



FACULTY OF LAW
Lund University

Sebastian Magnusson

The assured's post-formation
duty of utmost good faith in
marine insurance

Master thesis
30 credits

Abhinayan Basu Bal

Master's Programme in Maritime Law

Spring 2011

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Summary

The doctrine of utmost good faith in insurance contracts has long been a part of English law. It was codified with the Marine Insurance Act 1906. In the pre-formation stage the doctrine consists of a duty to avoid non-disclosure and misrepresentation. Which facts are to be disclosed or represented under the doctrine is determined by a test of materiality. The assured does not have a duty to disclose every piece of information that he might have, only that which is material to the risk. Both facts related to the physical hazard and the moral hazard can be material. The physical hazard concerns the actual object, usually a ship, whereas the moral hazard is for example the moral integrity of the assured. Materiality is determined using a “prudent insurer” test, seeing what a hypothetical insurer would have factored in during his decision-making. There is now also a subjective element, inducement. Even material non-disclosure cannot result in the prescribed remedy for a breach if there was no actual inducement into the contract resulting from it.

What is the purpose of utmost good faith in the Marine Insurance Act 1906? The definition of materiality and the now established requirement of inducement demonstrate that the purpose of utmost good faith and the assured’s duty of disclosure and non-misrepresentation is to aid the underwriter in making an informed decision as to whether he wants to enter into the contract and at what premium. Those duties as detailed in sections 18 and 20 of the Act no longer apply after the decision has been made. Once an insurance contract has been entered into, there is no general duty of the assured to keep supplying the insurer with information for the duration of that contract. That would clearly place a too big burden on the assured and give the insurer a way to escape cover. Nevertheless, the doctrine of utmost good faith continues to play a role after the formation of the contract, one that is not entirely clear.

Some areas of post-formation utmost good faith can be identified. The three main areas discussed in judgements and debate are variation, held covered clauses and fraudulent claims. Support for a singular

“overarching” principle of utmost good faith linking these, and other instances, together is derived from section 17 of the Marine Insurance Act which states that “A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.” There has been a desire to connect instances of post-formation good faith through this section, which would have the result that all post-formation breaches lead to avoidance. This is clearly not appropriate in all situations. While the courts support the idea of a single continuing principle, it does not need to be that in section 17. The problem of the courts being restricted to applying the “draconian” remedy of avoidance, even when it is too drastic, could be solved by treating all post-formation instances of utmost good faith as falling outside the scope of section 17 altogether. This would reduce section 17 to an introduction to the pre-formation sections 18 and 20.

In *The Star Sea* Lord Hobhouse supported that only in cases of creation or variation of obligations should the doctrine apply. It appears it can only apply where the insurer has further underwriting decisions to make. The underwriter can be faced with a new decision if the assured wishes to alter the policy to change the scope or duration of the policy. If such a situation arises it is the equivalent of the underwriter making a new decision on whether or not to accept risk, and the duty of utmost good faith once again applies. In a situation where the assured is looking to alter the policy, his duty of disclosure and representation is limited to what would be material to the changes, not the entire policy.

Section 17 should be reduced to a pre-formation introduction to the duties of sections 18 and 20 in the Marine Insurance Act 1906. The ultimate sanction of avoidance should be reserved for the breach of fraud. It is time to fully recognize a post-formation principle that falls outside the scope of section 17 and takes on a different nature in different situations. Only in cases of fraud should it be applied with full severity. While there have been calls for reform on the law of marine insurance that may be unnecessary as far as post-formation good faith goes, the current Act should allow for the suggested interpretation.

1 Introduction

1.1 Background

The doctrine of utmost good faith in insurance contracts has been a part of English common law for almost 250 years. It was first identified by Lord Mansfield in *Carter v Boehm*¹. A governor in the East Indies had taken out an insurance on a fort, in the event that it would be captured by the enemy. The fort was captured by the French but the underwriter denied liability based on “non-disclosure” by the assured, who he claimed had known all along that there was an attack pending. Lord Mansfield held that withholding the information was deceiving the insurer, and that it could be so even if it was by mistake. He also said that this duty of “good faith” was mutual between the parties. This was, it is believed, the origin of the doctrine of utmost good faith in insurance law. The doctrine was included in the Marine Insurance Act 1906, an attempt by Sir Mackenzie Chalmers at codifying the law of marine insurance, and is still going strong over 100 years later. Fairly recently the issue arose of whether the duty of utmost good faith continues beyond the making of the contract. This is particularly interesting because the remedy for breach prescribed by the Act is avoidance of the entire policy.

1.2 Purpose

This thesis will deal with the insurance law doctrine of utmost good faith in the post-formation context. The purpose of the paper is first to investigate post-formation duty of good faith in general and identifying prospective areas where such a duty might manifest. The author will then aim to determine, in light of recent court decisions, what the post-formation duty of good faith is and in particular consider the notion of an overarching duty of

¹ (1766) 3 Burr 1905.

good faith contained in section 17 of the Marine Insurance Act 1906. The complications brought on by the “remedial straightjacket” in the Marine Insurance Act will be further analyzed. Finally suggestions will be made, such as how the principle should be applied, to what extent the Act should have a post-formation application and if there is a need for new legislation.

1.3 Method

When trying to get an overview of the duty of utmost good faith, certainly at the post-formation stage, it is easy to get the feeling that one is chasing something very elusive. Richard Aikens likened it to the Cheshire cat, saying “it never disappears entirely, but at certain times you can only see its smile”. In analyzing the doctrine the author starts with the Marine Insurance Act 1906 and a general presentation of the pre-formation duty, and then proceed to look at the important English decisions in all areas where post-formation utmost good faith has been either claimed or positively identified by the courts. English case law on this area is plentiful, but the post-formation issue really only rose to prominence with the controversial ruling in *The Litison Pride* in 1985. More recent cases include *The Star Sea* and *The Mercandian Continent*. There is not always an obvious order in which to address the various elements of the doctrine of good faith. To establish a reference the paper first presents the duty in the fairly clear pre-formation context. While there is also room for discussion here, this paper will focus on the post-formation doctrine and not go into depth on the former.²

1.4 Delimitation

While the doctrine theoretically applies to all insurance law, the paper is entirely limited to the marine insurance aspect. The focus of this thesis will be the post-contract aspect of utmost good faith. It is necessary to first discuss the pre-formation nature of the doctrine, but in that area only the

² For a critique of the current pre-formation law see Peter Macdonald Eggers, “Pre-contractual duty of utmost good faith – materiality and remedies”, Thomas p 49.

current law will be presented, with focus on the important *Pan Atlantic* case. While it is not questioned that the duty of utmost good faith, both in a pre- and post-contractual situation is reciprocal, applying equally to insurers and assured, this paper will deal primarily with the duties of the assured. Most cases are instances of the insurer wanting to escape cover by relying on a breach of the duty to get avoidance of the policy.

2 The doctrine of utmost good faith

A contract of marine insurance, like other contracts, is a result of the will of the parties. However, an insurance law doctrine tempers the negotiation freedom for an insurance policy, that of utmost good faith. Marine insurance contracts are *uberrimae fidei*. The duty, independent from the insurance contract itself³, is enshrined in section 17 of the Marine Insurance Act 1906: “A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.”

The principle is traced back to Lord Mansfield in *Carter v Boehm*⁴ where he said that pre-formation non-disclosure was fraud. In *Bell v Lever Bros Ltd*⁵ Lord Atkin noted that the duty could not be a result of the contract since it arises before the contract is formed. If an obligation exists before the formation of the contract, it cannot be said to arise from the contract itself. It was again submitted in *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd*⁶ that the duty of utmost good faith is based on an implied term in the contract, but that was rejected by the Court of Appeal and the House of Lords⁷. There is argument to be made for the implied term theory⁸, but it is currently not supported by the courts. The duty exists independent of the contract. The Marine Insurance Act is considered to apply to all forms of insurance by analogy.⁹

The duty of utmost good faith is mutual, that is to say that it applies both to the insurers and the assured, but the majority of cases are

³ Chuah page 412.

⁴ *Carter v Boehm* (1766) 3 Burr 1905.

⁵ [1932] A.C. 161.

⁶ [1990] 1 Q.B. 665.

⁷ [1991] A.C. 249.

⁸ Andre Naidoo, “The confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?” [2005] J.B.L. MAY 351.

⁹ *Joel v Law Union & Crown Insurance Co* [1908] 2 K.B. 863; *Lambert v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485; *Pan Atlantic Insurance Corp v Pine Top Insurance Corp* [1995] 1 A.C. 501.

instances of the insurer wanting to rely on the doctrine to avoid paying cover. It was considered in the Australian case of *CGU Insurance v AMP Financial Planning*¹⁰, where the assured claimed that the insurers were in breach of good faith because they had not made a timely decision on whether or not to agree to extended cover. There are no English decisions where an insurer has been held in breach of utmost good faith. As the remedy for a breach is avoidance, it would only become relevant if an assured wishes to avoid the policy completely.

The remedy prescribed for by the Marine Insurance Act is avoidance of the policy. The reasoning behind this is that if one party has acted in breach of good faith the consent that the contract should be based upon is consumed.¹¹ The remedy will be addressed in depth below, but first the nature of utmost good faith in a marine insurance context must be investigated.

2.1 Non-disclosure and misrepresentation

While section 17 of the Act acknowledges a mutual duty of good faith, the remaining sections deal exclusively with the duties of the assured towards the insurer. The duties placed on the assured by sections 18 and 20 are those of disclosure and representation. Section 18(1) states: “the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured...” Section 20(1) states: “Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true.” Thus, if insufficient information is given by the assured to the insurer, that is non-disclosure, and where information is given, but it is incorrect, that constitutes misrepresentation. They are both breaches of the duty of utmost good faith.

The assured is deemed to know, as per 18(1) “every circumstance which, in the ordinary course of business, ought to be known

¹⁰ [2007] H.C.A. 36.

¹¹ Chuah p 413.

by him”. However, it would of course be unreasonable and impractical if the assured were obliged to disclose all and any information that he might possess or come across. This notion, that of materiality, predates the Marine Insurance Act. In *Ionides and Another v Pender*¹² Blackburn J acknowledged the practical aspect of disclosure, saying: “We agree that it would be too much to put on the assured the duty of disclosing everything which might influence the mind of an underwriter. Business could hardly be carried on if this was required.”¹³ Materiality as a concept was also referenced in *Tate and Sons v Hyslop*¹⁴, where Bowen LJ stated: "The materiality of the fact depends upon whether or no [sic] a prudent underwriter would take the fact into consideration in estimating the premium, or in underwriting the policy."

Materiality is recognized by the 1906 Act and applied to both disclosure and representation duties by sections 18 and 20. According to section 18(2) “Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk”. A similar duty applies to misrepresentations, as per section 20(2): “A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.” Section 18(5) states that the term circumstance “includes any communication made to, or information received by, the assured”. 18(4) and 20(7) provide that whether or not a circumstance or a representation are considered material is a matter of fact.

It is clear from the wording in the Act that there is a test of materiality to decide whether a circumstance must be disclosed under the duty of utmost good faith, but what exactly is meant by sections 18(2) and 20(2)?

¹² (1874) LR 9 QB 531

¹³ *Ibid*, 539.

