable why they did not included section 17 of MIA 1906, which is about the duty of good faith and ensures fairness, in MIA 1908. However, sections regarding disclosure and representation have been added almost verbatim.<sup>17</sup> British marine insurance law, as set out in MIA 1906, also formed the basis of all Canadian provincial and federal marine insurance legislation as well as Australian and New Zealand marine insurance legislations.<sup>18</sup> Therefore, development of the duty of good faith in Canada, Australia and New Zealand are, because of this reason, very much connected to the British marine insurance law. As far as the development of the duty of good faith in US law is concerned, as early as 1808, Justice Sedgwick of the Supreme Judicial Court Massachusetts recognized that “good faith” had a role in

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<sup>14</sup> *Supra*, Foot Note 5, p 66.

<sup>15</sup> *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co Ltd* [1995] 1 AC 501.

<sup>16</sup> [2001] UKHL 1.

<sup>17</sup> See, s. 18 to s. 20 MIA 1908.

<sup>18</sup> Edgar Gold, Aldo Chircop, Hugh Kindred, *Essentials of Canadian Law, Maritime Law*, p. 306, Irvin Law, Toronto, 2003.

contractual relations. He observed that “not only good morals but the common law requires good faith, and that every man in his contracts should act with common honesty.”<sup>19</sup> Good faith emerged in the early US law’s willingness to “imply” both promises and terms to contractual relations. Later, in 1933, the duty of good faith was defined as a covenant. It was held in the court of appeals, New York, that neither party shall do anything, which will have the outcome of destroying, or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith.<sup>20</sup> Presently, the law of United States recognizes the duty of contractual good faith. The duty of good faith in United States originates from two sources: Uniform Commercial Code (UCC)<sup>21</sup> and The Restatement (Second) of Contracts 1981 (RSC 1981).<sup>22</sup>

## 2.2 The Duty of Good Faith in the Marine Insurance Contract Law

The principle of good faith is common to the entire law of contract but the insurance law requires advanced standards of good faith. This is because the insurer is put on the mercy of the assured due to the extraordinary established traditions and circumstances in this trade. Relying on the information provided by the assured without verifying is just one example. Conversely, insurance would be impracticable as a real business unless the insurer could rely upon the information provided by the assured, which enable him to work out cautiously the likely incidence of the risk.<sup>23</sup> In *Container Transport International Inc v. Oceanus Mutual Underwriting Association (Bermuda)*,<sup>24</sup> Lord Stephenson said that section 17 of MIA 1906 restates the long established duty of the utmost good faith in contracts of marine insurance. It is not necessary, even if it were possible, to go into

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<sup>19</sup> *Bliss v. Thompson*, 4 Mass. 488, 492 (1808).

<sup>20</sup> *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, N.E. 163 (1933).

<sup>21</sup> First Published in 1952, changing since then, promulgated to harmonize the sales of goods in United States. 60 out of 400 sections of UCC require good faith.

<sup>22</sup> See s. 205. RSC 1981 are recognized and frequently-cited legal treatises in all US Jurisprudence.

<sup>23</sup> N J J Gaskell, C Debattista, R J Swatton, Chorley and Giles’ Shipping Law, p. 524, 525 Eighth Edition, Financial Times, Pitman Publishing, 1987.

<sup>24</sup> [1984] 1 Lloyd’s Rep. 476 at p. 525, CA.

degrees of good faith applicable to other contracts. This is because of the recognition that much more than an absence of bad faith is required from both parties to all contracts of insurance. Nevertheless, the degree of good faith may be judged based on circumstances in each case. Consideration may be given to the fact whether the parties did their best to be fair in disclosing all relevant information and avoid any misrepresentation or not.

It is established beyond doubt that the *uberrimae fidei* principle, as it is sometimes called, imposes reciprocal duties on the assured and insurer. The parties must not only abstain from bad faith but also observe in a positive sense the utmost good faith by disclosing all material circumstances.<sup>25</sup> Conceivably, to observe fairness, MIA 1906 in section 17 places duty of observing utmost good faith on both parties to the contract.<sup>26</sup> Nevertheless, actually the duty of good faith is usually one-sided duty. On the basis of information provided by the assured, the insurer makes his decision whether to take the risk or not, if yes at what premium. However, it seems inequitable to place burden of providing all information about the material facts on the assured only. On the other hand, it seems practically impossible for the insurer to check all material fact before taking risk. Moreover, there can be facts that are known to the assured only. For that reason, the assured must disclose all facts which are material to the proposed risk.<sup>27</sup> Lord Mansfield stated 244 years ago that “good faith forbids either party, from concealing what he privately knows, to draw the other into bargain from his ignorance of that fact, and from his believing to the contrary.”<sup>28</sup>

The assured describes the risk personally or through the agent, and insurer has to rely upon the information provided by the assured or his agent. Therefore, it cannot be sufficient merely to demand that no lies are told; the assured must not be allowed to give false representation by keeping information.<sup>29</sup> In making a full disclosure, the assured must ensure that what

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<sup>25</sup> *Banque Keyser Ullmann v. Skandia* [1987] 1 *Lloyd's Rep.* 69 at p. 93.

<sup>26</sup> Robert H. Brown, *Marine Insurance*, p. 79, Volume 1, Sixth Edition, Witherby & Co Ltd, London, 1998.

<sup>27</sup> *Supra*, Foot Note 18, p. 322.

<sup>28</sup> *Carter v. Boehm* (1766) 3 *Burr.* 1905.

<sup>29</sup> Robert Grime, *Shipping Law*, p. 372, Second Edition, Sweet & Maxwell, London, 1991.

is presented to the insurer is true.<sup>30</sup> Otherwise, the insurer has the option to avoid the contract if false representation influenced the judgement of the insurer in fixing the premium or in determining the risk.<sup>31</sup>

In the marine insurance contract law, the parties to the contract must not only avoid misrepresentation but must also disclose all material facts.<sup>32</sup> The well-developed regime of disclosure is one of the most distinctive characteristics of the marine insurance contract law. The need for this principle is immense because of the informational lop-sidedness between the insurer and the assured. The latter is seeking to transfer the risk of some uncertain and undesirable incident to the former. Therefore, the facts related to the risk are as a rule primarily within the knowledge of the assured. Generally speaking, with regard to the particular incidents of event or property in respect of which cover is sought, this proposition is true. On the contrary, some of the matters of which an able insurer might desire to be mindful prior to subscribing a risk, and of which the courts have held him allowed to be aware, may not be completely apparent to the assured.<sup>33</sup> Therefore, for instance, if the insurer wants to know about some physical hazards of the voyage, which are not in the knowledge of the assured, the insurer must make his own inquiry before subscribing a risk. If he fails to do so, he cannot later blame the assured for absence of good faith.

Furthermore, the relationships between the assured and the insurer require that the assured must disclose all facts regarding the risk. This is because the particular facts upon which the contingent chance is to be calculated lie most commonly in the knowledge of the assured only; the insurer trusts to his representation and proceeds upon self-belief that he does not keep back any circumstances in his knowledge to mislead the insurer into a belief that the circumstance does not exist. Misleading insurer by keeping any information back is fraud, and therefore policy based on such information is void. This also applies if insurer holds back some information

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<sup>30</sup> *Supra*, Foot Note 18, p 322.

<sup>31</sup> *Desrosiers v. Fishing Vessel Insurance Plan (1994)*, 87 F.T.R. 101.

<sup>32</sup> *Supra*, Foot Note 29.

<sup>33</sup> *Supra*, Foot No. 5.

from the assured.<sup>34</sup> The policy will not void automatically in case of non-disclosure or misrepresentation but may be avoided by the aggrieved party.<sup>35</sup>

In practice, it is quite unlikely that the assured will take the trouble to avoid the contract as it will not be beneficial for him – he would not wish to expose himself to the risk against whom he got insurance – except where he would do this to get his premium back. For that reason, virtually it is the insurer who can be affected by a breach of the duty of good faith and thus may be considered most appropriate party to avoid the contract.<sup>36</sup>

## **2.3 The Duty of Good Faith in the General Contract Law**

While notion of good faith influences the general contract law, English contract law does not, yet, recognize the existence of a doctrine of good faith. Nevertheless, it does not really mean that rules of the general contract law do not generally conform to the requirements of good faith. Would it not be surprising if the rules encourage the parties to act in bad faith? It is quite interesting to know that Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR 1999) have introduced a requirement of good faith in English law, which is applicable to significant number of consumer contracts. Although there is no reason, why the influence of good faith under UTCCR 1999 will extend to other contracts, especially commercial contracts, but this may be taken as a sign that there is a change in scholarly attitudes to the duty of good faith in the general contract law. The hostility is being replaced by acknowledgement of good faith in consumer contract area, atleast to start with. Therefore, it is not away from the bounds of likelihood that the English courts will recognize the existence of doctrine of good faith in very near future. It is, for that reason, necessary to compare and examine the doctrine of good faith in the general contract law with doctrine of utmost good faith in the marine insurance contract law

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<sup>34</sup> *Carter v. Boehm (1766) 3 Burr. 1905.*

<sup>35</sup> *Pacific Queen Fisheries v. L. Symes 307 F.2d 700, 1962.*

<sup>36</sup> *Supra*, Foot Note 26.

in order to understand why the duty of good faith is an important duty in all contracts.<sup>37</sup>

During the pre-contractual negotiations, the parties make a variety of representations to each other. Many of these representations eventually become terms of the contract between the parties. The negotiating party may be held responsible if it makes any misrepresentation during the negotiations to mislead the other party.<sup>38</sup> The law of contract, therefore, recognises that the innocent party may avoid the contract in case of misrepresentation at pre-contractual stage. A successful claim for misrepresentation will render a contract voidable.<sup>39</sup> Damages may also be available for misrepresentation because only damages can save the innocent party from falling into worse position than he was before the contract.

If there is no fiduciary relationship<sup>40</sup> between the parties to the contract, no party is bound to disclose any fact exclusively within his knowledge, which might reasonably be expected to influence judgment of the other party. The general law of contract maintains a strict distinction between speaking and non-speaking. The courts have always been pragmatic about the boundary between the two. Using a word, treating a nod or a wink, or a shake of head, or a smile as a statement was held to be sufficient proof of material disclosure.<sup>41</sup> However, an active duty to disclose material facts remained confined. Although recent years have seen learned advocacy of the desirability of a general duty to disclose material facts in the general contract law, no matter what the merits of such a development are, there is a little evidence of any noteworthy common law movement.<sup>42</sup> This is because the parties cannot disclose the information without

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<sup>37</sup> Ewan McKendrick, *Contract Law, Text, Cases and Materials*, p. 542, Second Edition, Oxford University Press, 2005.

<sup>38</sup> Linda Mulcahy, *Contract Law in Perspective*, p. 99, Fifth Edition, Routledge Cavendish, London, 2008.

<sup>39</sup> Ryan Murray, *Contract Law – The Fundamentals*, Contract Law, p. 125, First Edition, Sweet & Maxwell, London, 2008.

<sup>40</sup> Special relationship of trust and confidence which, in the words of justice Benjamin Nathan Cardozo (1870-1938; US Supreme court judge from 1932 to 1938) is "something more than the ordinary honour of the marketplace, honesty and forthrightness." Fiduciary relationships exist between an agent and principal, customer and the bank etc. Definition available on: <http://www.businessdictionary.com/definition/fiduciary-relationship.html> (18-03-2010).

<sup>41</sup> Lord Campbell in *Walters v. Morgan (1861) 3 De G F and J 718, 724*.

<sup>42</sup> *Supra*, Foot No. 5, p 67.

achieving benefits in their favour. Disclosing tactical information first and then negotiating with the other party is factually irrational. Holding information to use it at appropriate time is very important to achieve personal advantages in a business negotiation. Besides, it is believed that it is the duty of the buyer to beware; *caveat emptor* rule applies in this respect.<sup>43</sup> However, it does not mean that the seller is allowed to stay quite in reply to a question of the buyer and later use the pretext of *caveat emptor* in defence. Question arises here that whether the parties to a marine insurance contract can use *caveat emptor* in defence or not? The principle of *caveat emptor* does not apply to the insurance contracts because in the insurance contracts parties must disclose all material facts of which they have knowledge and about which other party does not know. Disclosing all material facts is important in insurance contracts to win over the confidence of other party and to put him in the same position with the party that has the knowledge of such facts.<sup>44</sup>

Lord Bingham<sup>45</sup> recognized that good faith is an objective criterion, which imports the notion of fair and open dealing. He further observed that concept of good faith is not completely unknown to British law. Based on these two observations it may be said that good faith is not an unknown principle to the contract law. But real question is how will the concept of good faith as recognized in UTCCR 1999 extend to other contracts, especially commercial contracts, that are outside the scope of the Regulation? It may be argued that the duty of good faith has a function to do in the general contract law but real problem is a decision of House of Lords in *Walford v. Miles*<sup>46</sup> in which it was held that the English law did not recognize the validity of an obligation to negotiate in good faith. It is quite logical that any recognition of general duty of good faith will require re-consideration of the decision in *Walford v. Miles*. House of Lords is the only forum that can re-consider its earlier decision.<sup>47</sup>

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<sup>43</sup> *Smith v. Hughes* (1871) LR 6 QB 597.

<sup>44</sup> *Conlon v. Simms* [2006] EWCA Civ 1749.

<sup>45</sup> *Director General Of Fair Trading v. First National Bank Plc* [2001] UKHL 52.

<sup>46</sup> [1992] 2 AC 128.

<sup>47</sup> *Supra*, Foot Note 37, p 544.

Australian and New Zealand law of contracts are in a similar position as far as the duty of good faith in the general contract law is concerned. Both are not yet ready to incorporate the principle of good faith in the general contract law<sup>48</sup> because there is no clearly defined condition to formulate 'good faith' in pre-contractual relationships of the parties. Concepts, such as cooperation and legitimate interest, looks vague, however often linked with the duty of good faith.<sup>49</sup> Nevertheless, cooperation by the parties in pre-contractual situation is almost not viable, because the parties make contracts for maximum personal gains; therefore, cooperation on the cost of losing personal benefits will not be acceptable to the contracting parties.<sup>50</sup> As for as legitimate self interest of the party is concerned, the duty of good faith and self-interest are two distinctive notions. It is not viable for the parties to look after their self-interests and observe good faith, which demands to compromise self-interest for the best interest of the other party. In the business world, such a compromise is not beneficial for the compromising party, as the purpose must be to obtain maximum benefits not to compromise them. Moreover, as the principle of good faith is contrary to the competitive principle of self-interest, negotiation process at pre-contractual stage, for instance, would become irrational when the actual purpose of the parties to achieve maximum benefits from negotiations would no longer be attractive.

As for as Canadian contract law is concerned, all provinces in Canada, except Quebec, follow English contract law. It would be incorrect to say that the general contract law in Canadian does not recognize the duty of good faith. The doctrine of unconscionability<sup>51</sup> has frequently been used by common law courts in Canada to imply an obligation to deal fairly and in good faith. So the notion of good faith and fair dealing has long been established as a basic principle of contract law in Canada.<sup>52</sup> The former Chief Justice of the

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<sup>48</sup> *Gibbons Holdings Ltd v. Wholesale Distributors Ltd* [2008] 1 NZLR 277.

<sup>49</sup> Dr Elizabeth Peden, *The Meaning of Contractual Good Faith* (2001) 22 ABR 235.

<sup>50</sup> *Burger King Corp v. Hungary Jacks Pty Ltd* (2001) NSWCA 187.

<sup>51</sup> Unconscionability is a term used in contract law to describe a defence against the enforcement of a contract that contains unjust terms.

<sup>52</sup> Fredric L. Carsley, *Good Faith and Fair Dealing in The Commercial Context*, p. 3, Article available at: [http://www.cba.org/CBA/newsletters/pdf/04-08\\_addendum\\_obyrne.pdf](http://www.cba.org/CBA/newsletters/pdf/04-08_addendum_obyrne.pdf) (3 March 2010).

Supreme Court of Canada, Justice Dickson, pointed out the following: ‘where the contract is unconscionable as might arise from situations of unequal bargaining power between the parties, the courts should interfere with agreements that parties have freely concluded. The courts do not blindly enforce harsh or unconscionable bargains.’<sup>53</sup>

This is, certainly necessary, to imply observation of fair dealing and good faith between the contracting parties at negotiating stage. If the negotiating parties are not in equal bargaining position, the party who has the access to the information that is not available to the other party, should share that information to such party. This is important to avoid unconscionability and to promote fair dealing and good faith at negotiating stage.<sup>54</sup>

The duty of good faith is not required in the general contract law in Australia and New Zealand, because system is already working very well without it. Besides, the contract law already recognizes other similar rules; estoppel is just one example, which can be used where good faith principle is not available. Besides, the good faith principle will increase inconsistency in judicial interpretation.<sup>55</sup> The parties who are believed to safeguard only their own interests in business negotiations will not benefit from this principle, as they have to consider other party’s interest as well.<sup>56</sup> On the other hand, if the duty of good faith is incorporated in the Australian and New Zealand contract law, it will promote the notion of fair dealing and consequently the parties will enjoy productive business relationships.<sup>57</sup> It is, for this reason, seems likely that the Australian and New Zealand contract laws will recognize the duty of good faith in near future.

Canada is also at the same position to Australia and New Zealand, the Supreme Court of Canada has recognized employment contract

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<sup>53</sup> *Hunter Engineering Company Inc. v. Syncrude Canada Ltd* [1989] S.C.R. 425, at p. 46.

<sup>54</sup> *Bryandreu Holding Ltd v. Sifton Properties Limited*, [1994] 38 R.P.R. (2d) 95.

<sup>55</sup> Mathew Harper, The Implied Duty of Good Faith in Australian Contract Law, Murdoch University Electronic Journal of Law, November 2004, available at: <http://www.murdoch.edu.au/elaw/issues/v11n3/harper113.html> (11 May 2010).

<sup>56</sup> See Meagher JA’s view in *Renard Constructions v. Minister for Public Works* (1992) 26 NSWLR 234 at 275.

<sup>57</sup> See Priestly JA’s view in *Renard Constructions v. Minister for Public Works* (1992) 26 NSWLR 234 at 268.

for the application of the duty of good faith.<sup>58</sup> This may be considered recognition of the duty of good faith in contractual relationships, however, this recognition does not apply to all contract, because the general duty of good faith is not an obvious part of the general contract law in Canada.<sup>59</sup> Nevertheless, the doctrine of unconscionability<sup>60</sup> has regularly been used by common law courts in Canada to imply good faith.<sup>61</sup> Moreover, if the courts do not allow the unconscionable bargains between the parties,<sup>62</sup> it will help to promote fair dealing and good faith between the parties at negotiation stage and consequently will promote trustworthy business contractual relationships.<sup>63</sup>

### **2.3.1 Whether English Contract Law recognizes the Duty of Good Faith or not?**

It is generally believed that English contract law does not recognize the duty of good faith, but this is not completely true. Recognizing misrepresentation, which is an element of the duty of good faith, is one indirect way of recognizing the duty of good faith at pre-contractual conditions. It can be argued further that marine insurance contract law recognizes misrepresentation as one of the factors, which can make the contract voidable, and *Bryandreu Holding Ltd. v. Sifton Properties Limited*,<sup>64</sup> acknowledges it as one of the elements of the duty of utmost good faith. Misrepresentation has the same effect in the general contract law as it has in the marine insurance contract law; the innocent party may rescind the contract and can claim damages. Then there must be no problem in accepting that the duty of good faith exists in the general contract law. The difficulty seems to be in its direct recognition. The courts are reluctant to recognize the duty of good faith in English contract law but they do not hesitate to recognize misrepresentation. Therefore, the actual problem appears to be more or less of well-set minds towards the non-recognition of

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<sup>58</sup> *Wallace v. UGG* [1997] 3 SCR 701.

<sup>59</sup> *Mesa Operating Ltd Partnership v. Amoco Canada Resources Ltd* (1994) 149 AR 187.

<sup>60</sup> *Supra*, Foot Note 51.

<sup>61</sup> *Supra*, Foot Note 52.

<sup>62</sup> *Hunter Engineering Company Inc. v. Syncrude Canada Ltd.* [1989] S.C.R. 425, at p. 462.

<sup>63</sup> *Bryandreu Holding Ltd v. Sifton Properties Ltd* [1994] 38 R.P.R. (2d) 95.

<sup>64</sup> (1995) 38 R.P.R.

this principle. It is believed that the non-recognition of the duty of good faith increases market competence and benefits to the business community as it protects the parties to negotiate at length, discover possibilities and exchange the information that makes the trade beneficial for the party exchanging such information. Traditionally, the boundaries of contractual obligations start working when agreement is reached and not before that.<sup>65</sup> However, this is an older notion. A party cannot say whatever he wants to say to the other contracting party. Every party not only has to refrain from dishonestly ascertaining the facts but not to mislead the other party by exaggerated and unfounded statements.<sup>66</sup> There is, obviously, a change in traditional approach of considering that boundaries of contractual obligations start working when agreement is reached. Trade Description Act 1968 (TDA 1968), Consumer Protection Act 1987<sup>67</sup> (CPA 1987), UTCCR 1999 and more recent addition of Consumer Protection (Distance Selling) Regulations 2000 (CPR 2000)<sup>68</sup> explain that overall approach has been to take up piecemeal solutions, to fine the misleading party, in response to problems of unfairness rather than to adopt overriding principle of good faith.<sup>69</sup> TDA 1968, CPA 1987, UTCCR 1999 and CPR 2000 may be considered an evidence of a step forward towards recognizing the duty of good faith indirectly in English contract law. Nevertheless, there is a little hope that such indirect recognition will extend to the most important commercial contracts. However, this may be taken as proof that the principle of duty of good faith is not completely unknown to the English contract law. But if we admit, contrary to factual position, for instance that, there is no duty of good faith in English contract law presently, there is likelihood that English contract law will recognize the duty of good faith

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<sup>65</sup> *Supra*, Foot Note 38.

<sup>66</sup> Patrick Atiyah, *The Rise and Fall of Freedom of Contract*, Oxford University Press, 1985. Quoted at p.100, Linda Mulcahy, *Contract Law in Perspective*, Fifth Edition, Routledge, Cavendish, London, 2008.

<sup>67</sup> The purpose of TDA 1968 and CPA 1987 is to prohibit false or misleading indications as to the price of goods and services, quantity, composition, strength and fitness for purpose. Fines are imposed on the misleading parties, and in extreme circumstances they may be imprisoned as well. See, for instance, s.18 of TDA 1968 and s. 20 of CPA 1987.

<sup>68</sup> The purpose of CPR 2000 is to prohibit false or misleading information about the description of the goods, the price, delivery costs etc.

<sup>69</sup> *Supra*, Foot Note 38, p. 100.

directly in the near future instead of adopting indirect approach. Yet again, this high likelihood is based on the recognition of fair dealing in above given acts – that is in fact indirect recognition of the duty of good faith.

### 2.3.2 Negotiating the Contract in Good Faith

As we have discussed earlier that case of *Walford v. Miles*<sup>70</sup> is the real problem in the process of recognizing the duty of good faith during negotiations. It was held in this case that the contract law does not recognize good faith during negotiations. In addition, agreement to negotiate in good faith has no legal content. Immediate question arises here; does not it impose a restriction on freedom of contract as envisaged in the UNIDROIT Principles of International Commercial Contracts<sup>71</sup> (UNIDROIT Principles)? The straightforward answer to this question is, obviously, yes. Besides, the freedom of contract is of supreme significance in international trade as the parties negotiate at length to gain personal business objectives. If the parties decide to negotiate in good faith, there must be no problem in validating this agreement, as freedom of contract is important for an open, market-oriented and competitive economic order.<sup>72</sup> Lord Steyn<sup>73</sup>, while discussing House of Lords decision in *Walford v. Miles* argued that the UNIDROIT Principles make clear that a party is free to negotiate and is not liable for a failure to reach an agreement. On the other hand, where the party negotiates with the other party in bad faith, not intending to reach an agreement, for instance, he is liable for losses caused to the other party. He further argued that this line of reasoning not considered in *Walford v. Miles* case. The result of the decision is even more questioning when one takes into account that the House of Lords regarded as best endeavours undertaking as enforceable. If the issue were to arise again, with the benefit

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<sup>70</sup> [1992] 2 AC 128.

<sup>71</sup> New addition of UNIDROIT Principles published after some amendments in 2004, ten years after UNIDROIT Principles 1994.

<sup>72</sup> See Article 1.1, UNIDROIT Principles 2004, Published by International Institute for the Unification of Private Law and available at: <http://www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf>

<sup>73</sup> See extra-judicial writing, Contract Law: Fulfilling Reasonable Expectations of Honest Men, (1997) 113 LQR 433, 439, quoted at p. 552, Ewan McKendrick, Contract Law, Text, Cases and Material, Second Edition, Oxford University Press, 2005.

of fuller argument, I would hope that the concept of good faith would not be rejected out of hand, he concluded.

Contracting parties do not infrequently make use of language of good faith. For example, in a standard clause of a joint venture agreement the parties agree that they shall endeavour by good faith efforts to resolve by mutual agreement any dispute arising in connection with the agreement. Is this type of clause valid? It is not possible to give clear answer to this question as *Walford v. Miles* case has casted a shadow over validity of such clauses.<sup>74</sup> However, in *Haines v. Carter*<sup>75</sup>, majority of their lordships held that an agreement made as a result of an informal mediation contained a clause which stated that ‘the parties confirm that they have reached the agreement contained in this mediation in all good faith’ was legally meaningful. This is to validate that the purpose of the courts is to help business community, not to hinder them, give effect to their transactions, not to frustrate them, oil the wheels of commerce, not to put grit in the oil.<sup>76</sup> In this context, it may be argued that in *Walford v. Miles*, the House of Lords failed to consider US case law on this issue.<sup>77</sup> See for example *Teachers Insurance and Annuity Association of America v. Tribune Company*<sup>78</sup> in which court recognized that negotiation in good faith is valid. In addition, the House of Lords was mistaken to assume that an adversarial or competitive negotiation is the only type of negotiation. They ignored that there is another type of negotiation, namely, problem solving negotiation. Therefore, by adopting option of negotiating in good faith, the parties opt for problem solving negotiations. If they opt to give such undertaking to negotiate in good faith, it shows their intention that they want to be legally binding by it, for the courts to deny effect to such undertaking is not commercially fair.<sup>79</sup>

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<sup>74</sup> *Supra*, Foot Note 37, p 552.

<sup>75</sup> [2002] UKPC 49.

<sup>76</sup> *Homburg Houtimport BV v. Agrosin Private Ltd* [2004] AC 715, at p. 749, citing Lord Goff, ‘Commercial Contracts and the Commercial Court’ [1984] Lloyd’s Maritime and Commercial Law Quarterly 382, at p. 391.

<sup>77</sup> Alan Berg, ‘Promises to Negotiate in Good Faith’ (2003) 119 Law Quarterly Review 357.

<sup>78</sup> 670 F. Supp. 491, 1987.

<sup>79</sup> Alan Berg, ‘Promises to Negotiate in Good Faith’ (2003) 119 Law Quarterly Review 362.

It is difficult to pronounce whether making an agreement to negotiate in good faith is rejection of adversarial negotiation. However, obviously a new question may arise here. What does really indicate if the parties make an agreement to negotiate in good faith? Making an agreement to negotiate in good faith shows that the parties want to keep their minds open in a sense to show willingness in order to resolve any dispute arises during negotiations.<sup>80</sup> It also shows that the parties are willing not to take advantage of the known ignorance of the other party in the course of negotiations.<sup>81</sup> Besides, it creates an obligation on the parties not to withdraw from the negotiations without giving enough opportunity to the other party to respond and not to withdraw giving reason that is untrue.<sup>82</sup> One may state these reasons to accept problem solving negotiation and rejection of adversarial negotiation. Besides, it is favourable for the healthier relationships between the contracting parties – which can be the desire of both parties. Moreover, the rejection of adversarial negotiations is practical in real world, especially in business world, where the parties act as the seller and the buyer – both are crucial for each other. Would the seller like to make new buyers for his products but at the same time would not like to make relationships with them based on trust and understanding? Such relationships may not be expected if the contracting parties do not observe the duty of good faith at negotiation stage. Moreover, there should not be any problem in agreeing to negotiate in good faith. It must be useful for both the parties in order to establish their mutual relationships if they undertake to enter into negotiations with open minds and with a motive to resolve, if, any differences arise in the course of negotiations.

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<sup>80</sup> *Aiton Australia Pty Ltd v. Transfield Pty Ltd* [1999] N.S.W.S.C. 996 at p. 147.

<sup>81</sup> See Lord Hoffmann's dissenting opinion in *BCCI v. Ali* [2001] UKHL 8, [2002] 1 A.C. 251 at 68.

<sup>82</sup> *Supra*, Foot Note 79.

## 2.4 Relationship of The Duty of Good Faith with Non-disclosure and Misrepresentation

The law relating to disclosure and representations is codified in section 17 to section 20 of MIA 1906<sup>83</sup>, which is applicable to non-marine cases as well.<sup>84</sup> The reason for this is the similarity between marine insurance and non-marine insurance. As section 17 of MIA 1906 is the first of a set of sections appear under the heading of disclosure and misrepresentation, it may be assumed that simply non-disclosure and misrepresentation are related to the duty of utmost good faith. One may also assume after reading section 18 of MIA that it should apply to pre-contractual conditions. Unquestionably, both are closely linked to the doctrine of utmost good faith and applicable to pre-contractual as well as post-contractual situations.<sup>85</sup> Does it mean that non-disclosure and misrepresentation are identical to the duty of utmost good faith? Since the duty of utmost good faith is a source from which principles of disclosure and representation originate, they may not be separate but the duty of utmost good faith must be wider and further persuasive of the two principles. The proof of non-disclosure or misrepresentation is presented to establish the breach of the duty of utmost good faith. This, over the years, has drawn a line between the defences of non-disclosure and misrepresentation.<sup>86</sup>

In *Container Transport International Inc v. Oceanus Mutual Underwriting Association (Bermuda)*<sup>87</sup> Lord Justice Kerr described that the duty of utmost good faith is an overriding duty, of which the duty of disclosure is only an aspect. Lord Justice Parker, in the same case, expressed

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<sup>83</sup> Also see s. 18 to s. 20 of MIA 1908, s. 23 to s. 26 of MIA 1909 and s. 20 to s. 22 of MIA 1993.

<sup>84</sup> R. J. Lambeth, *Templeman On Marine Insurance, Its principles and Practice*, p. 21, Sixth Edition, Pitman, London, 1986. Also see, for example, *Lambert v. Co-operative Insurance Society Ltd C.A. [1975] 2 Lloyd's Rep. 485*.

<sup>85</sup> Susan Hodges, *Law of Marine Insurance*, p. 83, Cavendish Publishing Limited, London, 2004.