¹⁴ (1885) 15 QBD 368, CA

2.2 Materiality and inducement

The meaning of the wording “influence the judgment of a prudent insurer” was interpreted in *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda)*¹⁵. The facts were that a container leasing company had failed to disclose that they had previously been declined insurance as a result of an inaccurate claims record. The insurers sought to rely on this to avoid the policy. Should the information have been disclosed? The question was not whether the test should use a hypothetical “prudent insurer”. Instead, the issue was whether influence, resulting from non-disclosure or misrepresentation, on the hypothetical prudent insurer has to be *decisive* for it to be a breach of good faith. Lloyd J interpreted section 18(2) as follows. The wording in section 18(2) could mean that a circumstance will be material if a prudent underwriter would wish to have known it because it might have led him to either decline risk or charge a higher premium. Alternatively, it could instead mean that a circumstance will be material only if it would actually have led him to act that way. There is a clear difference here in that the second approach requires a real influence, and that was the approach favoured by the judge. This was, however, reversed in the Court of Appeal. There the judges held that the test of materiality must be taken to refer to whether a circumstance would have had any impact on the risk-taking decision of the insurer. Kerr L.J. said: “The point at issue turns mainly on the meaning of ‘judgement’ in the phrase ‘would influence the judgement of a prudent insurer in fixing the premium or determining whether he will take the risk’. [The trial judge] in effect equates ‘judgement’ with ‘final decision’, as though the wording of these provisions had been ‘would induce a prudent underwriter to fix a different premium or to decline the risk’.”¹⁶ The judge, who consulted the Oxford English Dictionary to prove his point, clearly made a difference between influence and *decisive* influence. Kerr L.J. further confirmed that the prudent underwriter refers to a hypothetical insurer, not the actual insurer in

¹⁵ [1984] 1 Lloyd’s Rep. 476, CA; [1982] 2 Lloyd’s Rep. 178

¹⁶ [1984] 1 Lloyd’s Rep. 491, CA

a particular case. In the previous case of *Berger & Light Diffusers Ltd v Pollock*¹⁷ focus had been, arguably incorrectly, mostly on the actual insurer.

On whether the insurer has to prove that he was actually induced to offering cover on less favourable terms Parker LJ said: “The very choice of a prudent underwriter as the yardstick in my view indicates that the test intended was one which could sensibly be answered in relation to prudent underwriters in general. It is possible to say that prudent underwriters in general would consider a particular circumstance as bearing on the risk and exercising an influence on their judgment towards declining the risk or loading the premium. It is not possible to say, save in extreme cases, that prudent underwriters in general would have acted differently, because there is no absolute standard by which they would have acted in the first place or as to the precise weight they would give to the undisclosed circumstance.”¹⁸ The test of materiality put forward in *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda)* thus lacks a subjective element. The insurer would not need to prove that he was actually induced into offering cover on less favourable terms, only that a hypothetical prudent underwriter would have been influenced in his decision making.

The issue was revisited in *Pan Atlantic Insurance Co Ltd v Pine top Insurance Co Ltd*¹⁹. Pan Atlantic had reinsured their excess of loss with Pine Top. When Pan Atlantic sought a reduced premium, they failed to disclose important parts of their previous loss history, information that Pine Top for obvious reasons would have wanted to take part of. Based on this, Pine Top declined payment. The court found, in favour of the underwriters, that the non-disclosure was material. The majority agreed that “prudent insurer” is indeed a hypothetical insurer and that the “influence” spoken of in section 18(2) does not need to be decisive. Lord Goff stated: “First, it seems to me, as it does to Lord Mustill, that the words in s 18(2): ‘...would influence the judgement of a prudent insurer in...determining whether he will take the risk...’ denote no more than an effect on the mind of the insurer

¹⁷ [1973] 2 Lloyd’s Rep. 442.

¹⁸ [1984] 1 Lloyd’s Rep. 511, CA

¹⁹ [1995] 1 A.C. 501

in weighing up the risk. The sub-section does not require that the circumstance in question should have decisive influence on the judgement of the insurer; and I, for my part, can see no bases for reading this requirement into the sub-section."²⁰ Lord Mustill perhaps did the most to cogently discard the notion of decisive influence, by looking at the wording of the Marine Insurance Act: "The legislature might here have said 'decisively influence'; or 'conclusively influence'; or 'determine the decision'; or all sorts of similar expressions, in which case Pan Atlantic's argument would be right. But the legislature has not done this, and has instead left the word 'influence' unadorned. It therefore bears its ordinary meaning, which is not, as it seems to me, the one for which Pan Atlantic contends. 'Influence the mind' is not the same as 'change the mind'"²¹. With Pan Atlantic it became clear that the objective test of materiality, that of the prudent insurer, does not require decisive influence²². However, it should be noted that Lords Lloyd and Templeman did not agree, their reasons will be mentioned further down.

The majority disagreed with the ruling in the *Container* case on an important point - inducement. In addition to establishing the influence on a hypothetical prudent insurer, the underwriter must also prove that he was actually induced into accepting the contract based on the non-disclosure or misrepresentation. This introduced a subjective element in addition to the test of materiality, more on this further down.

To sum up this sub-chapter, the duty of disclosure and the duty to avoid misrepresentation²³ are subject to a test of materiality. It is only material information that must be disclosed and only material representations must be true. One can say either that there are two tests, or that there is one test with two parts – an objective and a subjective criteria. The most common approach is to refer to the objective factor as materiality and the subjective factor as inducement.

²⁰ [1995] 1 A.C. 501 at p 431

²¹ *Ibid* p 440

²² The by the majority discarded test was referred to as the "decisive influence test" by Lord Goff. Bennett refers to it as the "different decision test". See Bennet p 114.

²³ The latter is not as commonly relied on by insurers as the former.

2.2.1 The objective test

The objective element of materiality is based on the notion of a prudent insurer and what such an insurer would want to know. There must have been an effect on the mind of the hypothetical insurer as he considers if he is willing to take on risk and at what premium. As held in both *Container* and *Pan Atlantic* it does not require that the influence led to the ultimate decision. For this criteria to be fulfilled it is enough that a prudent underwriter would have had his thought process affected in some way by the non-disclosure or misrepresentation while weighing the risk.

While this was the view of the majority in *Pan Atlantic* it is interesting to note the view of the dissenters to better understand the issue. On the subject of the prudent insurer test Lord Lloyd said: “The purpose of the test ... was to establish an objective test of materiality, not dependent on the actual insurer's own subjective views. The test should therefore be clear and simple. A test which depends on what a prudent insurer would have done satisfies this requirement. But a test which depends, not on what a prudent insurer would have done, but on what he would have wanted to know, or taken into account, in deciding what to do, involves an unnecessary step. ... What the prudent insurer would have wanted to know is as nebulous and ill-defined as the alternative is precise and clear-cut”²⁴. The dissenting judge was of the opinion that the subjective test should not focus on what the prudent insurer would have wanted to know, but rather what he would have done. By saying so he took a stance the exact opposite of the majority.

The opinion of the prudent insurer is generally established by expert testimony.²⁵ On this topic Lord Templeton, the other voice of dissent in *Pan Atlantic* said: “If an expert says, ‘If I had known I would not have accepted the risk or I would have demanded a higher premium,’ his evidence can be evaluated against other insurances accepted by him and against other insurances accepted by other insurers. But if the expert says, ‘I

²⁴ [1995] 1 A.C. 501. at p 556.

²⁵ Bennett p 114.

would have wanted to know but the knowledge would not have made any difference' then there are no objective or rational grounds upon which this statement of belief can be tested. The law is already sufficiently tender to insurers who seek to avoid contracts for innocent non-disclosure and it is not unfair to require insurers to show that they have suffered as a result of non-disclosure."²⁶ Bennett says that the opposing view expressed by the dissenting Lords is not without merits and that the majority decision favors an assured who tries to calculate the bare minimum of what to disclose, at the expense of an assured who makes an honest mistake, moreover that rejection of the decisive influence test clearly favors underwriters.²⁷

What would affect the mind of the prudent insurer is strictly a matter of facts. In *Brotherton v Aseguradora Colseguros SA (No 3)*²⁸ the insurer had agreed to a professional indemnity insurance policy with a Colombian bank. In Colombia the bank's president had been receiving some bad press. The issue was whether the bank should have disclosed information about the media allegations. The assured, who denied any substance to the reports, argued that for the allegations to be material they would first have to be proven true. Both the High Court and the Court of Appeal held that even rumours and reports, as long as they were not merely speculations, were material facts that should be disclosed. The case also saw argued by the claimants that the remedy of avoidance was under the circumstances inequitable and should not be granted, referring to Colman J's reasoning in *The Grecia Express*²⁹. The Court of Appeal did not agree. Mance LJ held that "it would be an unsound step to introduce into English law a principle of law which would enable an insured either not to disclose intelligence which a prudent insurer would regard as material or subsequently to resist avoidance by insisting on a trial ... to investigate its correctness".³⁰

²⁶ [1995] 1 A.C. 501 at p 515

²⁷ Bennett p 114

²⁸ [2003] EWHC 1741, [2003] Lloyd's Rep IR 762

²⁹ [2002] EWHC 203.

³⁰ [2003] EWCA Civ 705 para 31.

In *The North Star*³¹ a similar instance of objective materiality relating to allegations against the assured was addressed by the court of appeal. She was a bulk carrier insured under a war risk policy, and was subsequently damaged by an underwater explosive device resulting in a constructive loss. The underwriters refused to pay based on civil and criminal proceedings for fraud against the owners, information which had not been disclosed prior to entering into the insurance contract. The owners argued that the proceedings had no relevance to the risk of the policy and thus they were not obligated to disclose them.

The court held that the mere fact that proceedings were underway at the time of the underwriters' decision was material information and should have been disclosed. It would no doubt have influenced the decision of the "prudent insurer". Waller LJ in his statement agreed that the law in this area is "capable of producing serious injustice", but that nevertheless it is a matter of fact whether information would influence the mind of the prudent insurer. LJ Longmore said in *The North Star* that "This case does, however, bring into sharp focus the problems of the present state of the law about non-disclosure", but that the law as set out in the Marine Insurance Act leaves the courts with only one alternative. Based on these two cases³², *Brotherton* and *The North Star*, it appears that accusations or allegations against the assured are, unless manifestly speculative, considered to be material circumstances that should be disclosed to the insurer. This is not changed even if the assured believes them to be false³³, or if they later turn out to be false.