<sup>86</sup> *Ibid.*

<sup>87</sup> *[1984] 1 Lloyd's Rep. 476 at p 512, CA. Also read the same view by Hoffmann L.J. in Societe Anonyme d'Intermediaries Luxembourgeois v. Farex Gie [1995] L.R.L.R. 116 at 149.*

the opinion that the duty imposed by section 17, MIA 1906, goes further than merely to require fulfilment of the duties under the succeeding sections. Does not it mean that duties of disclosure and representation are not the only duties originate from the duty of utmost good faith? The answer is obviously yes, in one word. Although, it may be difficult to point out any other duty in pre-contractual situation but it may be said that making fraudulent claim, just one example, in post-contractual condition, constitute a breach of the duty of utmost good faith.<sup>88</sup>

The law of contract does not recognise the duty of good faith in general and the duty of disclosure in particular. The parties cannot disclose all information to the other party during the process of negotiation. For instance, a buyer who buys steel from a party in a foreign country and sells in his own country to the second buyer cannot disclose specific details of his clients to the manufacturer. However, yes, of course, he can disclose the purpose of buying steel generally, i.e. use in bridge-making industry. If he specifies the second buyer, he will risk losing his clients to the original manufacturer of the steel. The original manufacturer can approach the second buyer directly to sell that steel in comparatively cheaper rates. Therefore, the duty of disclosure at the negotiating stage of the contract seems not viable. It may be said, in this context, that misrepresentation is the only element that represents the duty of good faith in the general contract law. Nevertheless, undoubtedly, the duty of good faith in the general contract law has wider meanings than misrepresentation, as must be in case of the marine insurance contract law. However, unlike in the marine insurance contract law, misrepresentation in the general contract law is dealt independently as one of the factors that can vitiate the contract but it is not explicitly acknowledged as absence of good faith. The marine insurance contract law, on the other hand, recognizes both misrepresentation and non-disclosure the factors, which can make the contract voidable by the innocent party.

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<sup>88</sup> *Black King Shipping Corporation and Wayang (Panama) S.A. v Mark Ranald Massie* [1985] 1 Lloyd's Rep. 437 (*The Litsion Pride*).

## 3 Non-Disclosure

### 3.1 Non-Disclosure – A Vitiating Factor or a Tool to Manipulate

The notion of disclosure in the marine insurance contract law and the general contract law is fairly dissimilar. The Marine insurance contract law recognizes that the assured must disclose all material circumstances known to the assured, which would influence the judgment of the insurer while agreeing the marine insurance policy whereas general contract law does not recognize the duty of disclosure.<sup>89</sup> Because it is believed that the parties can look after their personal interests and therefore are not under any obligation to disclose any information to the other party. Nevertheless, one party cannot avoid answering a question asked by the other party. As for as disclosing material circumstance in marine insurance contract law is concerned, questions arise; why and when the assured must disclose all material circumstances; and which circumstance is material? We will discuss latter question under next heading. It may be said in reply to former question that the insurance business would be very risky if the assured is allowed to take shelter behind his bad memory or lack of knowledge.<sup>90</sup> For this reason, the assured must have knowledge of every circumstance, which in the ordinary course of business ought to be known to him<sup>91</sup> Having knowledge is not sufficient; the assured must disclose the information to the insurer before the contract is concluded. A time limit is set by the words ‘when the contract is concluded’. They give an impression that the disclosure is attached to the pre-contractual conditions only. This is not erroneous impression, although not entirely true.<sup>92</sup> The assured must

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<sup>89</sup> See s. 18 (1), MIA 1906. Also see s. 21 (1) MIA 1993, s. 24 (1) MIA 1909, and s. 18 (1) MIA 1908.

<sup>90</sup> *Supra*, Foot Note, 23, p 526.

<sup>91</sup> See s. 18 (1), MIA 1906. Also see s. 21 (1) of MIA 1993, s. 24 (1) MIA 1909, and s. 18 (1) MIA 1908.

<sup>92</sup> Mr. Justice Hirst in *Black King Shipping Corporation and Wayang (Panama) S.A. v. Mark Ranald Massie [1985] 1 Lloyd’s Rep. 437 (The Litsion Pride) at 51*, said that “as part of the duty of good faith, it must be the duty of the assured to keep all relevant information with him at the time he gives it. And in any event the self-same duty required the assured to

disclose all material circumstances before the contract is concluded because this is the time when the insurer makes his decision whether to take the risk or not and if yes, at what premium. In addition, if the situation changes, or new information comes, which was not previously disclosed, the assured must disclose that information to the insurer as well. Therefore, the principle of disclosure is not attached only to the pre-contractual conditions. However, it mainly applies to pre-contractual conditions.

The agent of the assured has nearly the same duty to disclose, according to section 19, MIA 1906,<sup>93</sup> as the duty of assured to disclose. He must also disclose the fact about which he has knowledge, and the agent must have knowledge of every circumstance, which he ought to know in the ordinary course of his business. In addition, he must have knowledge of every circumstance, which ought to have been communicated to him by his principle. Moreover, the agent is deemed to know every material circumstance which the principal ought to disclose, unless the circumstance comes to the knowledge of the latter too late to communicate.

The assured, must know all material circumstances as he is expected to be in the most appropriate position to be familiar with all the facts.<sup>94</sup> The insurer is in a sense at the mercy of the assured, as he explains the risk and the insurer has to make a decision on this information whether to provide insurance cover and at what premium. Therefore, this is not adequate to require that the assured must speak truth only; he cannot be allowed to give false impression by staying quiet, so there is a duty to speak.<sup>95</sup> The duty to disclose is most important element of the general duty of good faith.<sup>96</sup> This is because the assured has access to information. Furthermore, particular facts on which contingent probability is to be calculated lie mainly in the knowledge of the assured only; the insurer has to rely on his disclosure and proceeds upon confidence that he does not keep back any circumstance by

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furnish to the insurer any further material information which he acquires subsequent to the initial notice as and when it comes to his knowledge, particularly if it is materially at variance with the information he originally provided.”

<sup>93</sup> Also see s. 21 (6) MIA 1993, s. 25 MIA 1909 and s. 19 MIA 1908.

<sup>94</sup> This also applies to the agent under section 19, MIA 1906. Also see s. 21 (6) MIA 1993, s. 25, MIA 1909, and s. 19, MIA 1908.

<sup>95</sup> *Supra*, Foot Note 29.

<sup>96</sup> *Seaton v. Burnand* [1899] 1 QB 782. Also see *Greenhill v. Federal Ins* [1927] 1 KB 65.

staying quite.<sup>97</sup> In addition, if the assured holds back information, the insurer may avoid the contract. Therefore, the duty of disclosure is a vitiating factor in the marine insurance contract law.<sup>98</sup>

On the other hand, this may be acknowledged that we are living in the times of knowledge. Burden of providing information cannot be placed on the assured only. It may not be said that the decision is informed if the insurer takes it on the information of the assured. In this technologically advances world, where information is nearly a click away, the insurer may not be allowed to avoid the contract on the pretext of non-disclosure by the assured. If the insurer wishes to avoid the contract, he must take this decision after evaluating whether he has tried to make his own research on any particular issue about whom he was not supposedly informed by the assured. If he does not take informed decision, by not collecting information by himself, he must not be allowed to avoid the contract exclusively on non-disclosure. The duty of the insurer to take informed decision may not be restricted to the information provided by the assured. If it is the duty of the insurer to disclose what he privately know, it must also be his duty to take informed decision after confirming information provided by the assured. How can the insurer issue a policy merely relying on the information provided by the assured, especially when he could confirm such information by himself, and then later on take a shelter behind the pretext of non-disclosure? In this situation, if the insurer is allowed to avoid the policy for non-disclosure, this will be an unearned favour for the insurer. In addition, the non-disclosure must not operate as trap because many assureds, particularly small businesses, are unaware of the duty to disclose. The insurer may deny a claim by the assured even if the assured acted honestly and sensibly. If the assured answers a question by the insurer honestly and thinks that some information is not necessary to be provided to the insurer as that is not relevant, may find that insurer can avoid the contract because

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<sup>97</sup> *Carter v. Boehm* (1766), 3 *Burr.* 1905.

<sup>98</sup> *Supra*, Foot Note 18, p 322.

of non-disclosure.<sup>99</sup> Also in a situation where the assured act honestly but carelessly, the avoidance of the contract by the insurer may be a harsh penalty,<sup>100</sup> because it will place the assured into worse position as he was before the contract.

In case of the general contract law, the parties are not under any obligation to disclose. This is because the parties are free to manipulate their own terms in the name of non-disclosure right perhaps to protect their individual interests or reasonable expectation. It is not a principle or rule of law. It is the objective, which has been the chief moulding force of the general contract law.<sup>101</sup> The parties during commercial negotiations are entitled to protect their own interests and need not lose tactical advantages of intelligence or research by giving up their information to the other party.<sup>102</sup> The question arises here: how a party may be allowed to protect his own interests at the cost of other party's interest; and does not it promote unfriendly business relationships between the contracting parties?

On the one hand, answer to these questions is easy, both logical and economic hypothesis maintain that the parties must look after their own economic benefits but disclose when level of information increases between the parties. This suggests a default rule of disclosing all relevant information.<sup>103</sup> This means that the possessor of such valuable information will lose this information at some stage of negotiations. In addition, the disclosure rule may require each party to share that information which they would like to hear if they were on the other side of the bargain. Therefore, the concept of superior information does not have any real meaning as the parties to the contract have to disclose the information at some stage before concluding the contract. It may discourage the non-disclosure of

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<sup>99</sup> The Law Commission Consultation Paper No. 182, p. 17, available at: [http://www.lawcom.gov.uk/docs/cp182\\_web.pdf](http://www.lawcom.gov.uk/docs/cp182_web.pdf) (30 March 2010). Also see *Lambert v. Cooperative Insurance Society Ltd* [1975] 2 *Lloyd's Rep.* 485.

<sup>100</sup> Ombudsman Case Study, Financial Ombudsman Service, Ombudsman News (April 2003, Issue 27). Also see, *Supra*, Foot Note 99, p. 18.

<sup>101</sup> See Steyn LJ's views at p 196 in *First Energy (UK) Ltd v. Hungarian International Bank Ltd* [1993] 2 *Lloyd's Rep.* 194.

<sup>102</sup> Janet O'Sullivan, Jonathan Hilliard and Series Editor Nicola Padfield, *The Law of Contract*, p. 218, Third Edition, Oxford University Press, 2008.

<sup>103</sup> See s. 161, RSC 1981. Also see Jeffrey L. Harrison, *Rethinking Mistake and Non-Disclosure in Contract Law*, available at: [http://www.georgemasonlawreview.org/doc/17-2\\_Harrison.pdf](http://www.georgemasonlawreview.org/doc/17-2_Harrison.pdf) (31 March 2010).

information and parties may share information right after they feel that they have gained objectives of holding such information.<sup>104</sup> A person who is selling his house is under no obligation to disclose that, for instance, the electricity company is planning to install windmills nearby, there are plans for building a highway across the road or local school is about to shut. It is up to the buyer to make his own inquiries. Obviously, one way of making inquiry can be to ask the seller about them. The seller is free to answer that the buyer should make his own inquiries but if he replies to the questions, he must speak truth.<sup>105</sup> Therefore, mere silence, though morally wrong, will not support a legal action for deceit because parties are free to protect their own interests.<sup>106</sup>

As far as promoting unfriendly business relationships is concerned, the simple answer to this question is yes, holding back information may affect relationship of the contracting parties. In addition, this may be taken as one of the unique features of the general contract law. The parties negotiate with each other while keeping information in their control but make the other party feel that they were very flexible on their stance by offering some less important information to leave a good impression on the other party or, may be, to influence the other party to share their undisclosed information. This may be just an option to keep friendly business relationships intact. Nevertheless, both parties must reconsider their stances to hold back the information at every stage, before the contract is concluded. This will help them to understand how can they make use of undisclosed information and save business friendly relationships as well and, where necessary, disclose part of such undisclosed information. Moreover, non-disclosure raises the problem of informational asymmetry between the parties; the parties with less relevant information generally comes worse in the contract, sometimes disastrously so.<sup>107</sup> It is well known that the accurate information enhances the efficiency of the market system so it may be

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<sup>104</sup> Jeffrey L. Harrison, Rethinking Mistake and Non-Disclosure in Contract Law, available at: [http://www.georgemasonlawreview.org/doc/17-2\\_Harrison.pdf](http://www.georgemasonlawreview.org/doc/17-2_Harrison.pdf) (31 March 2010).

<sup>105</sup> Patrick Atiyah, *The Rise and Fall of Freedom of Contract*, p. 249, Oxford University Press, 1985.

<sup>106</sup> *Bradford Third Equitable Benefit Building Society v. Borders [1941] 2 All ER 205*.

<sup>107</sup> Mindy Chen - Wishart, *Contract Law*, p. 207, Oxford University Press, 2005.

argued because of this reason that parties should be given the incentive to acquire such information, which is necessary to place the party in a better position in the contract. Therefore, a well-informed party must be allowed to take advantage of a less informed party. If an oil company has invested heavily in research to identify land holding possible oil reserves, for instance, it should not have to disclose this valuable information at the time of buying the land at going market rate.<sup>108</sup> This is because of the advantage a knowledgeable party enjoys in compare to a less informed party. Additionally, if this type of non-disclosure is not allowed it will discourage the acquisition of such information. This would also challenge the traditional picture of contracting at arms length, in which parties can play their cards close to their chest, competing for the best bargain. On this view, those who gain more in contract are considered successful and who gain less are considered losers, who deserve their fate in free enterprise society.<sup>109</sup>

Recognition of the duty of disclosure in the general contract law can create many problems in contractual dealings. Since no one can be expected to disclose everything, it will provide a pretext to the innocent party to avoid the contract and even claim damages. Moreover, it will discourage informed party to acquire information to negotiate and make a contract with favourable terms. Conversely, blanket immunity for non-disclosure would result in what might be regarded as sharp practice and unacceptable advantage taking.<sup>110</sup> Therefore, it may be concluded that the non-disclosure in the marine insurance contract law is considered a vitiating factor whereas in the general contract law, it is used as a tool to manipulate in order to gain and protect each party's own interests.

### **3.2 Materiality of the Circumstance**

Every circumstance is material which would influence the judgment of prudent insurer in fixing the premium or deciding whether he will take

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<sup>108</sup> C Fried, *Contract As Promise; A Theory of Contractual Obligations*, p. 79, Harvard University Press, 1981.

<sup>109</sup> *Supra*,, Foot Note. 107.

<sup>110</sup> *Supra*, Foot Note 107.

the risk.<sup>111</sup> This may be assumed after reading sections 18 (2) and 19, MIA 1906 that the insurer claiming non-disclosure by the assured or his agent must prove two things. The facts not disclosed by the assured or his agent could influence the judgement of the insurer and the actual underwriter was induced to accept the risk because of non-disclosure.<sup>112</sup> The question arises here: whether it be shown that full and accurate disclosure would have made the prudent insurer to take a different decision in accepting the risk; or should a lesser standard of impact on the mind of prudent insurer sufficient. It was held in *the CTI* case<sup>113</sup> that it was not necessary to establish that the non-disclosure would have had a decisive influence on the prudent insurer and, thus, lesser standard of impact was adequate. This is because the actual purpose of the disclosure seems to be that the assured or his agent must not withheld any information with a purpose to deceive the insurer. If decisive influence is stressed, it will encourage the assured or his agent to withheld relevant information on the pretext of withholding less or irrelevant information. If the assured or his agent does not disclose material facts, he deceives the insurer and deprive him access to the relevant information before making his decision concerning the risk. Consequently, it may be understood from the House of Lords decision in *the CTI* case that if the assured or his agent tries to deceive the insurer by withholding material facts, the insurer may avoid the policy. It does not really matter whether the assured or his agent is successful in his attempt to deceive the insurer or not. On the other hand, it may create further imbalance between the rights of the assured and the insurer. The insurer can miss use the criteria set by the House of Lords in *the CIT* case in his favour in order to avoid the contract under the pretext of attempt of deception by the assured. This may be revisited with an objective to make it a little fair for both, the insurer and the assured.