2.2.2 The subjective test

The subjective element is the element of inducement. If misrepresentation or nondisclosure of a material fact did not actually induce the underwriter into

³¹ *North Star Shipping Ltd v Sphere Drake Insurance Plc* [2006] EWCA Civ 378

³² The same conclusion had also been reached in *March Cabaret Club & Casino Ltd v The London Assurance* [1975] 1 Lloyd's Rep. 169, and *The Dora* [1989] 1 Lloyd's Rep. 69

³³ Although that was the view of Forbes J in *Reynolds and Anderson v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep. 440, it was not supported the Court of Appeal in *The North Star*.

entering the contract, then he cannot rely on it for avoidance. There is no mention of “inducement” in the Marine Insurance Act 1906. Nevertheless, a causal link between misrepresentation and conclusion is an element of general law of contract.³⁴ In *Berger & Light Diffusers Ltd v Pollock*³⁵ it was the view of Kerr LJ that to render a policy voidable simply because objective materiality was present, even if there was no subjective inducement, would be “absurd”³⁶. This was, as seen above, overruled by the Court of Appeal in *Container*. The grounds for the overruling (on the part of actual inducement) were that such a subjective requirement is not contained in the Marine Insurance Act 1906. This was then reversed back by the court in *Pan Atlantic*. The House of Lords held that: “if the misrepresentation or non-disclosure of a material fact did not in fact induce the contract (in the sense in which that expression is used in the general law of misrepresentation) the underwriter is not entitled to rely on it as a ground for avoiding the contract”³⁷ While there is no reference to influence in section 20(1) it is a part of the general law of misrepresentation, and section 91(2) preserves common law rules unless inconsistent with express provisions in the Marine Insurance Act 1906. The court did not make a distinction between non-disclosure and misrepresentation in this regard.³⁸

Lord Mustill said that the test for inducement was the same as that in general contract law³⁹. It was not apparent at the time what exactly that entails. In *Edgington v Fitzmaurice*⁴⁰ the issue of whether an inducing factor relied upon needs to be the sole inducing factor, or if it is enough that it merely contributes to the final decision arose. The court held that it was enough for a misrepresentation to be “actively present to [the person receiving the misrepresentation’s] mind when he decided to advance his money”⁴¹. That same reasoning also applies to cases of a breach of the duty

³⁴ Bennett p 116

³⁵ [1973] 2 Lloyd’s Rep 442.

³⁶ *Ibid* 563.

³⁷ [1995] 1 AC 501 at p 453.

³⁸ Bennett p 117.

³⁹ [1995] 1 AC 550

⁴⁰ (1885) 29 ChD 459

⁴¹ *Ibid* 483.

of utmost good faith.⁴² The question remains, however, of just how decisive a factor needs to be to meet the requirement of being “inducing”. This is similar to the objective criteria discussed above, where the same questions were asked regarding the hypothetical prudent insurer. It is now the view of the courts that for the objective criteria to be fulfilled the information needed only to have been taken into account when the insurer weighing the risk.

The Privy Council held in *Barton v Armstrong*⁴³ that for the criteria of duress (thus not related to misrepresentation or non-disclosure) to be fulfilled it was enough if the threat was among the reasons present for entering into the contract. The court did not support the idea of comparing importance where there are many contributing causes present⁴⁴, and further said that that approach was appropriate for any situation where “the party has been subjected to an improper motive for action”. Despite this suggestion by the Privy Council it may not be appropriate in cases where an insurer is arguing non-disclosure or misrepresentation. Another non-marine case on causality between misrepresentation and entering into a contract was *JEB Fasteners Ltd v Marks, Bloom & Co*⁴⁵, where a company had acquired another company based on misrepresented account figures, and sued the auditors for damages. Donaldson LJ said that “[some factors] may be subsidiary factors which support or encourage the taking of the decision. If these latter assumptions are falsified in the event, whether individually or collectively, this will be a cause for disappointment to the decision-taker, but will not affect the essential validity of his decision in the sense that if the truth had been known or suspected before the decision was taken, the same decision would still have been made.”⁴⁶ Another judge, Stephenson LJ said that as for inducement the misrepresentation should play a “real and substantial part, though not by itself a decisive part”⁴⁷. In the *JEB Fasteners*

⁴² Bennett p 117, see also *Assicurazioni Generali SpA v Arab Insurance Group (BSC)* [2002] EWCA Civ 1642, [2003] 1 WLR 755, p 59,62.

⁴³ [1976] AC 104

⁴⁴ *Ibid* 118

⁴⁵ [1983] 1 All ER 583.

⁴⁶ *Ibid* 588.

⁴⁷ *Ibid* 589.

case there were thus two different approaches to an “influence test”⁴⁸, the influence can either be decisive, or merely substantial. In *Avon Insurance plc v Swire Fraser Ltd* Rix J made a “distinction between a factor which is observed or considered by a [claimant], or even supports or encourages his decision, and a factor which is sufficiently important to be called a real and substantial part of what induced him to enter a transaction”⁴⁹ In *Assicurazioni Generali SpA v Arab Insurance Group (BSC)*⁵⁰ the Court of Appeal favored a “different decision” test⁵¹. “In order to prove inducement the insurer ... must show that the non-disclosure or misrepresentation was an effective cause of his entering into the contract on the terms on which he did. He must therefore show at least that, but for the relevant non-disclosure or misrepresentation, he would not have entered into the contract on those terms”⁵². In *Brotherton v Aseguradora Colseguros SA (No 2)*⁵³ this was affirmed by Mance LJ, who said that there was a requirement for the insurer to have acted “differently, either by refusing to write the risk at all or by writing it only on different terms”. This wording is similar to that of Lord Mustill in *Pan Atlantic*⁵⁴. We already know, as per *Pan Atlantic*, that in the context of objective materiality influence does not need to be decisive for an insurer to successfully rely upon non-disclosure or misrepresentation. It is interesting to note that while the view of the courts is currently the opposite for subjective inducement (they favor a different decision test)⁵⁵, the same critique that was successfully voiced against a decisive influence test for objective materiality was also put forward (but rejected) in the context of subjective inducement.⁵⁶

⁴⁸ Bennett 119

⁴⁹ [2000] Lloyd’s Rep IR 535, para 18.

⁵⁰ [2002] EWCA Civ 1642 [2003] Lloyd’s Rep IR 131

⁵¹ Bennett p 119.

⁵² *Supra* para 59, 62. See also para 187.

⁵³ [2003] EWCA Civ 705, [2003] Lloyd’s Rep IR 746.

⁵⁴ [1995] 1 AC 501, 549, 551.

⁵⁵ The decisive influence test on subjective inducement is also supported by *Industrial Properties (Barton Hill) Ltd v Associated Electrical Industries* [1977] QB 580; *Horry v Tate & Lyle Refineries Ltd* [1982] 2 Lloyd’s Rep 416; *The Lucy* [1983] 1 Lloyd’s Rep 188; *St Paul Fire & Marine Insurance Co (UK) Ltd v McDonnell Dowell Constructors Ltd* [1995] 2 Lloyd’s Rep 116.

⁵⁶ See Ward LJ in *Assicurazioni Generali SpA v Arab Insurance Group (BSC)* [2002] EWCA Civ 1642, [2003] Lloyd’s Rep IR 131, para 218.

Who is to prove inducement? There has previously been a notion of a common law presumption of inducement that found support in *St Paul Fire v McConnell Dowell*⁵⁷, which was decided before *Pan Atlantic* had been concluded. However, in the *Pan Atlantic* it was held that inducement must be proven by the insurer for the subjective test to be fulfilled. This is contradicted by the *St Paul Fire* case where the Court of Appeal held that by proving objective materiality the insurer can rely on a presumption of inducement. The *Pan Atlantic* decision favours the assured because it placed the burden of proof on the insurers. *St Paul Fire* clearly favours the insurers as it employed a presumption of inducement. However, one might note that in *St Paul Fire* there were co-insurers present, and inducement had already been proven towards them. This possibly played a part in the presumption of inducement.⁵⁸ In *Pan Atlantic* Lord Mustill said that a presumption of inducement results in a heavier burden on the insured to show that the insurer was not induced into accepting the contract. The approach of a “presumption of inducement” leads to problem with evidence, as it is difficult for the assured to prove that an insurer was not induced. Bennett argues that the purpose of introducing the subjective requirement, that is to make the procedure less favourable to the by the *Container* case already overly favoured insurer, cannot be lived up to if the burden of proof is placed on the assured in such a heavy fashion.⁵⁹ If proven materiality means a presumption of inducement it would be very difficult for the assured to prove that the material circumstance did not lead the insurer to enter into the contract at certain terms. The presumption was in *Pan Atlantic* branded “heresy” by Lord Lloyd⁶⁰. Bennett writes that while it is natural that cogent evidence in favour of objective materiality will also work towards proving subjective inducement, as the actions of a prudent insurer and the actual insurer are bound to be similar, it does not by itself lead to a presumption of inducement.⁶¹

⁵⁷ [1996] All E.R. 96

⁵⁸ Chuah p 416.

⁵⁹ Bennet p 121.

⁶⁰ [1995] 1 AC 501, 570.

⁶¹ Bennett p 121. For additional authority that the burden of proving inducement is on the party claiming to be induced see *Arkwright v Newbold* (1881) 17 ChD 201, *March Rich &*

2.3 The extent of the duty of disclosure

The duty of disclosure is enshrined in section 18 of the Marine Insurance Act 1906.⁶² Sub-section 3 provides that some information does not need to be disclosed in the absence of inquiry by the insurer. This includes circumstances that would lower the risk or that are known or presumed to be known by the insurer. In addition to the circumstances that need not be disclosed according to section 18(3) of the Marine Insurance Act 1906, 18(3)(c) also provides that the assured doesn't need to disclose information that is waived by the insurer. It follows from public policy that fraudulent non-disclosure cannot be waived.⁶³ In *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*⁶⁴ the court said that it is possible to through contract exclude the liability resulting from fraudulent representation of an agent.⁶⁵ As for what must be disclosed, the Act only says "every material circumstance which is known to the assured". The material risk is divided into two categories, the physical hazard and the moral hazard.⁶⁶

The physical hazard is the risk related to the insured property, for example ship or cargo. Any such factors are material and must be disclosed (as well as not misrepresented). In *Liberian Insurance Agency Inc v Mosse*⁶⁷ the assured failed to disclose material facts related to insured cargo. The goods had not been properly marked and the risk of them being damaged was in fact much greater than what the markings would lead the insurer to believe. The non-disclosed facts were deemed material to the risk. In *Greenhill v Federal Insurance Co Ltd*⁶⁸ the assured not having disclosed to the insurer that some of the goods being transported were already

Co AG v Portman [1996] 1 Lloyd's Rep 430; *Moore Large & Co Ltd v Hermes Credit & Guarantee plc* [2003] EWHC 26 (Comm), [2003] 1 Lloyd's Rep 163; *Drake Insurance plc v Provident Insurance plc* [2003] EWCA Civ 1834, [2004] QB 601.

⁶² Pre-Act cases on disclosure of material risk: *Ionides v Pender* (1874) LR 9 QB 531; *Rivaz v Gerussi Bros & Co* (1880) 6 QBD 222.

⁶³ Bennett p 140.

⁶⁴ [2001] 1 All E.R. (Comm) 719

⁶⁵ Chuah p 418. See also *S Pearson & Son Ltd v Dublin Corporation* [1907] A.C. 351.

⁶⁶ Bennett p 127; Chuah p 418; Merkin p 25, 26. Bennett describes the division into moral and physical hazard as "useful shorthand", but not exhaustive.

⁶⁷ [1977] 2 Lloyd's Rep 560.

⁶⁸ [1927] 1 KB 65.

damaged was a breach of good faith. Previous losses and claims history can also constitute material facts that need to be disclosed. In *Noblebright Ltd v Sirius International Corporation*⁶⁹ it was held that included in material facts are previous attempted robberies. It is the circumstances of a loss rather than the value of it that determines if it is a material fact or not.⁷⁰ Hazards related to the voyage itself count as physical hazards if the insurer could not have found out about them himself or they were misrepresented by the assured.⁷¹

The moral hazard relates to the non-physical aspects of the risk, more precisely the human element. Most of the cases where this has been an issue have been relating to the history of the assured and his personal credibility. Both the *Container* case and *Pan Atlantic* were relating to moral hazard, specifically the assured's claims record. Personal facts are a part of the moral hazard if they present an increased risk of loss or likelihood of a false claim. Other examples of where moral hazard is likely to be argued is if the assured is in financial trouble or the target of criminal proceedings⁷². Circumstances relating to the master and crew of a ship could also be moral hazard.⁷³ In non-marine insurance it has been found material that the assured has previously been rejected by insurers⁷⁴, however in the marine case *Glasgow Assurance Corp Ltd v Symondson & Co*⁷⁵ it was held not material.