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<sup>111</sup> S. 18(2) of MIA 1906, s. 21(1) MIA 1993, s. 18 (1) MIA 1908 and s. 24 (1) MIA 1909.

<sup>112</sup> John Dunt, *Marine Cargo Insurance*, p. 73, Informa, London, 2009. Also see: *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep. 427. And, *Assicurazioni Generali SpA v. Arab Insurance Group (BSC)* [2003] Lloyd's Rep. IR 131 (CA).

<sup>113</sup> *Container Transport International Inc v. Oceanus Mutual Underwriting Association (Bermuda) Limited* [1984] 1 Lloyd's Rep. 476.

### 3.2.1 Test of Materiality

The test of materiality is simple. It is necessary that the information withheld would have influenced the judgement of the prudent underwriter whether to take the risk; and it is not requisite that the underwriter would have made a different choice, either as to the risk or premium, if complete disclosure had been made.<sup>114</sup> Therefore, it may be said that a fact is material if the insurer would have wished to be mindful of it in reaching his decision.<sup>115</sup>

In an Australian case,<sup>116</sup> Mr Justice Samuels J stated that it is not relevant what decision the insurer would in fact have taken if he had the undisclosed information. The main question is whether undisclosed information was relevant for the insurer to make his decision in order to accept or reject the insurance proposal. He further stated that a fact is material if it would have influenced the mind of the prudent insurer in determining whether he will agree to the insurance, and if so, at what premium and on what conditions. Justice Samuels J's statement is a little ambiguous, because it may be understood after reading his statement that the assured or his agent is under the obligation to disclose any thing that is of insurer's interest. The assured or his agent must disclose only those matters which would cause the insurer to decline the policy or to increase the premium. Essentially, the influence on the mind of the insurer, to which Samuels J was referring, should be something more than the effect produced by information in which the insurer would have been usually interested. The information in which the insurer is interested, may not necessarily be important for the insurer to make his decision about the acceptance or rejection of the insurance, setting of the premium or deciding conditions of

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<sup>114</sup> See Lord Mustill at pages. 452 to 453, *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep. 427. Also see an Australian Supreme Court of Victoria case: *Akedian Co Ltd v. Royal Insurance Australia Ltd and Sun Alliance Australia Ltd* (1997) 148 ALR 480.

<sup>115</sup> See Lord Goff at p. 521 in *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1995] AC 501.

<sup>116</sup> *Mayne Nickless Limited v. Pegler* [1974] 1 NSWLR 228.

the insurance. Therefore, the information, although of interest of the insurer, is not necessarily material.<sup>117</sup>

### 3.2.2 Facts which are Material

There are a number of cases in which the materiality of facts, for the purpose of non-disclosure, has been discussed by the courts. Any fact, which affects directly the risk insured, is material.<sup>118</sup> How would the assured know which facts might affect the risk insured? Answer to this question is available in Section 18 (1) of MIA 1906,<sup>119</sup> the assured must know every circumstance, which in ordinary course of business he ought to be known by him and he must disclose all such circumstances to the insurer.

#### 3.2.2.1 Physical Attributes

Any physical attributes of the subject-matter insured, which make it a bigger risk than would usually be supposed, must be disclosed. So, for instance, if the ship is under control of such a person who has been facing charges of smuggling. The assured must disclose this fact to the insurer because this fact increases the risk attached to the ship, rather it makes the ship a bigger risk, as may be assumed. Moreover, no underwriter would agree to insure a ship under the command of a smuggler. Therefore, any fact that can make the subject matter insured a greater risk must be disclosed.<sup>120</sup> Previous losses suffered by the assured and consequently filed claims may be material facts<sup>121</sup> because this shows the high probability that the insurer will face the claim. This is also quite comprehensible that if the risk is higher, the insurer will charge high premium. The assured must not conceal the losses suffered by him and claims filed to recover those losses with a purpose to make the insurer charge low premium. If he does so, he is in a breach of the duty of disclosure. Therefore, the insurer may avoid the

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<sup>117</sup> See Kirby P's dissenting judgment in *Barclay Holdings v. British National Insurance Co. Ltd* (1987) 8 NSWLR 514.

<sup>118</sup> Robert Merkin, *Marine Insurance Legislation*, p. 23, Third Edition, LLP, London, 2005.

<sup>119</sup> Also see s. 18 (1) of MIA 1908, s. 24 (1) of MIA 1909 and s. 21 (6) of MIA 1993.

<sup>120</sup> See, *Inversiones Manria SA v. Sphere Drake Insurance Co Ltd*, "The Dora" [1989] 1 *Lloyd's Rep.* 69.

<sup>121</sup> *Anthony John Sharp and Roarer Investments Ltd. v. Sphere Drake Insurance Plc Minster Insurance Co. Ltd. and E. C. Parker & Co. Ltd.*, "The Moonacre" [1992] 2 *Lloyd's Rep.* 501.

contract. On the other hand, the fact that the insurer refused the claim of the assured for non-disclosure is also relevant; and therefore the insurer must disclose this fact to the assured. This will enable the assured to take the insurance policy or decide otherwise.

### **3.2.2.2 Hazards of the Voyage**

The assured must disclose any particular hazards of the voyage, as they constitute material facts.<sup>122</sup> This is due to the increased risk attached to the policy because of hazards of the voyage. The insurer has the right to be familiar with every material fact before he makes his decision whether to take the risk. He also decides premium on the basis of information provided by the assured and while keeping in mind the extent of risk. Therefore, if a ship will go to an unsafe port, for instance, the assured must disclose this fact to the insurer. However, it does not mean that the assured must disclose those facts which the insurer ought to know in his ordinary course of business, under Section 18 (3) (b) of MIA 1906.<sup>123</sup> Therefore, the obligation of the insurer to know the circumstance in the ordinary course of business provides immunity to the assured against non-disclosure.

### **3.2.2.3 Contract with a Third Party**

The assured must disclose that he has entered into a contract with a third party, in the ordinary course of business, which potentially increases the insurer's liability or diminishes his right of subrogation in the event of loss.<sup>124</sup> Thus, where the assured has a contract with the third party that the assured will bear the losses of demurrage, he must disclose this fact to the insurer. The assured must also disclose if he has suffered any loss in this respect before. This is because the presumed knowledge of the insurer in reliance on *Carter v. Boehm*,<sup>125</sup> that the insurer who insures a risk within a particular industry ought to know or find out the practices of the industry or trade, does not apply in every case. What the insurer is not bound to know in the ordinary course of his business are particular circumstances specially

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<sup>122</sup> See, *Fraser Shipping Ltd v. Colton* [1997] 1 Lloyd's Rep. 586.

<sup>123</sup> Also see s. 18 (3) (b) of MIA 1908, s. 24 (3) (b) of MIA 1909 and s. 21 (6) (c) of MIA 1993.

<sup>124</sup> See, *Marc Rich & Co AG v. Portman* [1996] 1 Lloyd's Rep. 430.

<sup>125</sup> (1766), 3 Burr. 1905.

affecting the insured goods or ships. Conceivably, if the insurer is told facts about the cargo, and the insurer does not know the natural consequences, which follow from such facts, he ought to have asked. However, if there are extraordinary circumstances associated with the cargo, which would not follow from the facts that the insurer is told, then they ought to be disclosed.<sup>126</sup> Therefore, the insurer is not bound to know the extent of the liability if that is linked to the special circumstances or if the liability is not ordinarily inherent in the risk. There is nothing that can be said to constitute the ordinary loss experience if that is about actual loss experience. That cannot be a matter of common knowledge.<sup>127</sup> Furthermore, it is not the duty of the insurer to put question in order to make the assured to disclose material facts. The assured must disclose all material facts, which can influence the judgement of the prudent insurer.<sup>128</sup>

#### **3.2.2.4 Moral Hazards**

A moral hazard may lead the insurer to take a view that the assured is an undesirable person.<sup>129</sup> Any fact that goes to the moral hazard is material because the moral hazard aspect of materiality shows whether the assured will be an honest assured.<sup>130</sup> If the assured intends to over-insure the subject matter to an excessive amount, such over insurance must be disclosed,<sup>131</sup> because the over insurance shows bad intention of the assured. It may be assumed that the assured want to make profit of such insurance. Therefore, the over insurance is material as it may influence the judgment of the prudent insurer. Does it mean that over insurance is material in every case? Clearly, the simple fact that the proposed insured value exceeds the actual market value does not suggest moral hazard. Certainly, where the proposed value is consistent with reasonably prudent ship management, the excess over market value cannot be material to the risk, whatever its precise

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<sup>126</sup> See, *Greenhill v. Federal Insurance Co Ltd* (1926) 24 *L.L.Rep.* 383.

<sup>127</sup> See, *Greenhill v. Federal Insurance Co Ltd* [1927] 1 *K.B.* 65.

<sup>128</sup> *Container Transport International Inc v. Oceanus Mutual Underwriting Association (Bermuda) Limited* [1984] 1 *Lloyd's Rep.* 476.

<sup>129</sup> Jonathan Gilman and Robert Merkin, *Arnould's Law of Marine Insurance and Average*, Para 16-106, Seventeenth Edition, Sweet & Maxwell, London, 2008.

<sup>130</sup> Barlow Lyde & Gilbert, *Reinsurance Practice and The Law*, p. 187, Informa, London, 2009.

<sup>131</sup> See, *Slattery v. Mance* [1962] 1 *Lloyd's Rep.* 60.

extent is. This is because of the generally accepted practice of the insurance market that the owner is at liberty to put whatever value he considers appropriate upon his capital asset, namely his ship or goods, and to decide what the monetary loss will be to him, if the ship or the goods are lost. He has to accept that the premium will be enhanced by a higher value and this does, of course, enter into his calculation of the values for which he requires insurance.<sup>132</sup> Where an owner actually and reasonably believes that his vessel ought to be insured for a particular value which is in excess of the market value, he does not have to disclose the true market value, for, given his reasonable perception, the disparity is not capable of suggesting moral hazard. As a matter of logic, it is nothing to the point that the insurer is thereby deprived of the opportunity of investigating why there is a disparity. It is only where the disparity cannot be justified on reasonable commercial grounds it ought to be disclosed. If the insurer wishes to secure the right to investigate the justification for any significant disparity, he has the simple remedy of requiring the assured to provide an independent market valuation and to explain any disparity in the insured value.<sup>133</sup>

### **3.2.2.5 Criminal Conviction**

Criminal conviction of the assured and the outstanding criminal charges against the assured are material facts<sup>134</sup> as they increase the likelihood that the assured can act deceitfully to gain benefits from the insurance policy. It also seems quite logical that if the assured must disclose previous claims then he must obviously disclose previous criminal convictions because the criminal conviction is more serious issue than previous claims. In addition to this, if there are criminal charges against the assured, he must also disclose this fact to the insurer. As this is an equally important issue for the insurer as criminal conviction. The most relevant circumstance for disclosure is therefore that the assured has actually committed an offence of a character that would in fact influence the judgement of the insurer. The assured is bound to disclose the commission

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<sup>132</sup> See, *Strive Shipping Corporation and Another v. Hellenic Mutual War Risks Association (The "Grecia Express")* [2002] 2 Lloyd's Rep. 88.

<sup>133</sup> *Ibid.*

<sup>134</sup> See, *Allden v. Raven, "The Kylie"* [1983] 2 Lloyd's Rep. 444.

of that offence even though he has been acquitted or even if no one other than he has the slightest idea that he committed it: the material circumstance is the commission of the offence. A conviction of a criminal offence is itself also material fact even though the assured may prove his innocence or in fact has not committed the offence; a responsible insurer is himself entitled to assume that prima facie the assured was rightly convicted and has, therefore, in fact committed the offence. If, therefore, an allegation of a relevant criminal offence is made and the allegation is true the assured must disclose it not because the allegation has been made but because the offence has in fact been committed; it is not then the allegation which must be disclosed but the underlying fact that a crime has been committed.<sup>135</sup> A convict has to disclose his conviction and consequently there is a remote chance that the insurer will take the risk to give insurance policy to a convict. Does not this mean that a convict cannot take insurance at all? Is not this injustice to a convict who amended his ways and decided to live a peaceful life as an honest and responsible law abiding citizen? Although a title of being a convict runs after a person through out his life and society does not accept him as a normal law abiding human being. However, it is quite illogical for a person to display his criminal conviction, through out his life, especially before taking an insurance policy. Interestingly, a convict does not have to face unreasonable disclosure of criminal conviction if he has completed it under the Rehabilitation of Offenders Act 1974 (ROA 1974).<sup>136</sup> Sentence spent under ROA 1974 allows a convict to apply for a job or to take insurance without mentioning his conviction but, on the other hand, it does not extend to the serious criminal conviction until they are very old.<sup>137</sup> This is perhaps for the discouragement of those involved in serious criminal offences. A person, who commits any serious offences, will not be able to get rid of criminal conviction through out his life and therefore will not be allowed to conceal his conviction at the time of getting insurance. An other question arises here: are only criminal conviction and

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<sup>135</sup> See, *Inversiones Manria SA v. Sphere Drake Insurance Co Ltd*, “The Dora” [1989] 1 *Lloyd’s Rep.* 69.

<sup>136</sup> *Supra*, Foot Note 118, p.25.

<sup>137</sup> Information available at: <http://www.lawontheweb.co.uk/rehabact.htm> (12 April 2010).

criminal charges material or simple charges of dishonesty also material fact? It may be argued that charges of dishonesty create a fear for the insurer that the assured will deceive him. Therefore, the assured must disclose charges of dishonesty to the insurer so he could take an informed decision.<sup>138</sup> Therefore, if the assured prepared invoices to defraud its banker, he must disclose this fact to the insurer because of the above-given reason. Besides, it may be considered that the insurer would not have offered insurance policy to the assured if he knew about the dishonesty of the assured.<sup>139</sup>

### 3.2.2.6 Other Material Facts

The fact is material if it is not part of physical or moral hazard but affects the acceptance of the risk or the amount of premium. This is because the insurer is entitled to take for granted, as the basis of the contract between him and the assured, that the latter will communicate to him every material fact of which he has, or, in the ordinary course of business, ought to have knowledge.<sup>140</sup> Therefore, the assured is not entitled to hold back any information, if such information can affect the judgement of the insurer with respect to the acceptance of the risk or the amount of premium.

The fact that the assured is short of money is material because it creates a risk for the insurer that he will not be paid. It is the right of the insurer to get full premium on time regularly. For this reason, he will like to know if there is a risk of non-payment. The assured must also disclose if he failed to pay premium in a previous policy because this also creates the same kind of risk as the fact that the assured is short of money creates.<sup>141</sup>

Information about the existence of the material fact is also material but this does not mean that mere rumour can be material fact. This is because the only circumstance that influences the judgment of the prudent insurer is material.<sup>142</sup> Besides, if the insurer is allowed to avoid the contract on just a rumour of undisclosed information about the material fact, he may take advantage of this alternative to avoid the contract for breach of

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<sup>138</sup> *North Star Shipping Ltd v. Sphere Drake Insurance plc* [2005] 2 Lloyd's Rep. 76.

<sup>139</sup> *Insurance Corp. of The Channel Islands v. Royal Hotel* [1998] Lloyd's Rep. IR151.

<sup>140</sup> *Supra*, Foot Note 118, p. 25.

<sup>141</sup> *O's Kane v. Fones, "The Martin P"* [2004] 1 Lloyd's Rep. 389.

<sup>142</sup> *Brotherton v. Aseguradora Colseguros SA (No.2)* [2003] Lloyd's Rep. IR 746.

disclosure. Alternatively, it will make the insurer to authenticate the information before making his decision to avoid the contract. Nevertheless, if he avoids the contract after confirming the non-existence of material fact, he is in breach of the duty of good faith.<sup>143</sup>

### 3.2.3 Facts Which are not Material

In the absence of inquiry, the assured is not obliged to disclose any circumstance which diminishes the risk or which is known or presumed to be known a matter of common notoriety and knowledge and any matter which the insurer in his ordinary course of business ought to know.<sup>144</sup> This indicates that if the insurer inquires about any fact then the assured has to give true answer but if the insurer does not inquire, the assured is free not to disclose immaterial facts. The assured will assume about the materiality of the facts and the decisive factors for this would be as given above, under the present heading. This must also be understood that the assured cannot make it a defence that the insurer did not inquire that is why he did not disclose. This is because of the duty of the assured to disclose every material circumstance to the insurer before the contract is concluded.<sup>145</sup> Moreover, although the insurer is in a better position to judge which facts are material and therefore must disclose those facts, it cannot be said that the assured's duty of disclosure is dependent on the inquiry by the insurer.

The facts within the knowledge of the insurer need not be disclosed. This was the ground for the decision in *Carter v. Boehm*.<sup>146</sup> This is because the insurer writing a particular type of business is deemed to know the types of risk and course of losses within that class of business.<sup>147</sup> Nevertheless, this does not mean that the insurer must know a particular business experience of loss by the assured, which is peculiar to such business. The insurer cannot carry in his head full facts of every item of intelligence that might be available to him concerning every particular

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<sup>143</sup> *Drake Insurance plc v Provident Insurance plc* [2004] *Lloyd's Rep IR* 277.

<sup>144</sup> See s. 18 (3) (a) (b), MIA 1906. Also see s. 18 (3) (a)(b) of MIA 1908, s. 24 (3) (a)(b) of MIA 1909 and s. 21 (6) (c) of MIA 1993.

<sup>145</sup> See s. 18, MIA 1906.

<sup>146</sup> (1766), 3 *Burr.* 1905, 1910.

<sup>147</sup> *North British Fishing Boat Insurance Co Ltd v. Starr* (1922) 13 *LIL Rep.* 206.

vessel, unless, of course, the casualty to the vessel in question is of such importance as to have achieved common notoriety.<sup>148</sup> This is where the assured is expected to disclose material facts and any pretext for non-disclosing may be discouraged to protect the insurer who cannot simply recognize the particular but unusual facts about a business.<sup>149</sup> Therefore, the insurer is assumed to be familiar with matters of common notoriety and especially to have knowledge regarding trade usages, stowage and packing of cargoes, etc. However, any contemplated departure from the ordinary course or methods must, of course, be disclosed.<sup>150</sup>

If the insurer does not inquire about any fact, it amounts to waiver of disclosure and therefore the assured is not obliged to disclose. Subsequently, the insurer cannot refuse the payment for non-disclosure if the subject matter insured is lost by a peril insured against.<sup>151</sup> Although it is the duty of the assured to disclose every material circumstance, this duty does not apply if the insurer waives this duty where he fails to ask follow-up questions, especially, when he must be attentive to do so. The duty of disclosure also does not apply if the insurer takes no action after becoming aware of un-disclosed information. In this situation, if the underwriter seeks to avoid the contract for non-disclosure he must be ready for the waiver argument because of his own ignorance.<sup>152</sup> The waiver must negate the insurer's right to seek avoidance for non-disclosure because the waiver neutralises the original materiality. Therefore, where the section 18 (3) (c) of MIA 1906,<sup>153</sup> doctrine of waiver, applies there must be no need for disclosure; it is impossible to talk about non-disclosure or materiality.<sup>154</sup> There is no way the insurer can, first, acknowledge the immateriality of any fact by waiving it and then may seek avoidance for non-disclosure of material fact. However, there must be no question of waiver if the insurer

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<sup>148</sup> *Supra*, Foot Note 84.

<sup>149</sup> *Marc Rich & Co AG v. Portman* [1996] 1 *Lloyd's Rep.* 430.

<sup>150</sup> *Supra*, Foot Note 84.

<sup>151</sup> *Mann, MacNeal & Co v. General Marine Underwriters* [1921] 2 *K.B.* 300.

<sup>152</sup> *Supra*, Foot Note 112, p. 87.

<sup>153</sup> Also see s. 18 (3) (c) of MIA 1908, s. 24 (3) (c) of MIA 1909 and s. 21 (5) (c) of MIA 1993.

<sup>154</sup> *Wise (Underwriting Agency) Ltd v. Grupo Nacional Provincial SA* [2004] 2 *Lloyd's Rep.* 483.

continues his enquiry about the non-disclosed facts.<sup>155</sup> Besides, if the insurer mistakenly overlooks to ask any question, it does not give any right to the assured to hold back any material information.

Any circumstance which is unnecessary to be disclosed because of any express or implied warranty need not be disclosed in absence of inquiry.<sup>156</sup> This is because an express warranty imposes specific requirements on particular aspect of the risk. Under a towage warranty, for instance, the insurer requires an appointed surveyor of his own choice to inspect the towage arrangement and confirm that they are in order. Once the warranty has been complied with, the insurer, who has forced his own standard, cannot say that some aspect of the towage covered by the towage survey, carried out by his nominated surveyor, has not been disclosed to him. This is similar to doctrine of waiver to the extent that insurer, after imposing the warranty, waive in that sense his right about disclosure.<sup>157</sup> As for as implied warranty is concerned, there are two implied warranties about voyage policies: a warranty that the ship is seaworthy<sup>158</sup> and ships is reasonably fit to carry the goods.<sup>159</sup> The insurer who knows that the ship is unseaworthy and give the insurance policy, cannot take shelter behind non-disclosure later because of waiving his right about disclosure. On the other hand, if the warranties are not complied with, and the insurer has no knowledge of it, he has no liability due to non-disclosure.

### 3.3 Inducement

The concept of inducement in the marine insurance contract law is quite similar to same concept in the general contract law.<sup>160</sup> However, since there is no duty to disclose in general contract law, inducement in general contract law may only be discussed in relation with representation. Although a knowledgeable party can take advantage of the ignorant party,

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<sup>155</sup> *McCormick v. National Motor & Accident Insurance Union Ltd (1934) 49 Ll.L. Rep. 361.*

<sup>156</sup> S. 18 (3) (d), MIA 1906. Also see s. 18 (3) (d) of MIA 1908, s. 24 (3) (d) of MIA 1909 and s. 21 (5) (d) of MIA 1993.

<sup>157</sup> *Supra*, Foot Note 112, p. 88.

<sup>158</sup> S. 39 (1), MIA 1906.

<sup>159</sup> S. 40 (2), MIA 1906.

<sup>160</sup> *Avon Insurance plc v. Swire Fraser Ltd [2000] Lloyd's Rep. IR 535.*

non-disclosure in order to induce the other party to enter into the contract must be discouraged. This is because the inducement must have same effect, whether it is due to non-disclosure or misrepresentation. In addition, no party should be allowed to take advantage of the other party under the excuse of non-disclosure.

On the other hand, in the insurance contract law, the insurer is considered to be induced, if the missing information must have effectively persuaded the contract and prompted a different decision on the risk or premium or the insurer would have not entered into the contract on those terms if relevant information was disclosed.<sup>161</sup> *Kerr J in Berger & Light Diffusers Pty Ltd v. Pollock*,<sup>162</sup> said that a strong case on materiality may mean that the court may need a little or no evidence to decide in favour of the insurer on inducement, while in other cases the court may require evidence from the actual insurer. Does not it mean that inducement and materiality or closely connected? Obviously, yes is the one word answer. Besides, if the insurer proves that non-disclosure of material facts influenced him to make a decision, which he would not have taken if the information was provided, then he has a strong case of inducement. Thus, if the insurer wants to avoid the contract for non-disclosure, he has to prove that he was induced by the non-disclosure.<sup>163</sup> This is important because if the insurer is allowed to avoid the contract without having any substantiation of inducement, it will create great uncertainty for the assured in recovering insurance amount, which will serve no good to insurance business.

### **3.3.1 Actual Inducement Test**

The House of Lords in *Pan Atlantic Case*<sup>164</sup> unanimously agreed that the 'actual inducement test' is based on a casual link between the non-disclosure and the decision of the insurer to enter into the contract. The non-disclosure must induce the insurer to enter into the contract. If the non-

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<sup>161</sup> *Supra*, Foot Note 112, p. 75.

<sup>162</sup> [1973] 2 *Lloyd's Rep.* 442 at 463.

<sup>163</sup> *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1995] AC 501 at 571.

<sup>164</sup> *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1994] 2 *Lloyd's Rep.* 427.

disclosure did not actually induce the making of the contract, the insurer must not be allowed to rely on it as a ground for avoiding the contract. This is because the law is already sufficiently tender to the insurer who seeks to avoid the contract for non-disclosure and it is not unfair to require the insurer to show that he suffered as a result of non-disclosure.<sup>165</sup> Therefore, it is obvious that the insurer does not have an unencumbered or invariable right to avoid the contract. The insurer has to prove that he was induced because of non-disclosure in addition to prove materiality.<sup>166</sup>

In the same case<sup>167</sup> on this important subject, their Lordships unanimously held, however, that the prerequisite for avoidance is that the actual insurer should have been induced. This is perhaps because, firstly, the underwriter decides to take the risk and amount of premium. Secondly, the actual insurer writes the risk based on information provided by the assured. Therefore, because of these two reasons, it is important for the actual insurer to prove that he, himself, was induced because of non-disclosure.

The question of whether the non-disclosure must be the sole inducement was addressed in *JEB Fasteners Ltd v. Marks, Boom and Co*<sup>168</sup>. It was held that non-disclosure must not be sole inducement but must be a real and substantial cause affecting the decision of the insurer. Clarke L.J. in *Assicurazioni Generali SpA v. ARIG*,<sup>169</sup> presented the same view: the non-disclosure must be an effective inducement but must not necessarily be sole inducement. Although inducement is not a requirement in any of the marine insurance acts, this was probably introduced to make the insurance contract law in line with the general contract law. The general contract law acknowledges that the contract is voidable on the ground of fraud in order to induce the party to enter into the contract. Similarly, a contract of marine insurance must be voidable if the insurer is induced to enter into the contract.<sup>170</sup>

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<sup>165</sup> See Lord Templeman's view at page 430 in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 2 Lloyd's Rep. 427.

<sup>166</sup> *Supra*, Foot Note 85, p. 92.

<sup>167</sup> *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] AC 501 at 571.

<sup>168</sup> [1983] 1 All E.R. 583.

<sup>169</sup> [2003] 1 Lloyd's Rep. I.R. 131.

<sup>170</sup> *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1995] AC 501.

### 3.3.2 Presumption of Inducement

The insurer may rely on the assumption that he has been induced by the non-disclosure to enter into the contract. However, before such assumption, an undisclosed fact is shown to be material. This is because once such fact is shown to be material, a presumption arises that non-disclosure induced the insurer to enter into the contract.<sup>171</sup> Nevertheless, if the insurer would have been entered into the contract on the same terms anyway, the insurer must not avoid the contract for inducement due to non-disclosure. The making of contract on the same terms indicates absence of inducement, and therefore there is no room for insurer to avoid the contract. On the other hand, it gives a sense of security to the assured that if he will substantiate that the insurer would have taken the same decision if the undisclosed information was provided, the insurer will not be entitled to avoid the contract. However, this does not allow the assured to withhold information on the pretext of non-inducement of the undisclosed information.

It is obvious that, there is no absolute agreement amongst any of the courts in common law jurisdictions as to the definition of a material circumstance and inducement.<sup>172</sup> As a result, the materiality of a circumstance, for instance, is variously defined as something a prudent insurer would simply like to know about;<sup>173</sup> something which is determined of the acceptance or rejection of the risk by a prudent insurer.<sup>174</sup> This leads to the uncertainty in the law. What is needed is a precise definition of a material circumstance and clarification of the necessity for the actual insurer to be induced by the non-disclosure so that the assured can be as certain as possible about the scope of the duty of disclosure and thus the likelihood of recovering if the need to claim arises.<sup>175</sup>

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<sup>171</sup> *Supra*, Foot Note 118.

<sup>172</sup> Dr Sarah Derrington, Australia: Perspectives and Permutations on the Law of Marine Insurance, Edited by D. Rhidian Thomas, *The Modern Law of Marine Insurance*, p. 382, Volume Two, LLP, London, 2002.

<sup>173</sup> *Container Transport International Inc v. Oceanus Mutual Underwriting Association (Bermuda) Limited* [1984] 1 *Lloyd's Rep.* 476; *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1995] AC 501.

<sup>174</sup> *Barclay Holdings v. British National Insurance Co Limited* (1987) 8 *NSWLR* 514.

<sup>175</sup> *Supra*, Foot Note 172.

## 4 Misrepresentation

Similar to the duty of disclosure, the principle of representation stems from the doctrine of *uberrimae fidei* as given in section 17 of MIA 1906<sup>176</sup>. In the same manner as the duty of good faith requires the assured to disclose every material circumstance to the insurer before the contract is concluded, it also requires that the disclosure be truly represented.<sup>177</sup> This is because the true representation in respect of the risk is significant to justify the observance of the duty of good faith. If the assured misrepresents, the insurer cannot understand the risk accurately. Consequently, the insurer can underestimate the premium in addition to make his decision to take the risk, which otherwise he may refuse to take.<sup>178</sup> Furthermore, the insurer may avoid the contract for misrepresentation as he can do for non-disclosure. Materiality and inducement also have the same connotations in relation to representation as they have in relation to disclosure. The tests of materiality and inducement in misrepresentation are the same, as explained earlier in chapter 3. The purpose of keeping the tests of materiality and inducement in both, non-disclosure and representation, similar is perhaps to keep the law simple. Furthermore, logically there must not be different connotations for materiality and inducement in disclosure and representation because both have generally the same purpose; to influence the insurer to enter into the contract. Every circumstance is material in representation, as it is in case of non-disclosure, which influences the judgment of the prudent insurer while fixing the premium or deciding whether he will take the risk.<sup>179</sup> In practice, the issue of misrepresentation more often depends on a factual disagreement as to what was said, and the meaning of what was written, rather than issues of materiality that tend to dominate issues of disclosure.<sup>180</sup>

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<sup>176</sup> Also see s. 23 of MIA 1909 and s. 20 of MIA 1993.

<sup>177</sup> *Supra*, Foot Note 26, p. 83.

<sup>178</sup> *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd* [1995] AC 501.

<sup>179</sup> S. 20 (2), MIA 1906.

<sup>180</sup> *Supra*, Foot Note 112, p. 90.