In *The Dora*⁷⁶ the assured applied for insurance of a vessel, but did not disclose that the crew of the vessel was being investigated for smuggling in Italy. The insurer was allowed to avoid the contract based on non-disclosure of material facts. In *Strive Shipping Corp v Hellenic Mutual War Risks Association (The Grecia Express)*⁷⁷ the assured's moral integrity became a target of the insurer. The insurer argued that it had not been

⁶⁹ [2007] Lloyd's Rep IR 584

⁷⁰ Merkin p 26. See also *Sharp v Sphere Drake Insurance Co Ltd* [1992] 2 Lloyd's Rep 501.

⁷¹ Ibid.

⁷² See Philip Clarke, "The Disclosure of Criminal Information To Insurers" [1984] LMCLQ 100.

⁷³ Bennett p 128.

⁷⁴ *Glicksman v Lancashire & General Assurance Co Ltd* [1927] AC 139

⁷⁵ (1911) 104 LT 254.

⁷⁶ *Inversiones Manria SA v Sphere Drake Insurance Co plc (The Dora)* [1989] 1 Lloyd's Rep 69.

⁷⁷ [2002] EWHC 203.

disclosed that the owner of the assured had fraudulently scuttled a (different) ship before applying for the policy. The assured defended himself by saying that there was no proof that the owner had been complicit in sinking the yacht. As the allegations against the owner were very serious, it would be a criminal offense if he had sunk the yacht; the court held that the standard of proof should be higher than in a civil proceeding. The insurer did not manage to meet that standard and thus the sinking of the ship was not subject to a duty of disclosure. In *Brotherton v Aseguradora Colseguros SA (No 3)*⁷⁸ claimant reinsurers argued non-disclosure of media reports relating to the moral integrity of the president of an insured bank. The defendants argued that the writings in the media were mere rumours and not material. This was dismissed by the court, saying that the media was “reporting ... what appeared to be a hard fact”⁷⁹. There is clearly a balance to be achieved between the insurers’ desire to know as much as possible and the assureds wish to not have his integrity questioned on loose grounds.

2.4 Constructive knowledge

The assured is not required to disclose what he cannot know, but he should disclose what he “ought to” know. Section 18(1) of the Marine Insurance Act 1906 provides that an insured is “deemed to know every circumstance which, in the ordinary course of business, ought to be known by him.”. This should in theory be true for all insurance, but in *Economides v Commercial Union Assurance Co. plc*⁸⁰ the court of appeal decided that this notion of constructive knowledge does not apply to private insurance taken outside the course of business. The wording does not mean that the insured has to investigate his own business, but if he does he must disclose any material circumstances found⁸¹.

Is the test of constructive knowledge objective or subjective?

In *London General Insurance Co. Ltd. v. General Marine Underwriters*

⁷⁸ [2003] EWHC 1741 (Comm), [2003] Lloyd’s Rep IR 762.

⁷⁹ *Ibid* para 34.

⁸⁰ [1998] Q.B. 587.

⁸¹ *Australia & New Zealand Bank Ltd. v. Colonial & Eagle Wharves Ltd.* [1960] 2 Lloyd’s Rep. 241, 252.

*Association*⁸² the court held that mistakes made due to high pressure of business in a particular insurer's office did not excuse the non-disclosure of information that ought to have been known by the insurer, but it might have if it had instead been a question of high pressure at the entire Lloyd's market.

Despite this, more recent cases have favored a subjective approach to constructive knowledge. In *Australia & New Zealand Bank Ltd. v. Colonial & Eagle Wharves Ltd*⁸³ McNair J held that the assured should be deemed to know what he could be expected to know in the course of his own business, not in comparison with a "reasonable insured". McNair J reasoned that "*[t]o hold otherwise would be tantamount to saying that underwriters only insure those who conduct their business prudently; whereas it is a commonplace that one of the purposes of insurance is to obtain cover against the consequences of negligence in the management of the assured's affairs*"⁸⁴. In *Simner v New India Assurance Co Ltd*⁸⁵ the court held that an assured was not obligated to enquire into matters outside his knowledge when complying with the duty of disclosure.

2.5 Remedies

The remedy for a breach of utmost good faith is found in the Marine Insurance Act 1906 as simply avoidance of the contract. Section 17 states that "if the utmost good faith be not observed by either party, the contract may be avoided by the other party." Sections 18(1) and 20(1) contain that if the assured fails his duties of disclosure and representation, respectively, "the insurer may avoid the contract". Avoidance entails that the insurer is retroactively freed of any liability under the contract and any benefits received by the assured are returned. The remedy is effective from the

⁸² [1921] 1 K.B. 104.

⁸³ [1960] 2 Lloyd's Rep. 241.

⁸⁴ *Ibid*, p 254.

⁸⁵ [1995] L.R.L.R. 240.

moment the insurer elects to avoid and is not dependent on any judicial process.⁸⁶

The remedy of avoidance has been called draconian⁸⁷, and is sometimes referred to simply as “the draconian remedy”⁸⁸. This is because of the severity of the remedy and the fact that it follows upon any and all breaches of good faith, even if it was merely a result of carelessness. The remedy is a switch; there is no sliding scale to take into account the gravity of a breach and an innocent mistake is punished just as hard as callous conniving. To this must be added that an insurer is only likely to argue a breach of the duty of utmost good faith after a claim has been filed by the assured, at which point it is already too late for the assured to make good on an oversight. The assured is likely to find himself in a situation where he must desperately seek to prove that non-disclosure or misrepresentation was not material to the risk, or lose all cover. The limited choice of remedies the courts face was commented on by Nicholls V-C in the Court of Appeal in the *Pan Atlantic*: “Justice and fairness would suggest that when the inadvertent non-disclosure came to light what was required was an adjustment in the premium or, perhaps, in the amount of the cover. Those are not options available under English law. The remedy is all or nothing. The contract of insurance is avoided altogether, or it stands in its entirety. This is not the only field in which English law still seems to adopt a fairly crude, all-or-nothing approach, when what is needed is a more sophisticated remedy more appropriate, and in that sense more proportionate, to the wrong suffered.”⁸⁹

The Misrepresentation Act 1967 does contain proportional remedies, but there are several problems attached to trying to apply it to insurance law. It arguably deals only with active misrepresentations and thus does not apply to passive non-disclosure.⁹⁰ Furthermore, the nature of rescission in the law of misrepresentation may not be the same as that of avoidance in insurance law, in which case the law on misrepresentation

⁸⁶ Bennett p 160.

⁸⁷ *Ibid* p 161.

⁸⁸ See for example *The Star Sea* para 109.

⁸⁹ [1993] 1 Lloyd’s Rep 506.

⁹⁰ *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665, 790.

would not apply at all.⁹¹ The insurer (or hypothetically the assured) can lose the right of avoidance as a result of a waiver, either through affirmation⁹² or equitable estoppels resulting from inaction⁹³.

A remedy of damages as an addition to avoidance was addressed in *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd*⁹⁴, where it was the insurer who was originally found to be in breach⁹⁵. In the first instance damages were awarded to the assured for breach of the duty of utmost good faith by the insurer. The court held that assured's right to disclosure would only be adequately protected by a damages remedy. The Court of Appeal agreed that the insurer had been in breach of the duty of utmost good faith, but not with the award of damages, which was reversed. According to the court the remedy of damages would only be available if the doctrine of utmost good faith gave rise to contractual or tortious obligations.⁹⁶ The court rejected that the duty of good faith was based on an implied term in the contract, which would have given rise to a claim in damages. The court drew support from the wording of the Marine Insurance Act 1906, which mentions only avoidance as a remedy. The view that the duty of utmost good faith is a contingent condition precedent arising not from an implied term in the contract, but rather as an incident to the contract, has since found support.⁹⁷

The court further rejected the notion that a breach of good faith is a tort. One reason for this was that the wording in the Act expressly provides for avoidance without mentioning damages. Another reason was that as the pre-formation duty of good faith does not differ between innocent mistakes and calculated actions to make the breach a tort would have undesired consequences. A party responsible for inadvertent non-disclosure

⁹¹ Bennett p 163.

⁹² *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corp of India* [1990] 1 Lloyd's Rep 391, 398.

⁹³ *Clough v London & North Western Railway Co* (1871) LR 7 Ex 26,35; *Allen v Robles* [1969] 1 WLR 1193, 1196; *Morrison v Universal Marine Insurance Co* (1873) LR 8 Ex 197; *Simon, Haynes, Barlas & Ireland v Beer* (1945) 78 LILrep 337, 369; *Liberian Insurance Agency Inc v Mosse* [1977] 2 Lloyd's Rep 560, 565.

⁹⁴ [1990] 1 QB 665.

⁹⁵ The House of Lords later overruled that part.

⁹⁶ *Ibid* 776, 780.

⁹⁷ *Agnew v Länsförsäkringsbolagens AB* [2001] 1 AC 223, 240, 246, 265-6.

could still be in breach of the duty of utmost good faith and could thus be sued even if there was no real loss involved. Slade LJ said that “it would not be right for this court by way of judicial legislation to create a new tort, effectively of absolute liability, which could expose either party to an insurance contract to a claim for substantial damages in the absence of any blameworthy conduct”⁹⁸. Similar words had been used by Lord Moulton in the much earlier case of *Heilbut, Symons & Co v Buckleton*⁹⁹ where, on the topic of innocent misrepresentation, he said that it was of “the greatest importance ... that this House should maintain in its full integrity the principle that a person is not liable in damages for an innocent misrepresentation, no matter in what way or under what form the attack is made.”¹⁰⁰

⁹⁸ [1990] 1 QB 781.

⁹⁹ [1913] AC 30.

¹⁰⁰ *Ibid* 51.

3 Post-formation duty of utmost good faith

In *The Mercandian Continent* Mr Jonathan Hirst QC, counsel for the insurers, submitted that it is inappropriate and wrong to identify post-contract “good faith occasions”. He argued that the duty of utmost good faith is a general concept and applies in general terms throughout the contract, and that under this “over-arching principle of good faith” there are no occasions when the assured can act in bad faith without risking the remedy of avoidance. And while Lord Hobhouse agreed that the duty is a continuing one, what Mr Hirst wished the court would not do nevertheless appears to be the approach when it comes to discussing post-formation utmost good faith. Most of what has been written on a post-formation duty of good faith tends to approach the issue by first looking at situations where it might arise.¹⁰¹ Bennett used the expression “mapping” the doctrine of utmost good faith¹⁰², and that appears to be just what one has to do. The doctrine stems from common law so the best way to approach it must be to investigate English cases where references have been made to post-formation utmost good faith.

Before diving into case law a brief refresher on the Marine Insurance Act 1906 is warranted, as it is an attempt at codifying the law, and any post-Act ruling on utmost good faith will have it as starting point. Section 17 of the Marine Insurance Act 1906 states that “A contract of marine insurance is a contract based upon the utmost good faith and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party”. This is the only statutory recognition that the duty of good faith goes both ways. It has been suggested that the wording “based upon” could be taken to mean that it refers to the consent of the

¹⁰¹ See for example *The Star Sea*. See also David Foxton, “The post-contractual duties of good faith in marine insurance policies: the search for elusive principles” in Thomas p 71.

¹⁰² Howard Bennett, “Mapping the doctrine of utmost good faith in insurance contract law” [1999] LCMLQ 165.

contract, and does not include a continuing duty.¹⁰³ When discussing the wording of the act it is also interesting to note that in a previous draft of the text by Sir Mackenzie Chalmers it was explicitly stated that “even in litigation both parties must play with their cards on the table”¹⁰⁴. This was a reference to the ship’s papers cases which will be discussed further down.

In contrast sections 18 and 20 both contain “before the contract is concluded “ and are thus clearly limited to the pre-formation process. The purpose of these sections is to make sure the assured discloses information that is crucial to the insurer in making his underwriting decision. Once that decision is made sections 18 and 20 no longer apply. The duty of utmost good faith described in section 17 has no such obvious limitations in wording. Does it have a post-formation application, or is there perhaps a portion of the doctrine of utmost good faith that exists outside of the Act? Some important cases on post-formation good faith need an even closer look before individual areas can be discerned.

Longmore LJ described the *The Litsion Pride* as the “high point” of applying a post-formation doctrine of utmost good faith.¹⁰⁵ The vessel was insured under a war risk policy with an option for extended cover at added premium. The policy contained that voyages to certain especially dangerous areas would allow the insurer to exact a higher premium. The vessel was en route to a port in the Persian Gulf, which during the Gulf War was considered a war risk zone. It came under fire from Iraqi forces and sank after being hit by a missile. No notification had been given to the insurers of the dangerous voyage, but under the policy absence of prior advice would not affect cover if the information was provided as soon as practicable. After the loss the assured manufactured a letter that made it seem like failure to give notice was an innocent oversight. The insurer denied liability saying that notification had not been given and that the assured were fraudulent in that they had never had any intention to pay the additional war zone premium. Hirst J held that the assured were in breach of their duty of utmost good faith and that the falsely dated letter was fraud.

¹⁰³ Foxtton p 72.

¹⁰⁴ *Ibid.*

¹⁰⁵ *The Mercandian Continent* para 9.

The case is notorious for Hirst J extending the duty of good faith at the claims stage to “culpable misrepresentation or non-disclosure”¹⁰⁶.

In *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)*¹⁰⁷ the question of a post-formation duty of utmost good faith reached the House of Lords. The owner of *The Star Sea* also owned two other vessels, who had both been damaged by fire. The damage was a result of inadequate fire fighting systems operated by the beneficial owners. *The Star Sea* was then herself damaged by fire, a result of the same deficient system. The ship was a total constructive loss. When the assured sued for the loss the underwriters wanted to limit their liability under section 39(5) of the Marine Insurance Act, alleging that the vessel had been sent to sea in an unseaworthy condition with the privity of the assured. After the trial had begun the underwriters amended their plea saying that they were entitled to avoid the policy in its entirety on grounds of a breach by the assured of the duty of utmost good faith in section 17 of the Act. They based this on the assured failing to disclose the facts concerning the earlier fires at the time the underwriters were investigating the *Star Sea* claim. It was argued by the insurers that both parties were still bound by the duty of utmost good faith even after proceedings had started. The first instance judge found that there was no breach of duty by the respondent but that the vessel was sent to sea in an unseaworthy state, so he awarded the assured a lower amount for a partial loss. Both parties appealed. The insurers appealed against the court’s refusal to find a breach of section 17 duty and the assured cross-appealed against the decision on unseaworthiness.

In the first instance Tuckey J had reached the conclusion that section 17 no longer applies when court proceedings begin. He was of the view that when the parties proceed to litigation they take on a more adversarial relationship and the duty thus comes to an end with the rejection of the claim. While the Court of Appeal did not agree with this, it nevertheless agreed in rejecting the defendants’ plea. It was held that the nature of the section 17 duty at the claim stage and beyond was merely that

¹⁰⁶ *Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd’s Rep 437 at p 512.

¹⁰⁷ [2001] 2 W.L.R. 170.

no claims should be made or persisted in fraudulently. “When the assured makes his claim, the duty of utmost good faith requires that it should not be made fraudulently; and we are prepared to contemplate that the duty not to present a fraudulent claim subsumes a duty not to prosecute a claim fraudulently in litigation. There is no need to demand more of the assured than that, if the Draconian remedy is to apply.”¹⁰⁸ The Court of Appeal in *The Star Sea* limited the post-formation duty. They found that there is such a thing as post-formation duty of utmost good faith, but the nature of it is that a claim should not be made fraudulently or fraudulently pursued in litigation. The court did not support extending the duty so as to encompass claims made “culpably”. The Court of Appeal affirmed the unreported case of *Royal Boskalis v Mountain* and overruled the notion of extension to culpability made in *The Litsion Pride*.

The underwriters appealed and the House of Lords had to settle the issue of whether the section 17 duty extends beyond the making of the claim and the prosecuting of the claim, as well as determine what the nature of the duty is at post-claim stage. The appeal was struck down. Several cases were cited to support that section 17 has a post-formation application, but that the nature of it is different from pre-formation.¹⁰⁹ Lord Hobhouse said in his speech: “These authorities show that there is a clear distinction to be made between the pre-contract duty of disclosure and any duty of disclosure which may exist after the contract has been made. It is not right to reason, as the defendants submitted that your Lordships should, from the existence of an extensive duty pre-contract positively to disclose all material facts to the conclusion that post-contract there is a similarly extensive obligation to disclose all facts which the insurer has an interest in knowing and which might affect his conduct.”¹¹⁰

¹⁰⁸ [1997] 1 Lloyd’s Rep 371.

¹⁰⁹ Among others *Cory v Patton* (1872) 7 QB 304; *Niger Co Ltd v The Guardian Assurance Co Ltd* (1922) Ll. Rep. 75; *Britton v Royal Insurance Co* (1866) 4 F.&F. 905; *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd’s Rep. I.R. 209.

¹¹⁰ [2001] 2 W.L.R. para 57.

3.1 Potential areas of post-contract good faith

It appears that the doctrine of utmost good faith continues to play a role after the conclusion of a marine insurance contract, but the exact nature of this duty is not immediately clear. It must once again be stated that the doctrine of utmost good faith arises from common law and was not created with the Marine Insurance Act 1906. The Act was merely meant to codify existing law. This has led to confusion when discussing the notion of a continued duty of good faith that extends past the point of formation of the insurance contract, as it is not obvious whether parts of it exist outside of the Act. The Ship's Papers cases predate the act and are the first instance of the notion that the good faith later expressed in s 17 apply post contract. When "mapping", to use Bennett's expression, the doctrine of post-contract utmost good faith some separate topics can be identified.

3.1.1 A continuing duty of general disclosure?

Does the duty of general disclosure, in any form, continue past the conclusion of the contract? In *Niger Co Ltd v Guardian Assurance Co Ltd*¹¹¹ the House of Lords held that the assured was not under a duty to post-contract disclose facts that if the insurer had gotten a hold of he might have used to exercise a right to terminate the contract. On this Lord Sumner, in an often quoted statement, said: "The object of disclosure being to inform the underwriter's mind on matters immediately under his consideration, with reference to the taking or refusing of a risk then offered to him, I think it would be going beyond the principle to say that each and every change in an insurance contract creates an occasion on which a general disclosure becomes obligatory, merely because the altered contract is not the unaltered contract, and therefore the alteration is a transaction as the result of which a

¹¹¹ (1922) 13 L.I.L.R. 75

new contract of insurance comes into existence. This would turn what is an indispensable shield for the underwriter into an engine of oppression against the assured”.

The decision in *Niger* was affirmed by the Court of Appeal in *New Hampshire Co V MGN Ltd*¹¹² where the underwriters argued that as the policy had continuing cover subject to the insurers’ right to cancel there was also a continued obligation of disclosure on part of the assured. This obligation would extend to the facts that would be relevant to the insurer exercising his right to cancel. This was rejected both in first instance and by the Court of Appeal. Drawing authority from *Niger* and the pre-Act case of *Corey v Patton*¹¹³ the House of Lords in *The Star Sea* supported the view that for the assured to not disclose facts which might lead the insurer to terminate the policy does not constitute a breach of utmost good faith as expressed in section 17. If the insurer is entering into a long-term insurance contract with the assured and for the purpose of exercising some kind of right to termination wishes to have access to information then that can be included in the contract.¹¹⁴ It is clear that the duty of disclosure present in a pre-formation context does not extend, at least not in the same way, to post-formation.¹¹⁵

3.1.2 A continuing duty to not be culpable?

In *The Litsion Pride*¹¹⁶ Hirst J said: “... in contrast to the pre-contract situation, the precise ambit of the duty in the claims context has not been developed by authorities, indeed no case had been cited to me where it has been considered outside the fraud context in relation to claims. It must be right, I think ... to go so far as to hold that the duty in the claims sphere extends to culpable misrepresentation or non-disclosure”. The facts of the case had been that a vessel was insured against war risks under a policy that

¹¹² [1997] LRLR 24, 60-1.

¹¹³ (1872) 7 QB 304

¹¹⁴ This sentiment was also expressed by Bankes LJ in the *Niger* case at the appeal level. See (1921) 6 L.I.L.R 239.

¹¹⁵ See also Bennett p 175.

¹¹⁶ [1985] 1 Lloyd’s Rep 437.

certain dangerous destinations allowed the insurers to opt for additional premium. The vessel sailed towards such a dangerous port in the Persian Gulf, without notifying the insurers. It subsequently came under attack and sank. The owners then presented a fraudulent claim that included forging a letter of notice.

The Court of Appeal in *The Star Sea*¹¹⁷ did not agree that Hirst J's comment should be taken as a statement of principle. In judgement, delivered by Leggatt LJ the court said: "We agree with that analysis, and we come unhesitatingly to the conclusion in the present case that no enlargement of the duty not to make fraudulent claims, so as to encompass claims made 'culpably', is warranted. Such statements as were made in *The Litsion Pride* to the contrary, were wrong. In our judgment there is no warrant for any widening of the duty so as to embrace 'culpable' non-disclosure."¹¹⁸ The House of Lords agreed: "[Hirst J's statement] should not any longer be treated as a sound statement of the law. In so far as it decouples the obligation of good faith both from s.17 and the remedy of avoidance and from the contractual principles which would apply to a breach of contract it is clearly unsound ... In so far as it is based upon the principle of the irrecoverability of fraudulent claims, the decision is questionable upon the facts since the actual claim made was a valid claim for a loss which had occurred and had been caused by a peril insured against when the vessel was covered by a held covered clause"¹¹⁹.

The House of Lords in *The Star Sea* further drew some authority from *The Michael*¹²⁰, a case which had marked the beginning of the more thorough debate on post-formation good faith. In the case the assured has made a claim, but later found out that the vessel was lost by scuttling, and not as he had originally thought by perils of the sea. He did not tell the insurers of this new information. The insurers wanted to have the policy avoided based on non-disclosure. The court however did not find that the claim had been dishonestly maintained. Roskill LJ said that "[the

¹¹⁷ [1997] C.L.C. 481.