Representations are statements of fact. Statements of opinion or statements of future action are not statements of fact, but they may conceal such statements. The statement of the assured that ‘the ship will sail in three days’ cannot be false simply because the ship could not sail in three days.<sup>181</sup> On the other hand, if the assured knew while giving the statement that the ship will not sail in three days, he breached his duty of good faith by misrepresentation.<sup>182</sup> In addition, a statement concerning to a fact is regarded true if the difference between the original representation and what turns out to be the genuine fact does not amount to a material fact.<sup>183</sup> This is important to discourage the assured to take advantage of this special consideration. The assured will be able to justify his earlier statement if it is not considerably conflicting to the genuine fact and this is possible when difference of representation is due to only ordinary mistake. However, the assured can withdraw or rectify his representation but before the insurer accepts the risk.<sup>184</sup> What if the assured realizes about his misrepresentation after the contract is concluded and wants to rectify? MIA does not address this issue, nevertheless, it may be said that if the assured wants to rectify his misrepresentation after the contract is concluded, he has to give opportunity to the insurer as well to revise his decision about fixing the premium and even about taking the risk. In other words, the insurer may avoid the earlier contract but may agree a new contract on revised terms.

In the general law of contract, the law of misrepresentation is the law of induced mistake as one party is induced to enter into a contract due to a false statement of fact by the other party or a third party. This is why the ground on which relief sought does not rest on the mistake made by the claimant but rather rests on the fact that the mistake was induced due to the false statement of fact presented to the claimant. Therefore, a claimant who wishes to seek relief against misrepresentation must establish that the other party induced him to enter into the contract by misrepresentation.<sup>185</sup>

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<sup>181</sup> *Supra*, Foot Note 29, p 376.

<sup>182</sup> *Supra*, Foot Note 29, p 376, Also see s. 20 (3) (5), MIA 1906.

<sup>183</sup> *Commonwealth Insurance Co v. Groupe Sprinks S.A. [1983] 1 Lloyd's Rep. 67.*

<sup>184</sup> S. 20 (6), MIA 1906.

<sup>185</sup> *Supra*, Foot Note 37, p 657.

Misrepresentation Act 1967<sup>186</sup> (MA 1967), which is applicable to all contracts,<sup>187</sup> provides relief against misrepresentation to those who have been misled in pre-contractual negotiations. Fair Trading Act 1986 (FTA 1986) and The Contractual Remedies Act 1979 (CRA 1979)<sup>188</sup> of New Zealand and Trade Practices Act 1974 (TPA 1974)<sup>189</sup> of Australia provide more or less the same remedies. Generally, a party must not make any false and misleading statement to the other party, which induces him to enter into the contract. If he does, he may face successful claim for misrepresentation.<sup>190</sup>

The law of representation in the general contract law is complicated because it exists alongside of related doctrines that may deal with the same general problem but yielding different responses. For instance, it may not be assumed that the legal consequence of a false statement may lie solely in the law of misrepresentation; a plea for breach of the contract may give better remedy to the innocent party. Therefore, in the general contract law the claimant may navigate around the related doctrines to assess the relative remedial advantages instead of looking remedy for misrepresentation.<sup>191</sup>

The parties make a variety of representations to each other during the pre-contractual negotiations. These representations might be about formation of the goods, its market price, packing, marking etc. Many of these representation become terms of the contract due to their importance. However, some statements do not become contractual promises by the parties. The question whether a representation has become a term of the contract depends on an objective appraisal of whether the representor wanted to be bound to the truth of the statement to render liable to an action for breach.<sup>192</sup> In *Oscar Chess Ltd v. William*<sup>193</sup> Lord Denning gave a

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<sup>186</sup> See s. 2, MA 1967.

<sup>187</sup> Susan Hodges and Christopher Hill, *Principles of Maritime Law*, p. 246, LLP, London, 2001.

<sup>188</sup> See s. 22 of FTA 1986 and s. 6 of CRA 1979.

<sup>189</sup> See s. 59 and s. 75.

<sup>190</sup> *Supra*, Foot Note 38, also see p. 101.

<sup>191</sup> *Supra*, Foot Note 107, p. 195.

<sup>192</sup> *Supra*, Foot Note 38.

<sup>193</sup> [1957] 1 All E.R. 325. Also see *Supra*, Foot Note 38, p 101.

number of following point to distinguish from term to representation: 1. The more significant is the statement made during negotiations, more likely it is a term. 2. The longer the time between the making of the statement and agreement is reached, the more likely that it is not a term. 3. If an oral statement is not made written, it means the parties do not intend to make it a term. 4. A statement is more likely to be made a term if made by someone who has knowledge regarding its truth. It may be understood from this criterion that if the statement is important, it can induce the other party to enter into the contract. Therefore, it must be considered a term of the contract. This reason raises a question: what if the term is although as important so as to induce the party to enter into the contract but was not recorded in writing? The above-given criterion is very well prepared. No point was written in isolation. Therefore, it may be said that if the oral statement is not recorded in writing, it may be assumed that it is not an important statement, for that reason is not a term of the contract. Similarly, if a person who has special skills and knowledge about its truth makes the statement, it is an important statement and, therefore, is term of the contract. On the other hand, there must be no hard and fast rules when trying to establish whether a representation is a term or not, because it must be judged on whether it was reasonable in the circumstances to rely on the representation or not. The representor, on the other hand, can argue that he was entirely innocent of fault in representation and that it would not be reasonable in the circumstances for him to be bound by it.<sup>194</sup>

## **4.1 Actionable Misrepresentation in the General Contract Law**

The ingredients for actionable misrepresentation in the general contract law are similar to the requirement to establish misrepresentation in the marine insurance contract law and well established. Following three conditions have to be satisfied: First, the representation must be one of fact, not opinion or law. This is because of the concept that the misrepresentation

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<sup>194</sup> *Dick Bentley Productions Ltd v. Harold Smith Mothers Ltd (1965) 1 WLR 623.*

of law is not actionable as each party is supposed to know the general law of the land.<sup>195</sup> This means that the misrepresentation of foreign law must be treated as misrepresentation of fact, as it is impossible for the representee to know all foreign laws. In such situation, a remedy may be available for less informed party, who acts reasonably and relies on the better knowledge of the other party. This is rare that the both parties must have equal knowledge of the law.<sup>196</sup> Therefore, the court is likely to give a relief to the representee if there is a misrepresentation of law. Indeed, relatively recently the House of Lords decided that the rule whereby the money is not recoverable because it has been paid under a misrepresentation of law is no longer be maintained in English Law.<sup>197</sup> In this situation, it seems most unlikely that a person would be denied a remedy on the ground of misrepresentation of law.<sup>198</sup> As far as opinion is concerned, an opinion is a statement for which the representor does not have sufficient information to guarantee. It is not, therefore, reasonable for the representee to rely on information about which the representor himself is not sure. Therefore, because of this reason, a representor cannot be held liable.<sup>199</sup> Instead, an opinion by an expert in the matter is actionable because such opinion can induce the party to enter into the contract.<sup>200</sup>

Secondly, the representation must be false for actionable misrepresentation. Whether a statement is true or false depends on how it is interpreted. It is well established that every statement must be interpreted in fair and common sense way, objectively and in the context.<sup>201</sup> Interpretation in a fair and common sense way avoids an inaccurate construction of the representee's question, which may make the answer represented erroneously by generality.<sup>202</sup> Therefore, an answer by the representor with a little inaccuracy may not be held false statement but if the answer gives opposite

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<sup>195</sup> *Brisbane v Dacres* (1813) 5 Taunt 143.

<sup>196</sup> *Andre & Cie SA v. Ets Michel Blanc* [1979] 2 Lloyd's Rep. 427.

<sup>197</sup> *Brennan v. Bolt Burden* [2005] QB 303 (CA).

<sup>198</sup> Malcolm A Clarke, *The Law of Insurance Contracts*, p. 652, Fifth Edition, Informa, London, 2006.

<sup>199</sup> *Zurich General Accident & Liability Ins Co Ltd v. Leven* (1940) SC 406.

<sup>200</sup> *Supra*, Foot Note 5.

<sup>201</sup> *Supra*, Foot Note 198, p. 654.

<sup>202</sup> *Condogianis v. Guardian Assurance Co Ltd* [1921] 2 AC 125.

picture of the factual situation, it is false statement. What about making a statement which is true but which is misleading, does not reveal all the facts? It is misrepresentation because such statement may deceive the representee and mislead him to enter into the contract. Therefore, the statement that the building, which is subject to negotiations for sale, is fully let, while the tenants have given notice to quit, is misrepresentation as it is made to mislead the buyer.<sup>203</sup>

Regarding objectivity, if the statement is completely ambiguous, it must be given the meaning as the representor expected the representee to understand. It can be true or false according to that meaning. However, the representation is sometimes made in response to question asked by the representee, from which the replies take their shade. If there is any ambiguity in the question, it must go against the representee as he, in a sense, guides the representor to give ambiguous answer by putting ambiguous question.<sup>204</sup> Nevertheless, it does not excuse the representor to ask for clarification of the question. As for as context is concerned, the context may be any thing in which the statement appears; for instance, a representation that the representor has perfect vision is true, if his vision is perfect even with glasses.<sup>205</sup> Similarly, the representation that the property of the representor has not been insured before refers only to the subjected property and not any other property of the representor.<sup>206</sup>

Thirdly, the representation must induce the contract,<sup>207</sup> for which following conditions must be satisfied: the representation must be material, the representee must know it, it must be intended to be acted upon and it must be acted upon. If a representation influences the reasonable person to enter into the contract, as also mentioned in Chapter 3, it is material.<sup>208</sup> Therefore, where a statement is made with the purpose to

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<sup>203</sup> *Dimmock v. Hallett (1866) LR 2 Ch App 21*, quoted on p. 522, Jill Poole, Textbook on Contract Law, Eighth Edition, Oxford University Press, 2006).

<sup>204</sup> *Hair v. Prudential Assurance Co Ltd [1983] 2 Lloyd's Rep. 667*.

<sup>205</sup> *Austin v. Zurich General Accident & Liability Ins Co Ltd (1944) 77 Ll L Rep. 409*.

<sup>206</sup> *Yorke v. Yorkshire Ins Co Ltd [1918] 1 KB 662*.

<sup>207</sup> *Supra*, Foot Note 187.

<sup>208</sup> Jill Poole, Textbook on Contract Law, p. 529, Eighth Edition, Oxford University Press, 2006.

induce, and that can influence a reasonable person to agree, is material, it may not be difficult to assume actual inducement.<sup>209</sup>

The representation can not said to have induced the contract unless it was known to the representee. Similarly, if the representation is made to the agent, it must be considered known to the principal. In addition, a representation made by one party to another, which induces a third party to enter into the contract, is actionable by the third party provided the first party knew that the representation would be communicated to the third party.<sup>210</sup> Therefore, where a party makes a statement to induce the third party, third party can take action against the party making such statement because the purpose of the statement is to deceive him, and therefore is actionable. One the other hand, representee must owe the duty of care while acting on such statement. The cautious representee must do his own research before acting on a statement. If he, despite making his own research, does not notice misrepresentation at the time of taking decision, he will be justified to bring action against the representor later when he will discover such misrepresentation. In addition, mere fact that the representee fails to take advantage of a chance to find out the truth, for instance, by inspection of the goods, property or ship, does not thwart reliance on the misrepresentation.<sup>211</sup> As this missed chance does not give permit to the representor to misrepresent. Furthermore, to establish that the misrepresentation induced the contract, it must be sufficient to prove that it was made known to the representee, was material and representee entered into the contract. The representor, subsequently, can prove that the representee did not actually rely on the misrepresentation to enter into the contract, but was actually persuaded by some other reason. It seems, however, that this argument will not operate if the misrepresentation is fraudulent because fraudulent misrepresentation gives rise to a presumption of inducement, which is actionable in itself.<sup>212</sup>

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<sup>209</sup> *Avon Insurance plc v. Swire Fraser Ltd* [2000] 1 All ER 573.

<sup>210</sup> *Clef Aquitaine SARL v. Laporte Materials (Barrow) Ltd* [2000] 3 WLR 1760.

<sup>211</sup> *Supra*, Foot Note 208, p. 531.

<sup>212</sup> *Clinicare Ltd v. Orchard Homes & Development Ltd* [2004] EWHC 1694.

## 4.2 Representation of Fact, Material Fact and Belief in the Marine Insurance Contract Law

Section 20 (3) of MIA 1906<sup>213</sup> may initially give the impression that there are two types of representation, namely, as to matter of fact and as to a matter of expectation and belief. It may be ascertained after a careful reading of section 20 (2) and 20 (3) of MIA 1906<sup>214</sup> together that there are actually three types of representations: a representation of fact, representation of material fact and representation of expectation and belief. Whether representation of 'fact' is really a representation or not is doubtful because if a fact is not material it cannot possibly induce the insurer to enter into the contract. Besides, in order to avoid the contract, the insurer must satisfy the actual inducement test, as given in Chapter 3. Furthermore, the purpose of section 20 (4) of MIA 1906<sup>215</sup> is not to create new class of representation, that is of fact, but only to define meaning of the word 'true' when applied in relation to a material representation.<sup>216</sup>

It is easy to determine the dissimilarity between the representation of fact and belief because explicit statement is most probably to be treated as a statement of fact.<sup>217</sup> If the statement is clear, the test of materiality of any inaccuracy is to be judged by the prudent insurer standard. This discourages the insurer to avoid the contract for insignificant inaccuracies. On the other hand, a statement on which the assured has no control must be interpreted as a matter of belief. Besides, if the alleged misrepresentation consists of an expression of opinion or belief, it must be assumed true unless made in bad faith.<sup>218</sup> The absence of reasonable grounds for belief may point to the absence of good faith for that belief. There must be no reason for alleging the representation based on unreasonable grounds for belief if the bad faith

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<sup>213</sup> Also see s. 20 (3) of MIA 1908, s. 26 (3) of MIA 1909 and s. 22 (4) of MIA 1993.

<sup>214</sup> Also see s. 20 (2)(3) of MIA 1908, s. 26 (2)(3) of MIA 1909 and s. 22 (2)(4) of MIA 1993.

<sup>215</sup> Also see s. 20 (4) of MIA 1908, s. 26 (4) of MIA 1909 and s. 22 (5) of MIA 1993.

<sup>216</sup> *Supra*, Foot Note 85, p. 93 and 94.

<sup>217</sup> *Highlands Insurance v. Continental Insurance* [1987] 1 *Lloyd's Rep.* 109.

<sup>218</sup> *Supra*, Foot Note 112, p. 90.

is not alleged.<sup>219</sup> Therefore, if the owner of the vessel gives his opinion about the value of the vessel, it must be considered misrepresentation only if it is made in bad faith. Bad faith in this situation can be proved by the supported documents provided by the owner of the vessel to corroborate his opinion because such evidence can influence the judgment of the prudent insurer and therefore is material.<sup>220</sup> The question of whether provision of documents by the assured is sufficient evidence to prove bad faith is also necessary to be addressed. There are two aspects of this issue. It must be considered whether the documents are specially prepared to corroborate the mala fide opinion. Secondly, did the insurer rely on these documents? In both situations, the provision of documents must be considered misrepresentation because the purpose of the assured is to deceive the insurer and influence his judgement. Even if the insurer has not relied on the documents, it must be considered misrepresentation because the documents were presented to mislead the insurer and therefore the insurer may avoid the contract. Moreover, if the assured did not check the correctness of the documents before presenting, he cannot be said to have acted in good faith.<sup>221</sup> Similarly, the statement of the assured that the ship is equipped with the fire fighting apparatus would be false if the system was out of order. Nevertheless, if at the time of making the statement the assured did not know it was out of order, it cannot be said to have acted in bad faith. Therefore, the statement must be true as was not made in bad faith.<sup>222</sup>

### **4.3 Fraudulent, Negligent and Innocent Misrepresentation**

There are three types of misrepresentations in both the marine insurance contract law and the general contract law: fraudulent, negligent

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<sup>219</sup> See Peter Gibson LJ's view in *Economides v. Commercial Union Assurance Co Plc* [1998] 1 Lloyd's Rep IR 9 (CA) at p. 21.