¹¹⁸ *Ibid* 496.

¹¹⁹ [2001] 2 W.L.R. 170 para 71.

¹²⁰ [1979] 2 Lloyd's Rep 1.

assured] are not to be found guilty of fraud merely because, with the wisdom of hindsight, they had information which might, if appreciated at its true value, have led them to the truth at an earlier date. A plaintiff in litigation is not maintaining a fraudulent claim merely because during interlocutory proceedings he or his solicitors become aware of evidence which may militate against the correctness of the plaintiff's case and its likelihood of ultimate success. The relevant test must be honest belief.”¹²¹

Furthermore, the test of materiality must not be forgotten. In *The Mercandian Continent*¹²² the assured had forged a document, which it later turned out was of no relevance to the claim. Both the first instance and the Court of Appeal held that the insurer could therefore not avoid the contract. The court was of the view that requirements of materiality and inducement must also apply in a post-formation context. In *Agapitos v Agnew*¹²³ the Court of Appeal was of the same view but added that it would be difficult to require proof of subjective inducement. If the assured makes false statements to improve a claim it must be material to the claim and capable of improving the claim for it to be a reason by which the claim can be defeated. Determining whether a false statement improves a claim's likelihood of success can of course be difficult.¹²⁴

3.1.3 Varitation

Perhaps the most obvious place to look for a post-formation duty of utmost good faith is situations where there is a new underwriting decision to be made by the insurer. It could be that the assured wants to vary the policy, either by changing the scope or the cover, and then the underwriter will be making a risk weighing similar to when he first entered into the contract. In such a situation, the doctrine of good faith should apply analogous to the pre-formation duties. In *Iron Trades Mutual Insurance Co Ltd v Comaphnia de Seguros Imperio*¹²⁵ Hobhouse J stated: “Where there is an addition to a

¹²¹ *Ibid.*

¹²² [2001] EWCA Civ 1275.

¹²³ [2002] EWCA Civ 247.

¹²⁴ Chuah p 432.

¹²⁵ [1991] 1 Re LR 213.

contract, as where it is varied, there can be a further duty of disclosure but only to the extent that it is material to the variation being proposed. If the addition does not alter the contractual rights there will be no fact that is material to disclose and the same will apply if a variation is favourable to the insurer. It will only be when the insurer is being asked to take on some additional risk and/or needing to reassess the premium or terms of cover that disclosure of further facts could be material and, even then, the facts to be disclosed are only those which are material to what the insurer is being asked to do”¹²⁶. It is clear that when a variation is made to the policy, only facts relevant to that variation are material and must be disclosed. Extending the materiality further would give the insurer an unreasonably increased possibility to avoid the policy.¹²⁷

The only remedy the Marine Insurance Act 1906 allows for when there is a breach of the duty of utmost good faith is avoidance of the contract. This once again poses a problem when it comes to variation of the policy. In the third volume of Arnould the editors wrote that “It is open to question whether the right of avoidance arising from material misrepresentation or non-disclosure at the stage of negotiation of an amendment or a variation to the policy is or indeed can be restricted to the avoidance of the relevant amendment, even in those cases where severance is possible, in the light of the decisions on section 17 of the 1906 Act.”¹²⁸ Despite this, there is wide support for the idea that in a variation scenario post-formation duties of good faith apply only to the variation. In *Roadworks (1952) Ltd v J R Charman*¹²⁹ a slip was amended to remove a condition and then brokered to the following market without being accurately presented. The court held that the following market could avoid the second slip. The insurers argued that the policy had been entered based on the second slip and that any rights under the first slip were lost by breach

¹²⁶ *Ibid* 224.

¹²⁷ See also *Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1997] 1 Lloyd’s Rep 360, 370; *K/S Merc-Scandia XXXXII v Certain Lloyd’s Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275, [2001] 2 Lloyd’s Rep 563, para 22; *Agapitos Laiki Bank (Hellas) SA v Agnew (No 2)* [2002] EWHC 1558 (Comm), [2003] Lloyd’s Rep IR 54, para 72.

¹²⁸ Arnould’s Law of Marine Insurance and Average, Vol. III (1997) para 621.

¹²⁹ [1994] 2 Lloyd’s Rep 99.

of good faith. The insurers sought to rely on *The Litsion Pride*. The judge disagreed and held that the insurers could not avoid the entire policy, just the alteration. There is a clear rationale for this, as otherwise the insurer would be able to avoid risk that he has already agreed to without having been deceived.

It has been held that the “list” of available remedies in the Marine Insurance Act is exhaustive.¹³⁰ A problem thus arises, if the only remedy for breach of good faith in the areas concerning the variation is avoidance then the remedy appears to be unproportional. Can a proportional response to variation breach be created using the Marine Insurance Act? Bennett identifies three ways this can be done.¹³¹ The first would be to allow for a less literal approach to the wording in section 17. If “the contract” could be taken to mean either the contract as a whole, or when relevant only a severable part of it, then that part could be avoided in cases of variation to a policy. Such an interpretation could be said to clash with the rulings that have created the problem in the first place. If the courts are limited by the Act not mentioning any alternative remedies, why would they not be limited by the phrasing “the contract”? Some support was lent to it in *The Star Sea*: “In relation to amendment a duty of disclosure of facts material to the amendment will exist but the law is not, we think, clear as to whether the remedy is avoidance of the whole contract or merely the amendment. Since inducement of the actual underwriter is necessary, there seems much to be said for the point of view that avoidance of the amendment is all that should be permitted...”¹³².

The second way would be to treat a variation or extension of a policy as a new contract. This was supported by Longmore LJ in *The Mercandian Continent*¹³³ where he said “A duty of good faith arises when the assured (or indeed the insurer) seeks to vary the contractual risk. The right of avoidance only applies to the variation not to the original risk”,

¹³⁰ *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665.

¹³¹ Bennett p 177.

¹³² *The Star Sea* p 108.

¹³³ [2001] EWCA Civ 1275, [2001] 2 Lloyd’s Rep 563.

citing authority.¹³⁴ This would evade the problem of post-formation good faith by turning it into a pre-formation situation with the extension being avoidable without touching the prior contract. Bennett disagrees with this approach, saying that there is a “clear conceptual distinction” between terminating/recreating a contract and merely varying parts of it. In *O’Kane v Jones and others*¹³⁵ Longmore LJ said that “non-disclosure at [the point of variation] would give rise to a right to avoid only the variation, not the contract itself”¹³⁶. The third way, favoured by Bennett, would be to treat duties of utmost good faith in the post-formation context as falling outside the scope of section 17. It can be argued that the doctrine of utmost good faith does not in its entirety fit into section 17, so it would be possible to have this part of the doctrine be outside the scope of it.¹³⁷

Longmore LJ in *The Mercandian Continent* said “there is no authority for a proposition that a fraudulent misrepresentation leading to a variation will avoid the original contract as well as the variation”. Policy renewal in the true sense of the word, that is when a policy is renewed in its entirety after having expired, is sometimes mentioned as a potential area of post-formation duty of utmost good faith. This is dismissed by Bennett, as that is merely a case of establishing a new policy and falls under regular pre-formation duties.¹³⁸

3.1.4 Held covered clauses

A held covered clause is a provision that allows for the scope of a policy to be extended for additional premium if notice is given to the insurer.¹³⁹ There are two decisions on held covered clauses which are often referred to as being instances of post-formation good faith. In *Overseas Commodities Ltd v Style*¹⁴⁰ a held covered clause allowed for the assured to keep cover even if

¹³⁴ *Lishman v Northern Maritime Insurance Co* (1875) L.R. 10 C.P. 179; *Iron Trades Mutual v Cie de Seguros* [1991] 1 Re. L.R. 213, as well as *The Star Sea*.

¹³⁵ [2003] All ER (D) 510.

¹³⁶ *Ibid* para 229.

¹³⁷ Bennett p 177.

¹³⁸ Bennett p 178.

¹³⁹ See for example Bennett p 556.

¹⁴⁰ [1958] 1 Lloyd’s Rep 546.

there were errors in marking the insured cargo. There were discrepancies in marking of the goods and the assured had obtained two letters from the manufacturer with different explanations as for why. The assured forwarded to the insurer the letter with the most beneficial explanation. The case was not settled on this issue but the judge held that in order to be allowed to rely on the held covered clause the assured had to act in utmost good faith: “to obtain the protection of the ‘held covered’ clause, the assured must act with the utmost good faith towards the underwriters, this being an obligation which rests upon them throughout the currency of the policy”. Not having forwarded both the letters, including the one with the less favourable explanation, prevented the assured from relying on the clause. In *Liberian Insurance Agency v Mosse*¹⁴¹ the assured sued a firm of brokers and the brokers wanted to recover from the underwriters. They based this on the underwriters being liable to the assured and invoked a held covered clause to counter the insurers rejection of the claim. Just like in the case cited above the held covered clause was concerning misdescription of cargo. The court held that “the assured cannot take advantage of the clause if he has not acted in the utmost good faith”. The assured not having disclosed the nature of the cargo prevented the brokers from relying on the clause.

It was only with *The Michael* and *The Litsion Pride* that post-formation duty of utmost good faith became the target of academic discussion, and the two held covered cases predate them. In *The Mercandian Continent* Longmore LJ said about the cases that “to the extent that they are only an exercise by the insured of rights which he has under the original contract they are somewhat puzzling”¹⁴². He added: “although it is settled that good faith must be observed, it is never suggested that lack of good faith in relation to a matter held covered by the policy avoids the whole contract of insurance.”¹⁴³ In neither of the held covered cases were the assured found to be fraudulent, but in post-formation context lack of

¹⁴¹ [1977] 2 Lloyd’s Rep 560.

¹⁴² *The Mercandian Continent* para 22.

¹⁴³ *Ibid.*

good faith requires fraud.¹⁴⁴ The held covered clauses appear to be treated as pre-formation good faith.¹⁴⁵

It then seems from the held covered cases that non-fraudulent conduct can result in the loss of all cover through avoidance. This is strange considering that the very purpose of the held covered clauses in the two cases (which were both about misdescription of goods) was to excuse non-fraudulent mistakes. Should held covered clauses be treated as pre-formation good faith? There was no element of inducement in the *Overseas Commodities* and *Liberian Insurance* cases. Bennett says that in the context of these held covered clauses this should be remedied by having the application of good faith be limited to “circumstances ... that induce the actual insurer into agreeing to that alteration”¹⁴⁶ In the held covered cases there was no remedy of avoidance, the assured were simply not allowed to rely on the clauses because of breach of good faith. This suggests that the good faith is not section 17 good faith, and that it is outside the Marine Insurance Act 1906. In *The Mercandian Continent* Longmore LJ said “it is never suggested that lack of good faith in relation to a matter held covered by the policy avoids the whole contract of insurance”¹⁴⁷.

3.1.5 Fraudulent claims

That the assured has a duty not to make fraudulent claims has been the position of the courts for a long time. The law on fraudulent claims has been considered a part of the general duty of utmost good faith.¹⁴⁸ In *Goulstone v Royal Ins Co*¹⁴⁹ a fire insurance claim had allegedly been fraudulently exaggerated. Pollock CB addressed the jury, stating that if the claim was “wilfully false in any substantial respect” the claimant had “forfeited all benefit under the policy”. In another fire insurance case, *Britton v Royal Ins.*

¹⁴⁴ *The Star Sea* para 72.

¹⁴⁵ Foxton p 79. *The Mercandian Continent* p 22 and 31. Howard Bennett, “Mapping the doctrine of utmost good faith in insurance contract law” [1999] LCMLQ 165 at 204.

¹⁴⁶ *Ibid* at 205.

¹⁴⁷ *The Mercandian Continent* para 22.

¹⁴⁸ *Orakpo v Barclays Insurance Services; Royal Boskalis Westminster NV v Mountain* [1997] LRLR 523; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd’s Rep IR 209.

¹⁴⁹ (1858) 1 F.&F. 276

*Co*¹⁵⁰, Willes J stated “The law is, that a person who has made such a fraudulent claim could not be permitted to recover at all. The contract of insurance is one of perfect good faith on both sides, and it is most important that such good faith should be maintained.” It is clear that an assured cannot be allowed to make any benefit if he makes a fraudulent claim. But should it be related to the doctrine of utmost good faith?

There are different ways to view a fraudulent insurance claim. It could be a breach of the post-contractual duty of utmost good faith resulting in the insurer being able to elect avoidance with the retroactive consequences that follow from the remedy, which had long been the view of the courts. However, the notion that fraudulent claims were a part of the overarching principle of post-contractual good faith was questioned in *The Star Sea*¹⁵¹. On fraudulent claims Lord Hobhouse said: “The law is that the insured who has made a fraudulent claim may not recover the claim which could have been honestly made ... This result is not dependent upon the inclusion in the contract of a term having that effect or the type of insurance; it is the consequence of a rule of law. Just as the law will not allow an insured to commit a crime and then use it as a basis for recovering an indemnity ... so it will not allow an insured who has made a fraudulent claim to recover. The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing”. Lord Hobhouse in a review of previous cases on fraudulent claims found that there was no reference to avoidance.¹⁵² On *Orakpo* he said that the use of the word avoidance “cannot be treated as fully authoritative in view of the contractual analysis there adopted”¹⁵³.

The de-coupling of fraudulent claims and the general principle of utmost good faith is supported by subsequent judgements. It was followed and supported by *Agapitos v Agnew* where Mance LJ said “In the present imperfect state of the law, fettered as it is by section 17, my tentative

¹⁵⁰ (1866) 4 F.&F. 905

¹⁵¹ *The Star Sea* para 42.

¹⁵² *Ibid.* para 66.

¹⁵³ *Ibid.*

view of an acceptable solution would be ... to treat the common law rules governing the making of a fraudulent claim (including the use of fraudulent devices) as falling outside section 17".¹⁵⁴ In *The Mercandian Continent* Longmore LJ did express some uncertainty, but recognized the possibility of a non-section 17 common law principle.¹⁵⁵ With these rulings it seems safe to say that fraudulent claims are no longer a part of the overarching section 17 duty, although the common law rule applied may rise from the same doctrine that led to section 17. As a result the courts are not limited in applying remedy. The only remedy provided for by the Marine Insurance Act 1906 is avoidance of the contract.

It is only in *The Star Sea* that the question of what kind of mind state is required to make a claim fraudulent has been thoroughly investigated. The Court of Appeal said that "the dishonesty must lie in the mind of an individual making the claim or in the mind of those for whom the company is vicariously liable". As a result even if false evidence was submitted that would not make the claim fraudulent unless the people submitting the claim were aware of the incorrectness of the evidence. The Court of Appeal further suggested that fraudulent behaviour on the part of representatives would not reflect upon the assured unless the client had given them full control of the claim.

The question remains, however, how to treat a claim that is made in good faith but lately turns out to be false or inaccurate. Can an originally honest claim become fraudulent by the assured realizing the inaccuracy? This was left open in *The Star Sea*. But in *Agapitos v Agnew* Mance LJ said: "[A]s a matter of principle, it would be strange if an insured who thought at the time of his initial claim that he had lost property in theft, but then discovered it in a drawer, could happily maintain both the genuine and the now knowingly false part of his claim, without risk of application of the rule." Based on this it seems that a claim can become fraudulent even if it was originally honest. If the assured makes a claim knowing that there is a

¹⁵⁴ [2002] EWCA Civ 247

¹⁵⁵ [2001] EWCA Civ 1275 para 11.

defence to it, and he does not disclose that defence to the insurer, it is not valid.¹⁵⁶

It was said by Longmore LJ in *The Mercandian Continent*¹⁵⁷ that there is a difference between making a fraudulent claim and using fraudulent means to further a claim. In *Agapitos* the assured had exaggerated a claim but during proceedings it turned out that there was a good claim after all. Could the insurer despite this rely on the initially fraudulent means by the assured to avoid the contract? On this Mance LJ said: "...I would suggest that the courts should only apply the fraudulent claim rule to the use of fraudulent devices or means which would, if believed, have tended, objectively but prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects...". The judge supported some element of materiality when applying the fraudulent claims rule to cases where the assured has used fraudulent devices to further a claim. There is much more that can be said on the finer intricacies of fraudulent claims, but as it is considered to fall outside the scope of Act utmost good faith it will not be dwelled into further.¹⁵⁸

It is interesting to note that fraudulent claims were long treated as a part of the section 17 principle and something that could only be remedied with avoidance.¹⁵⁹ In *The Aegeon* Mance LJ suggested the approach "to treat the common law rules governing the making of a fraudulent claim (including the use of fraudulent device) as falling outside the scope of section ... On this basis no question of avoidance *ab initio* would arise." In *AXA General Insurance Limited v Gottlieb* he once again expressed the view that a fraudulent claim should not lead to loss of valid claims made earlier. "There is no basis or reason for giving the common law rule relating to fraudulent claims a retrospective effect on prior, separate claims which have already been settled under the same policy before any fraud occurs"¹⁶⁰.

¹⁵⁶ Chuah p 428.

¹⁵⁷ [2001] EWCA Civ 1275.

¹⁵⁸ For an analysis of the law on fraudulent claims see for example Foxton pp 92-104.

¹⁵⁹ *Orakpo v Barclays Insurance Services* [1995] LRLR 443; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209.

¹⁶⁰ [2005] EWCA Civ 112 para 22.

3.1.6 The ship's papers cases

The order for ship's papers, while no longer in use, could be what started the notion of a general post-formation duty of good faith¹⁶¹. Sir Mackenzie Chalmers cited two cases on ship's papers in his Marine Insurance Act as a comment on the good faith sections: *Boulton & Ors v Houlder Bros & Co*¹⁶² and *Harding v Bussell*¹⁶³. An order for ship's papers was a peculiarity of marine insurance aimed to rectify an imbalance in information that is not present in regular insurance. It was made by the common law courts for the disclosure of any documents related to the ship which had possible relevance to the claim. Sanction for non-compliance was a stay of proceedings. The order as an entitlement was criticized in *Leon v Casey*¹⁶⁴, where Geer LJ said it was an unnecessary instrument of unjust delay. It later became a matter of discretion¹⁶⁵ and is today obsolete¹⁶⁶. References to the doctrine of utmost good faith have been made in cases dealing with ship's papers, or vice versa and as a result it was at times considered to be a manifestation of that doctrine.¹⁶⁷ However, there are several arguments for why it should not be considered a part of utmost good faith. The order was unique to marine insurance, despite the Marine Insurance Act applying to all insurance. It became discretionary rather than an entitlement, it could not be made against insurers and the only remedy for not complying with it was a stay of proceedings. It could be argued that it was an example of extra-Act good faith, but it is not utmost good faith as contained in the Marine Insurance Act 1906.¹⁶⁸ That was indeed the view of Lord Hobhouse in *The Star Sea*, where he said that "whatever it was, it was not the obligation

¹⁶¹ Foxton p 73.

¹⁶² [1904] 1 KB 784.

¹⁶³ [1905] 2 KB 83.

¹⁶⁴ [1936] 2 KB 576.

¹⁶⁵ Foxton p 73.

¹⁶⁶ Lord Hobhouse in *The Star Sea* p 58

¹⁶⁷ *Raynor v Ritson* (1865) 6 B & S 888, 891; *China Traders' Insurance Co Ltd v Royal Exchange Assurance Corp* [1898] 2 QB 187; *Leon v Casey* [1932] 2 KB 576; *Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437, 511.

¹⁶⁸ Foxton p 73, Howard Bennett, "Mapping the doctrine of utmost good faith in insurance contract law" [1999] LCMLQ 165 at 199.

referred to in section 17”¹⁶⁹. Today the order of ship’s papers can no longer be considered relevant when discussing post-formation good faith, but it has left marks. Sir Mackenzie Chalmers’ reference to the ship’s papers cases was one of the first instances of what has become the idea that all references to good faith in a post-contract situation should be considered a part of the doctrine of utmost good faith as expressed in section 17 of the Act. On this Bennett wrote that when trying to make sense of the order for ship’s papers the doctrine of utmost good faith provided an “expedient explanation”¹⁷⁰.

3.2 Is there an overarching principle?

Can the above references to a post-formation duty of utmost good faith be linked through a single principle, what has been called the “over-arching principle of good faith”, and is it expressed in section 17 of the Act? The language of section 17 in the Marine Insurance Act 1906 does not have the restrictions of section 18 and 20. This opens up for the interpretation that there is a single, continuing, duty of utmost good faith, with all that it entails in forms of disclosure and representation. Nevertheless, section 17 is just as limiting as the other sections when it comes to the remedy – it is avoidance and avoidance only. There are obviously situations where this “draconian” remedy would be inappropriate.

The purpose of the duty of disclosure is to level the playing field and give the insurer access to information that only the assured has. Although section 17 duties do also apply to insurers, that it less commonly relied on, and the majority of cases concern insurers wanting to avoid cover. The problem when trying to find a balance between the parties was famously expressed by Lord Sumner in the *Niger* case where he advised against a proposed extension of the duty because it “would turn what is an indispensable shield for the underwriter into an engine of oppression against the insured”. The remedy of avoidance if applied too generously runs the risk of doing just that. *The Litsion Pride* was the high point of the courts

¹⁶⁹ *The Star Sea* para 60.

¹⁷⁰ *Supra* at 200.

accepting a general continuing duty of good faith. Because section 17 does not contain any limiting words, unlike sections 18 and 20, the court found it possible to make such an interpretation.

However, the situation has changed since *The Litsion Pride*. The rulings in recent cases have gone against the statement of Hirst J in that case and it today appears that no single overarching principle of section 17 good faith can be identified. In matters of variation, the case law so far does not support the idea of applying the over-arching principle. Longmore LJ said in *The Mercandian Continent* that “there is no authority for a proposition that a fraudulent misrepresentation leading to a variation will avoid the original contract as well as the variation”. A party simply being in lack of good faith in the post-contract scenario is not considered to be enough to avoid the entire contract. The only remedy prescribed by section 17 is avoidance, but it is clear that even fraudulent behaviour cannot be grounds for avoiding the policy if it did not induce the contract. Thus the section does not apply.