<sup>220</sup> *Eagle Star Insurance Co Ltd v. Game Video Co* [2004] 1 Lloyd's Rep. 238.

<sup>221</sup> *International Lottery Management v. Dumas* [2002] 1 Lloyd's Rep. IR 237.

<sup>222</sup> Professor Robert Merkin, *A guide to Reinsurance Law*, p. 133, Informa London, 2007. Also see, *Sirius International Insurance Group v. Oriental Assurance Corporation* [1999] Lloyd's Rep. IR 345.

and innocent. The House of Lords in *Derry v. Peek*<sup>223</sup> defined fraudulent misrepresentation, as a false statement made knowingly or without belief in its truth, or recklessly whether it be true or false. The essential element for fraudulent misrepresentation is, therefore, the absence of a truthful belief that the statement is true. Based on this definition, it is possible to distinguish recklessness, fraudulent misrepresentation, and mere lack of care, negligent misrepresentation. Above given definition of House of Lords requires a disregard for the truth, perhaps amounting to dishonesty. In other words, a statement maker would be reckless if he had no knowledge whether the statement was true or false but affirmed it as true and in so doing took a risk by making the statement.<sup>224</sup> If a statement is true when made but is falsified, before the contract is concluded, by the subsequent event, the maker of the statement must represent new information.<sup>225</sup> Similarly, a person may be held liable for a misrepresentation if at the time of making it, he believed it to be true but which he has subsequently discovered to be false but he did not rectify his statement.<sup>226</sup> This is due to the obligation of each party to make true representation during pre-contractual negotiations. Besides, by not disclosing subsequent change, the representor indirectly makes fraudulent misrepresentation, as the actual representation becomes untrue, and the representee still has to make his decision whether to enter into the contract.<sup>227</sup> Moreover, burden of disproving that the statement was fraudulent must be on the representor because under section 2(1), MA 1967, he must have reasonable grounds to believe that the statement he was making during negotiations was true.

Fraudulent misrepresentation can be distinguished from a negligent misrepresentation where the representor believes that the statement to be true but has been careless in reaching the conclusion. In other words, if the representor is casual in observing the duty of reasonable care and skill while

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<sup>223</sup> (1889) L.R. 14 App Cas 337.

<sup>224</sup> See Jacob J's View at p.587, *Thomas Witter Ltd v. TBP Industries Ltd* [1996] 2 All ER 573, Also see, *Supra*, Foot Note 208, p. 534.

<sup>225</sup> *Banks v. Cox* [2002] EWHC 2166. (Quoted at p. 534, Jill Poole, Textbook on Contract Law, Eighth Edition, Oxford University Press, 2006).

<sup>226</sup> *With v. O'Flanagan* [1936] Ch 575. (Quoted at p.675, Ewan McKendrick, Contract Law, Text, Cases and Material, Second Edition, Oxford University Press, 2005.

<sup>227</sup> *Supra*, Foot Note 102.

making the representation, the representation is negligent.<sup>228</sup> The breach of the duty to take reasonable care arises only in case of fiduciary relationship between the parties because of the requirement of confidence and trust in such relationship. Nevertheless, House of Lords in *Hedley Byrne & Co Ltd v. Heller and Partner Ltd*<sup>229</sup> recognized duty of care where a professional or business relationship existed, because the statement given and relied upon may cause loss in professional and business relationships. The duty of care is also recognized in the law of tort as regards statement made and relied upon which causes financial loss. Therefore, the person who suffered loss due to negligent misrepresentation had two remedies, namely, remedy under tort law and remedy under common law.<sup>230</sup> However, the development of common law doctrine of negligent misrepresentation became irrelevant with the introduction of the MA 1967. Under section 2(1) of MA 1967, a statutory liability for negligent misrepresentation was created, which does not rely on any special relationship. Significantly, MA 1967 reversed the normal burden of proof in civil proceedings from representee, claimant, to representor, who has to prove that he had reasonable grounds to believe, and believed up to the making of the contract, that the facts were true as represented. Because of this reason the representee prefer to take action under MA 1967 instead of common law doctrine of negligent misstatement. However, the *Hedley Byrne* principle, as give above under the present heading, may still be applied in situations where the party making the statement is not a party to the final contract.<sup>231</sup>

An innocent misrepresentation may be considered a false statement, which was made neither fraudulently nor negligently. Actually, because of the wording of section 2 (1) of MA 1967, it may appear that innocent representation has been restricted to those circumstances where the representor not only believed the statement to be true but also must be able to prove that he was not negligent. In other words, evidence of reasonable grounds for the representation is necessary to prove innocent

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<sup>228</sup> *Supra*, Foot Note 208, p. 534.

<sup>229</sup> [1964] A.C. 465.

<sup>230</sup> *Supra*, Foot Note 38, p. 105.

<sup>231</sup> *Supra*, Foot Note 38, p. 106.

misrepresentation. Moreover, before the development of negligent representation in the law of tort, it was supposed that every representation that is not fraudulent is innocent. Nevertheless, with the recognition of negligent misrepresentation in MA 1967, the innocent misrepresentation has now been severely limited. However, there are circumstances in which innocent misrepresentation will be relevant. For instance, if the claimant pursues an action under section 2(1) MA 1967, for negligent misrepresentation, the other party may rebut the presumption of negligence; as a result, the court may provide remedy for innocent misrepresentation.<sup>232</sup>

#### **4.4 The Difference between Non-disclosure and Misrepresentation**

It is sometimes complicated to draw difference between non-disclosure and misrepresentation because of overlapping characteristics and consequences of both. A failure, for instance, by the assured to answer the question may amount to a negative answer, consequently may be considered misrepresentation, although it is understood to be non-disclosure. Similarly, the assured, who reveals some but not all of the truth may also be regarded as having misrepresented, because what is not disclosed may cease the reliability of what has been said.<sup>233</sup> The insurer needs authentic and true information to make his decision to enter into the contract. If the assured tells the half-truth, he, by doing so, tries to hoodwink the insurer, so his half-truth becomes misrepresentation. This indicates that the pure non-disclosure is relatively rare.<sup>234</sup> Furthermore, where the assured makes accurate representation but becomes inaccurate as the circumstances change before the contract is concluded, failure to correct the statement by the assured will amount to misrepresentation, although nothing has actually be presented. If the assured corrects his statement in a manner that the true

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<sup>232</sup> *Supra*, Foot Note 39, p. 141.

<sup>233</sup> *Supra*, Foot Note 222, p. 125.

<sup>234</sup> *HIH Casualty and General Insurance Co v. Chase Manhattan Bank [2003] Lloyd's Rep. IR 230.*

picture is fairly presented to the insurer, he cannot be held liable for misrepresentation.<sup>235</sup>

In the general contract law, there is, sometimes, very delicate difference between misrepresentation and non-disclosure. It seems quite strange that a car seller does not tell the buyer at the time of selling the car that, for instance, he has fixed the car's engine temporarily, which will break down any time if the car travels two hours constantly. However, later on takes the shelter of *caveat emptor* when the purchaser complains for not disclosing the important fact. Nevertheless, this is true as the seller, in this case, is entitled to take shelter of *caveat emptor* because the parties are supposed to look after their own interests.<sup>236</sup> Morally, it does not seem reasonable to deceive the other party in the name of non-disclosure. Yet, legally speaking, the other party must be careful while taking his decision to buy the car. Therefore, it may be said that there is no room for moral values in general contract law, as far as disclosure is concerned. On the other hand, if the car seller says that the car is working well and has no problem, whatsoever, for instance, while he privately knows that this information is not true, he will be liable for misrepresentation. Therefore, although there is a clear distinction between non-disclosure and misrepresentation but it is difficult sometime to differentiate between duty of disclosure and representation as they shade into one another.<sup>237</sup>

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<sup>235</sup> *Assicurazioni Generali v. Arab Insurance Group* [2003] Lloyd's Rep IR 13.

<sup>236</sup> Also see under heading 2.3 for detailed reasoning.

<sup>237</sup> *Supra*, Foot Note 102.

## 5 Effects of Breach of the Duty of Good faith

The effect of breach of the duty of utmost good faith in the marine insurance contract law is that the innocent party may avoid the contract as the interest of the innocent party, which is usually the insurer, will be met if he rejects the claim made or set aside the policy. The innocent party is usually the insurer, because the assured will not take the risk to avoid the policy except where he prefers to receive back the premium instead of continuing with the policy, which secures him against a risk.

In contrast, the breach of the duty of good faith in the general contract law may give rise to a number of remedies. The innocent party may not only rescind the contract but claim damages. It must be noted that in practice, there is no difference between avoidance and rescission of the contract; term 'avoidance' is usually used in the marine insurance context whereas word 'rescission' is used in the general contract law.<sup>238</sup>

### 5.1 Why there is no Remedy of Damages In the Marine Insurance Contract Law?

There is no logical reason for not offering any remedy of damages in marine insurance contract law; and especially when not only the remedy of avoidance is sometimes inadequate to meet the needs of the innocent party but place the innocent party in worse position as he was before the contract. Conversely, the principle of avoidance in the marine insurance contract is a principle of law, which is sufficient to support the right to avoid the contract. In addition, since MIA 1906, MIA 1908, MIA 1909 and MIA 1993 do not recognize any remedy other than avoidance, it would not be right for the court to create a new tort by way of judicial legislation. This could expose either party to an insurance contract to a claim for substantial damages in the absence of any chargeable conduct.<sup>239</sup> The logic appears

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<sup>238</sup> Supra, Foot No. 5, p 70.

<sup>239</sup> *Banques Keyser Ullmann SA v. Skandia (UK) Insurance Co Ltd [1990] 1 QB 665.*

unquestionable, but is tort liability possible under statutory or common law in case of breach of the duty of utmost good faith? A breach of the duty of utmost good faith may, in some cases, also violate MA 1967, which provides liability for damages caused by a contractual obligation entered into because of a misrepresentation by the other party.<sup>240</sup> Furthermore, the fraud is also actionable as a tort at common law. A party who makes a fraudulent misrepresentation to persuade the other party to act must be held liable for deceit.<sup>241</sup> Therefore, where a party to a contract has fraudulently misrepresented a fact, the innocent party may request the court to rescind the contract and claim for damages for tort of deceit.

On the other hand, it may be argued that the insurer may avoid the contract and so can prevent the assured from taking benefit from his fraud. This is enough remedy for a fraudulent misrepresentation. If the court awards damages in addition to the remedy of avoidance, the purpose must be to deter fraud not to prize the insurer with profit. In case of negligent misrepresentation, in addition to damages under section 2(1) of MA 1967, the remedy of rescission is available to the innocent party section 1 of MA 1967.<sup>242</sup> For that reason, it may be said that, in English law, the avoidance is not necessarily the only remedy in case of misrepresentation but, yes, in most cases, it would be the only available remedy. But what about non-disclosure, is the remedy of damages available for non-disclosure? In case of non-disclosure, no damages are recoverable, even if the non-disclosure is fraudulent,<sup>243</sup> because none of the marine insurance acts offers any damages for non-disclosure. This shows that the Parliaments did not consider that the breach of the duty of disclosure would give rise to claim for damages, otherwise they would definitely have said so. Besides, there is no case law to support the existence of damages in case of non-disclosure. Apart from lack of case law, the powers of the court to grant relief in case of non-disclosure of material facts stems from the jurisdiction of the court to

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<sup>240</sup> Thomas J. Schoenbaum and Jessica L. McClellan, *The duty of utmost good faith: uberrimae fidei* Ch.19. Admiralty & Mar. Law 19-14 (4th ed.), 2010.

<sup>241</sup> *Supra*, Foot Note 11, p 270.

<sup>242</sup> *Supra*, Foot Note 187, p. 247.

<sup>243</sup> *HIH Casualty and General Insurance Ltd v. Chase Manhattan [2001] 2 Lloyd's Rep. 483.*

prevent imposition. The power of the court to grant relief by way of rescission of the contract when there has been undue influence or duress stem from the same jurisdiction. Since duress and undue influence do not give rise to claim for damages, in principle no damages can be awarded for non-disclosure.<sup>244</sup> Not all these arguments are very convincing. If none of the marine insurance acts provides any remedy of damages, it does not mean that there should not be any damages for non-disclosure. There is a strong need to revisit section concerning non-disclosure<sup>245</sup> because this is very strict in terms of application and time. The section regarding the duty of utmost good faith,<sup>246</sup> on the other hand, is quite flexible but still it does not offer remedy in terms of damages. In addition, the non-disclosure and misrepresentation are used for same purpose; to deceive the assured and inducing him to enter into the contract. If damages may be awarded for misrepresentation then the same remedy may be approved for non-disclosure.

The insurer seeks the remedy of avoidance against the assured in respect of misrepresentation and non-disclosure. However, the assured can have the same remedy of avoidance; the same rules apply if the innocent party is the assured.<sup>247</sup> Nevertheless, it looks quite irrational to expect the assured to expose himself to the risk insured against by avoiding the policy.

In the United States there is no marine insurance case awarding damages for breach of the duty of utmost good faith. There is no federal admiralty tort of misrepresentation, so it would appear that a suit for tort damages would have to be pleaded and proved under state law, which in most states would be the common law tort of deceit. Therefore, there is no tort of breach of utmost good faith in marine insurance law for which damages can be awarded. The remedy is avoidance which voids the insurance policy *ab initio*.<sup>248</sup>

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<sup>244</sup> *La Banque Financiere de la Cite v. Westgate Insurance* [1988] 2 Lloyd's Rep. 513. Also see Asif Tufal, Undue Influence in Equity, available at: <http://www.lawteacher.net/PDF/Undue%20Influence%20Lecture.pdf> (4 May 2010).

<sup>245</sup> See s. 18 of MIA 1906, s. 18 of MIA 1908, s. 24 of MIA 1909 and s. 21 of MIA 1993.

<sup>246</sup> See s. 17 of MIA 1906, s. 23 of MIA 1909 and s. 22 of MIA 1993.

<sup>247</sup> *Supra*, Foot Note 198, p. 724.

<sup>248</sup> Thomas J. Schoenbaum and Jessica L. McClellan, The duty of utmost good faith: *uberrimae fidei* Ch.19. Admiralty & Mar. Law 19-14 (4th ed.), 2010.

## 5.2 Effects of Avoidance of Insurance Contract *ab initio*

The effect of breach of the duty of utmost good faith by the assured is avoidance<sup>249</sup> of the insurance contract *ab initio*. This means that the contract is treated as had never existed. The consequence of the contract *ab initio* for the assured is that the insurer does not have to pay outstanding payable losses but the assured is entitled to recover the premium.<sup>250</sup> This is perhaps to limit the remedy to avoidance only. In addition, limiting remedy to avoidance provides protection to the assured against losing premium when he has already suffered due to avoidance by the insurer. Nonetheless, the penalty of avoidance is quite harsh. It allows the entire policy may be avoided, even retrospectively. In addition, the remedy of avoidance offers no concept of proportionality.<sup>251</sup> Where a fully enforceable contract has been entered to insure the assured, let's say, for one year, the premium has been decided and paid, a claim for a loss covered by the insurance policy. But later, when the assured filed a claim, the insurer certainly realized that the assured did not fulfil his duty of good faith; the insurer in this situation is not only authorized to treat himself discharged from any liability, whatsoever, but can undo all that has perfectly gone before. This cannot be prepared to accept with principle.<sup>252</sup> Besides, although either party can invoke the remedy of avoidance, in fact it is one-sided remedy since it is hard to imagine any circumstance where the assured would desire to invoke it.<sup>253</sup>

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<sup>249</sup> See s. 17 of MIA 1906, s. 23 of MIA 1909 and s. 22 of MIA 1993.