The law as applied in cases of held covered clauses does not today contain the over-arching principle. While the two held covered cases *Overseas Commodities* and *Liberian Insurance Agency* did go against the assured based on a breach of good faith, those rulings can today be considered inaccurate.¹⁷¹ The held covered clauses were treated analogous with pre-formation good faith, but there was no test of inducement in the cases. Following the *Pan Atlantic* case with the establishment of required inducement, the analogy seems to no longer be accurate. Bennett has suggested that the doctrine of good faith should be applied to held covered clauses only when there are “*circumstances ... that induce the actual insurer into agreeing to that alteration*”¹⁷². Moreover, going against the notion of the overarching duty applying is the remedy. It was said in *The Mercandian Continent* that “it is never suggested that lack of good faith in relation to a matter held covered by the policy avoids the whole contract of

¹⁷¹ See Longmore LJ in *The Mercandian Continent*, para 22. See also Foxton p 79.

¹⁷² Bennett, *supra* at 205.

insurance”¹⁷³. Despite this the consequences for the assured in the held covered cases was a complete loss of certain rights (to be held covered at increased premium) that existed prior to the breach occurring. The application of good faith in the held covered cases cannot be considered a part of the overarching principle.¹⁷⁴

Fraudulent claims is an interesting area because it has effectively been placed outside of section 17 altogether. They are instead dealt with using a special common law rule that no one can be allowed to benefit from their wrong-doing. The vast benefit of this approach is that the courts are not limited by the exhaustive list of remedies in section 17. Not only can the fraudulent claim be avoided without avoiding previous legitimate claims, but if a fraudulent claim is treated as a breach of utmost good faith the insurer would not be able to sue for damages. He would only be able to avoid the contract in its entirety and reclaim any payments made. For this reason Mance LJ said in *Axa General Insurance v Gottlieb*¹⁷⁵ that there is a post-formation duty to not make fraudulent claims, but it is not a part of section 17.

While Lord Clyde described limiting section 17 to the pre-formation context as "an option past praying for"¹⁷⁶, it was said by Lord Hobhouse in *The Star Sea* that the doctrine of utmost good faith in a post-formation context should be limited to creation or variations of obligations. Any other areas, such as non-performance, should not be considered a part of the doctrine but rather the regular contract law.¹⁷⁷ A result of adopting this approach would be that there is no post-formation application of section 17 unless the courts allow a variation to be treated as a severable part of the contract. Bennett supports a confinement of section 17 and suggests that duties of utmost good faith in the context of variations and extension of cover should be treated as falling outside of section 17.¹⁷⁸ He lists three reasons supporting this: The wording of section 17 may allow for it to

¹⁷³ [2001] EWCA Civ 1275 para 22.

¹⁷⁴ This is also the view of Foxton, see *supra* p 80.

¹⁷⁵ [2005] EWCA Civ 112.

¹⁷⁶ *The Star Sea* [2001] 1 Lloyd's Rep. 389 para 6.

¹⁷⁷ *The Star Sea* para 52. See also *Bonner v Cox* [2005] EWCA Civ 1515 para 86.

¹⁷⁸ Bennett p 180.

include post-formation, but that doesn't mean it has to be done. The wording "based upon" could be read as meaning that section 17 deals only with the formation of the contract. Further, the sections on utmost good faith introduced by section 17 all deal exclusively with formation. This supports the idea that 17 also only deals with formation. Lastly, authority for a post-formation application of section 17 is "slim". It consists of *The Litsion Pride*, much of which has since been overruled, and *The Good Luck*¹⁷⁹ where section 17 was applied to contract performance.

3.3 The remedy issue

A consequence of the draconian remedy prescribed by the Marine Insurance Act 1906 has been a kind of backwardness in the debate on when the doctrine of utmost good faith applies. Because the courts are limited to a single remedy, and that remedy is often considered too strict and can lead to manifestly inequitable results, the conclusion is sometimes drawn that section 17 should not apply, rather than that it does not apply.

If there was no failure of disclosure at the point an insurance contract was entered into, then why should the entire contract and risk that the insurer has already agreed to without being misled be voidable based on non-disclosure relating to a variation? How can a limitation to the remedy be consolidated with the language of s 17 of the Marine Insurance Act? It appears that the discrepancies in opinion and contradictions in rulings on the doctrine of post-formation good faith is a result of the conflict between wanting to avoid the extreme remedy, but at the same time housing a desire to link all identified instances through the mythical unifying "overarching principle" for the sake of convenience and neatness. The result is, to quote Naidoo, "confusion"¹⁸⁰.

A result of the ruling in *The Mercandian Continent* was that there is a continuing duty based on section 17 that exists post-formation. As per *The Star Sea* a breach of this duty can only be the result of dishonesty,

¹⁷⁹ *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1990] 1 QB 818.

¹⁸⁰ Andre Naidoo, "The confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?" [2005] J.B.L. May, 346-371.

not innocent mistakes. Some still argue in favour of treating the duty of good faith as rising out of an implied term of the contract, but that is not supported by the courts. It would allow for remedies other than damages, but that same solution can be reached by treating it as an instance of good faith that falls outside of section 17. Another benefit of stepping away from section 17 in the post-formation stage is that in situations where it is the insurer who has breached the duty of good faith the assured could be awarded damages.

4 Conclusion

The duty of utmost good faith is relatively clear in the pre-formation context. Sections 18 and 20 impose the duties of disclosure and accurate representation of material facts. Facts are material which are related to the risk weighing decision of the underwriter. In addition to materiality there must also be actual inducement of the insurer into the contract. English courts have recognized that the rules as originally applied had potential to be unfair and have accordingly narrowed the definition of materiality while expanding the concept of inducement. Section 17 is not limited in language to the pre-formation context and there is a number of cases where a post-contractual breach of the duty of utmost good faith, particularly that of disclosure, has been argued by insurers so that they can attain avoidance of a policy. The highpoint of applying a post-formation duty of utmost good faith was *The Litsion Pride*. Other important cases are *The Star Sea* and *The Mercandian Continent*.

There has been a trend to treat all situations of post-formation good faith, be they merely perceived or supported by the courts, as incarnations of the somewhat mystical “overarching” principle of utmost good faith that is allegedly contained in section 17 of the Marine Insurance Act 1907. Some authors and judges have suggested that this should be abandoned and that it is the very relationship between the parties in an insurance contract that is one of utmost good faith. It would then be possible to recognize that the manifestations of that duty can differ in nature between areas, and can fall outside of section 17. It was the view of the court in *The Star Sea* that post-formation application of section 17 should be limited to matters of alteration.

The relationship of *uberrimae fidei* should primarily focus on the construction of the contract. An example of this sentiment is *Cox v Bankside*, where the judge said “A contract of insurance is *uberrimae fidei*. One must approach any question of construction of the policy on the premise that the parties will act in good faith”. In the even earlier case of

*Britton v Royal Insurance Co*¹⁸¹ Willie J directed the jury that “the contract is one of perfect good faith on both sides, and it is most important that such good faith be maintained”. These statements, and others, can be read to focus on the contract itself. Recognizing that the duty of utmost good faith can apply in different ways to different areas would mean that what Foxton calls “the remedial straightjacket”, referring to the singular remedy of avoidance, can be avoided by the courts. That avoidance is the sole remedy for a breach of section 17 duty was established in *Ullman Keyser* and has so far been upheld by the courts.¹⁸²

Lord Hobhouse said in *The Star Sea*: “An inevitable consequence in the post-contract situation is that the remedy of avoidance of the contract is in practical terms wholly one-sided. It is a remedy of value to the insurer and, if the defendants' argument is accepted, of disproportionate benefit to him; it enables him to escape retrospectively the liability to indemnify which he has previously and (on this hypothesis) validly undertaken. ...it is hard to think of circumstances where an assured will stand to benefit from the avoidance of the policy for something that has occurred after the contract has been entered into.” This is in essence the unjustness of the remedy of avoidance in a post-contractual scenario. The relationship of utmost good faith between insurer and assured is supposed to be a two-way street, but with the exception of some extraordinary scenarios it is only the insurer who stands to benefit. In most cases where avoidance is argued the assured has nothing to gain, but everything to lose. Applying the remedy of avoidance to post-formation breaches of utmost good faith truly runs the risk of turning the doctrine into the “engine of oppression” that Viscount Sumner spoke of.

Diversifying the duty of utmost good faith would make it possible to allow different contents of the duty. Some areas, like variation,

¹⁸¹ (1866) 4 F&F 905 at 909.

¹⁸² Although some authors have questioned the correctness of this, see Peter MacDonald Eggers, “Remedies for the failure to observe the utmost good faith” [2003] LMCLQ 249. Richard Aikens, “The post-contract duty of good faith in insurance contracts: is there a problem that needs a solution?” J.B.L. 2010, 5, 379.

would require a stringent application analogous to the pre-formation duty of sections 18 and 20, but it should be limited to fraudulent breaches.

An example where fragmentation has already been accomplished is the law relating to fraudulent claims, which is de facto “independent” from other instances of good faith. Fraudulent claims are today recognized as not being a part of the overarching principle in section 17, but rather a separate legal doctrine founded on public policy. As a result the law on fraudulent claims is unusually clear, certainly when compared to other areas of utmost good faith.

Much of the confusion in the debate could have been solved by a better formulation in the Marine Insurance Act 1906. The Law Commission is currently reviewing consumer insurance law and there have been suggestion for changes to be made also to the law of corporate marine insurance. In Australian non-marine insurance the continuing duty of good faith was abolished with the Insurance Contracts Act 1984¹⁸³ and it has been said that much can be learned from the Australian approach.¹⁸⁴ The Australian Law Commission in 2001 proposed a change to Australian marine insurance which would solve the problem by creating by law an implied term in a marine insurance contract that each party should act with the utmost good faith.¹⁸⁵ It has been suggested that this could be followed in English law.¹⁸⁶ Despite this it should be possible to solve the problems without new legislation by the courts adopting a confinement of section 17 to the pre-formation context. Variations to a policy could then either be treated as pre-formation, if the courts allow that part of the contract to be severed, or a part of post-formation good faith that falls outside of section 17.

¹⁸³ *Re Zurich v Australia Insurance Ltd* (1999) 10 ANZ Ins Cas 61-429.

¹⁸⁴ Robert Merkin, “Reforming insurance law: is there a case for reverse transportation? A report for the English and Scottish law commissions on the Australian experience of insurance law reform”

¹⁸⁵ Report 91 of April 2001, “Review of the Marine Insurance Act 1909”.

¹⁸⁶ Richard Aikens, “The post-contract duty of good faith in insurance contracts: is there a problem that needs a solution?” [2010] J.B.L. May, p 393.

Sections 17-20 of the Marine Insurance Act 1906

17 Insurance is uberrimae fidei.

A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

18 Disclosure by assured.

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

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

(3) In the absence of inquiry the following circumstances need not be disclosed, namely:

(a) Any circumstance which diminishes the risk;

(b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;

(c) Any circumstance as to which information is waived by the insurer;

(d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.

(4) Whether any particular circumstance, which is not disclosed, be material or not is, in each case, a question of fact.

(5) The term “circumstance” includes any communication made to, or information received by, the assured.

19 Disclosure by agent effecting insurance.

Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer—

(a) Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and

(b) Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

20 Representations pending negotiation of contract.

(1) Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract.

(2) A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

(3) A representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief.

(4) A representation as to a matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer.

(5) A representation as to a matter of expectation or belief is true if it be made in good faith.

(6) A representation may be withdrawn or corrected before the contract is concluded.

(7) Whether a particular representation be material or not is, in each case, a question of fact.

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