<sup>250</sup> *Supra*, Foot Note 222, p. 157.

<sup>251</sup> Paul Todd, *Maritime Fraud*, para. 6.70, LLP, London, 2003.

<sup>252</sup> See Lord Hoffman's View in *Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co Ltd [2001] UKHL 1*, at p.187 (*The Star Sea*).

<sup>253</sup> See Lord Hoffman's view in *Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co Ltd [2001] UKHL 1*, at p.189 (*The Star Sea*).

## 5.3 Claims for Misrepresentation in the General Contract Law

In the general contract law, for a claim based on misrepresentation to succeed, there must be an unambiguous and false statement of existing fact, which induced the claimant to enter into the contract. What if the statement is ambiguous but induced the representee to enter into the contract? If the statement is ambiguous, the representee must ask for more information. If he does not ask for more information, it suggests that he understood the statement properly, thus statement may be considered unambiguous. Relying on ambiguous statement and later claiming remedy for misrepresentation is somewhat unreasonable, because no prudent party can be induced to enter into a contract by ambiguous statement. Conversely, a party can be induced to enter into the contract by false and unambiguous statement, because of the clarity of the statement. Therefore, the representation will give rise to the claim for misrepresentation if the meaning attached to the representation by the claimant is a rational conclusion to be drawn from the representation.<sup>254</sup>

There are two remedies for breach of the duty of good faith, generally and misrepresentation particularly in English contract law, namely; rescission and damages. Same remedies are available in New Zealand under CRA 1979 and FTA 1986<sup>255</sup> and in Australia under TPA 1974<sup>256</sup>. Rescission is the primary remedy for misrepresentation and available for all types of misrepresentation. A contract, which is rescinded for misrepresentation is set aside retrospectively and prospectively perhaps in order to restore the parties in the position they were before the contract. Rescission is harsh remedy; the reasons have already been explained. Here suffice to say that the representee relies on the statement of representor whereas he could take the opportunity to discover the truth by himself. Therefore, he must not be allowed to rescind the contract due to his own

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<sup>254</sup> *Supra*, Foot Note 208, p.522.

<sup>255</sup> See s. 6 and s. 7 of CRA 1979 and s. 13 and s.40 of FTA 1986.

<sup>256</sup> See s. 52 and 53. Also, see s. 6 and s. 7 of Misrepresentation Act 1972 of South Australia.

carelessness.<sup>257</sup> In addition, if the claimant affirms the contract after discovering misrepresentation, he cannot rescind the contract later because confirming contract after discovering misrepresentation shows that the representee acknowledge that the misrepresentation did not induce him to enter into the contract.<sup>258</sup> The claimant also loses his right to rescind the contract with the laps of time, because after the laps of time it is difficult to restore the parties to pre-contractual position, which is perhaps the most important purpose of rescission. Conversely, a defendant cannot oppose the rescission on the basis that he has suffered a loss which cannot be recovered. Therefore, the purpose of restoring the parties to the pre-contractual condition appears to prevent the unjust enrichment of any of the parties.<sup>259</sup> In addition to rescission, the damages may also be recovered.<sup>260</sup> As described above,<sup>261</sup> a representation may become a term of the contract in some circumstances, where the parties agree to incorporate a representation as a term of the contract. Unless fraud could be established, the innocent party would not prefer to bring a remedy for misrepresentation. Because if it is established that the terms of the contract has been breached, the innocent party may bring an action for breach of the contract, which is much more attractive remedy as compare to remedy for misrepresentation. However, since damages for negligent misrepresentation are obtainable, identifying the fact that a representation has become a term is not significant in terms of remedy. Moreover, the fact that a representation has become a term extinguishes the right to rescission for misrepresentation is no longer the case.<sup>262</sup>

The general contract law offers same remedy for fraudulent misrepresentation as available in marine insurance contract law, as mentioned before. The simple reason is application of MA 1967 to all contracts. In case of negligent misrepresentation, the innocent party can claim for negligent misstatement in tort and a claim for damages under

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<sup>257</sup> *Supra*, Foot Note 37, p 581.

<sup>258</sup> *Car and Universal Finance Co v. Caldwell [1965] 1 QB 525.*

<sup>259</sup> *McKenzie v. Royal Bank of Canada [1934] AC 468.*

<sup>260</sup> *Supra*, Foot Note 102, p. 227.

<sup>261</sup> See under the Heading 4.1.

<sup>262</sup> *Supra*, Foot Note 208, p.522. Also see s. 1 of MA 1967.

section (2) 1, MA 1967, in addition to the remedy of rescission. The statutory claim of damages under section 2 (1), MA 1906, for negligent misrepresentation is in one sense wider than the available remedy at common law; it does not really depend upon the existence of any kind of special relationship. Nevertheless, it is narrower because it applies only where the misrepresentation induces the representee to enter into the contract. It is also narrow because it does not apply to the exceptional cases of representation by silence, as such a misrepresentation is not made within the meaning of section 2 (1), MA 1967.<sup>263</sup>

Where a duty of special care arises based on the special relationship between the parties<sup>264</sup>, the party providing advice must know that the other party will rely upon his skills and judgement and so must exercise reasonable care when providing such advice. An action for negligent misrepresentation may be brought against a party not using due care and skill while providing such advice, because he must be cautious in his advice as the other party places reliance on such advice.<sup>265</sup> Nevertheless, the advising party cannot be held liable if there is a disclaimer in the contract about the advice. This is because by accepting disclaimer the party taking advice pledges for not taking any action against the advising party.<sup>266</sup> This also shows that the party giving statement accepting that he is not sure about the accuracy of the statement. Besides, the disclaimer does not give certificate to the advising party to give wrong advice deliberately, if he does so; it is equal to negligent misrepresentation, so he may be held liable. Furthermore, the advice is required for a purpose, whether particularly specified or generally described, the adviser knows that the advice so communicated is likely to be acted on without independent inquiry.<sup>267</sup> Therefore, where the adviser is negligent, the liability for negligent misstatement may be imposed.

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<sup>263</sup> *Supra*, Foot Note 208, p.537.

<sup>264</sup> For instance relationship between a client and his banker, where bank is requested to give its opinion about investing in particular company.

<sup>265</sup> *Supra*, Foot Note 39, p. 137.

<sup>266</sup> *Hedley Byrne & Co Ltd v. Heller & Partners Ltd [1964] A.C. 465.*

<sup>267</sup> *Merrett v. Babb [2001] EWCA Civ 214.*

## 5.4 Remedy for the Assured

The remedy of avoidance, as given in the marine insurance contract law, is a one sided remedy and only the insurer can benefit from this remedy, as has been described before. Nevertheless, by introducing the duty of utmost good faith as an implied term of the insurance contract, the parties can have a variety of contractual remedies, ranging from avoidance to claim damages.<sup>268</sup> The damages can place the parties to the position they were in before the contract. Besides, the assured will be secured against the harsh remedy of avoidance as he can claim damages if the insurer avoids the contract with bad faith. This deterrence will discourage the insurer to avoid the policy for insignificant reasons and consequently will promote the fairness in the marine insurance contract law.

Presently there is no such remedy available in MIA 1906 whereas Australian Law Reform Commission (ALRC) in its report<sup>269</sup> recommended that the duty of the utmost good faith be an implied term of a contract of marine insurance. This is consistent with the position in general insurance law in Australia, as section 13 of Insurance Act 1984 (ICA) provides that there is an implied term in a contract of insurance requiring each party to act towards the other party with utmost good faith. The justification of adopting such a provision of ICA in an amended MIA 1909 arises because of the clear one sided remedy of avoidance by the insurer in MIA 1909 and necessity of providing appropriate relief to the assured. The ALRC has not proposed any specific remedy in MIA 1909 for breach of the implied term.<sup>270</sup> Nevertheless, the remedy of the breach of the pre-contractual duty of utmost good faith would be damages, which is also a remedy available in the general contract law in case of breach of the contract.

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<sup>268</sup> *Supra*, Foot Note 172, p. 373.

<sup>269</sup> See Report No. 91, Review of the Marine Insurance Act 1909, 28 Feb 2001, (still to be implemented) available at: <http://www.austlii.edu.au/au/other/alc/publications/reports/91/> (11 May 2010).

<sup>270</sup> *Supra*, Foot Note 172, p. 373.

## 6 Conclusions

The principle of good faith is not limited to the insurance contract law as no contract can be made in bad faith. Nevertheless, the marine insurance contract law requires greater level of the duty of good faith by the assured because the insurer has to rely on the information provided by the assured in order to make his decision about the taking of the risk and calculating the premium. Besides, it is practically impossible for the insurer to take an accurate decision concerning the risk if the assured does not observe the duty of good faith by making full disclosure and true representation of all material circumstances attached to the subject matter to be insured. The insurer also owes the duty of utmost good faith. However, all material information is supposed to be in the knowledge of the assured therefore it is mainly his responsibility to observe the duty utmost good faith.

The duty of good faith is not unknown to the general contract law as it recognizes the duty of true representation, which is an element of the duty of good faith. The duty of true representation in the general contract law is the same duty as implied in the marine insurance contract law. The effect of misrepresentation is also same in both, the marine insurance contract law and the general contract law; the innocent party may avoid the contract and claim for damages. As a result, the recognition of the duty of good faith in the general contract law must not be controversial. There is a need to recognize the duty of good faith in the general contract law instead of adopting piecemeal solutions of imposing fine to the misleading party to enforce fairness in business dealings.

The duty of utmost good faith in the marine insurance contract law is wider than the duty of disclosure and representation, which in fact derive from the duty of good faith. The duty of disclosure is the most important duty, as the insurer has to make his decision regarding the risk and premium based on information provided by the assured. Therefore, the assured cannot be allowed to stay quiet when he has to disclose every material

circumstance, which he would like to know if he was the insurer. If the assured thinks that he must disclose any circumstance to the insurer, which if not disclosed will influence the insurer to take a decision that he could not take if the circumstance was disclosed, then he must disclose that circumstance because such circumstance is material. Furthermore, it is not significant whether the insurer took the different decision or not because the purpose of the duty to disclose is to prevent the assured from deceiving the insurer by holding back material information. However, it seems unreasonable to hold the assured liable for not disclosing information which could not have influenced the judgment of the insurer. Therefore, if the information is not of such importance to influence the insurer, it must not be material, consequently, the insurer must not be allowed to avoid the contract.

The insurer, on the other hand, has the right to take informed decision. However, the concept of taking informed decision must not be restricted to the information provided by the assured. If the insurer does not verify the information provided by the assured he must not be considered to have taken informed decision, as a result must not be allowed to avoid the contract because of his own recklessness. Nevertheless, if there is any particular circumstance attached to the subject matter, which can only be in the knowledge of the assured, and the assured does not disclose that circumstance, then the insurer cannot said to have taken informed decision because of the non-disclosure of the assured. However, it must not be the duty of the assured only to decide which circumstances are material, the insurer must be familiar with usual circumstances attached to the subject matter and therefore ask questions to the assured. Asking question by the insurer is important because it is likely that the assured considers a circumstance immaterial and therefore thinks it unnecessary to be disclosed. Besides, if the insurer takes the responsibility to ask question to get information it will reduce the extent of litigation on the duty of disclosure. The insurer will not be justified in avoiding the policy for non-disclosure when he fails to ask question to get material information. Moreover, the insurer cannot avoid the contract if he does not prove that the non-disclosure

actually induced him to enter into the contract. This is quite logical to demand from the insurer to prove inducement and materiality before avoiding the contract as to keep a check on the use of harsh remedy of avoidance by the insurer.

Disclosing tactical information and after that negotiating with the other party with a hope to attain economic benefits is literally illogical. The general contract law, because of this reason, does not recognize the pre-contractual duty of disclosure. In addition, the non-recognition of the duty of disclosure increases the market competence. The parties compete with each other for personal benefits by having access to better information as compare to the other party. On the other hand, it allows the informed party to exploit the other less informed party to achieve his own business objectives, ignoring the interest of other party, which does not serve any good in promoting strong business contractual relationships between the parties. However, if the parties do not require strong business relationships, non-observance of the duty of disclosure allows the parties to take care of their own interest at the cost of others' interests, which promotes unfairness in the contractual relationships.

As for as making an agreement to negotiate in good faith is concerned, there must be no barrier if the parties want to negotiate in good faith as the parties must be free to agree on what ever terms they want. Besides, the agreement to negotiate in good faith must be encouraged because of the following reasons: the agreement to negotiate in good faith shows aspirations of the parties to enter into a contract by accepting problem solving negotiations instead of adopting adversarial negotiations; the parties affirm not to take advantage of the known lack of knowledge of the other party; and the parties proceed in the negotiation with trust and confidence that the other party will not mislead and will not describe any reason which is untrue. Therefore, the decision in *Walford v. Miles [1992] 2 AC 128*, which prevents agreement to negotiate in good faith must be revisited to help the parties to observe good faith in their dealings if they desire so.

The principle of true representation is common to both, the marine insurance contract law and the general contract law. The parties are not allowed to induce the other parties to enter into the contract by misrepresentation. Similar to the marine insurance contract law, the general contract law recognizes that actionable misrepresentation is false statement of material fact, which can influence the representee to enter into the contract. Therefore, to bring a claim for misrepresentation in the general contract law, the claimant has to prove inducement to enter into the contract due to misrepresentation of material fact by the defendant. The marine insurance contract law has similar requirement in case of misrepresentation as well as non-disclosure. This is because the non-disclosure and misrepresentation are closely linked in the marine insurance contract law. The assured cannot hold back material information to induce the insurer. Similarly, the assured has to avoid misrepresentation about material circumstances in order to enable the insurer to take informed and properly calculated decision about the risk and the premium. In addition, as the purpose of non-disclosure and misrepresentation is usually the same: to deceive the insurer, except where the misrepresentation is innocent or negligent, claim for misrepresentation and non-disclosure cannot be made on dissimilar grounds. Consequently, the consequences of misrepresentation and non-disclosure must be same, but it is not the case.

The consequence of misrepresentation in the marine insurance contract law is that the innocent party, often the insurer, may avoid the contract and may claim damages for fraudulent misrepresentation. Often the insurer avoids the contract, because there is hardly any reason for the assured to avoid the contract. Nevertheless, the remedy of avoidance is sufficient remedy for the insurer he does not have to pay the claim. In addition, by avoiding the contract the insurer prevents the assured from taking advantage from the fraudulent misrepresentation. If the court awards damages in addition to avoidance, the rationale must be to discourage the fraudulent misrepresentation and not to enrich the insurer. Furthermore, the law of marine insurance contract is already sufficiently favourable to the insurer, who can avoid the contract *ab initio*. Awarding damages to the

insurer will make the marine insurance contract law further inequitable for the assured.

Remedies for the breach of the misrepresentation in the general contract law are rescission and damages under MA 1967, which is applicable to all contracts. Nevertheless, if the representation becomes the terms of the contract, the innocent party can claim a remedy for breach of the contract, which is also damages. Moreover, the remedy for the breach of the misrepresentation under the general contract law is not one-sided remedy and any party who claims to be affected by the misrepresentation may invoke it.

On the other hand, the remedy of avoidance in the marine insurance contract law is unfair in a sense that it only benefits the insurer and does not provide any security to the assured. However, introduction of the duty of utmost good faith as an implied term of the contract can secure the assured against harsh remedy of avoidance. The assured may invoke the remedy of damages if the insurer avoids the contract in bad faith. In addition, it can work as deterrence to discourage the insurer to avoid the contract for insignificant reasons and, consequently, will promote highly needed fairness in the marine insurance contract law.

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