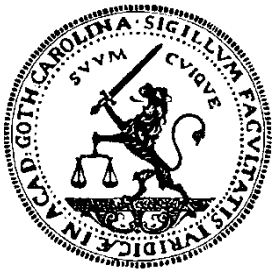

FACULTY OF LAW
Lund University

Maja Robertson

Moral hazard and the duty of disclosure under the doctrine *uberrimae fidei*

– A marine insurance law perspective

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Eva Lindell-Frantz

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Contents

Summary

A proposer to a marine insurance contract is subjected to a pre-contractual duty to disclose material information under the doctrine of utmost good faith (*uberrimae fidei*). The duty extends to comprise matters that concern moral hazard and the shipping company may consequently be required to volunteer information concerning the moral character of its owners, directors, employees and other agents connected with the insured interest at the pre-contractual negotiations with the insurance underwriter.

The thesis provides the reader with a thorough examination of the legal framework that shipping companies are required to consider when fulfilling their pre-contractual duty of disclosure of information that specifically relates to moral hazard. It is concluded that the current law subjects the prospective assured to making a rather complicated assessment of the materiality of such information in order to determine the need for disclosure – an assessment that, if done incorrectly, may have disproportionately harsh economic implications to the assured. The thesis contributes to a clarification of the state of the law within this specific area by discerning guiding principles from case law, doctrine and statutes that may be vital for the prospective assured to consider before engaging in pre-contractual negotiations with an underwriter.

The thesis does moreover provide an analytical evaluation of the current legal framework with the interests of the parties in mind. It is *inter alia* concluded that English marine insurance law does not take the perspective of the prospective assureds into consideration to the extent needed in order to achieve a balanced and proportionate legal apparatus within this specific field of law. Further legal clarification is needed in order to facilitate the predictability of the law from the assured's perspective, particularly in relation to the assessment of whether certain allegations of dishonesty must be disclosed to the underwriter or not. It is furthermore alleged that the implications to the assured for making a mistaken assessment of the materiality of the information are disproportionate.

Preface

I wish to express my appreciation to Professor Proshanto K. Mukherjee (World Maritime University) and Professor Lars-Göran Malmberg (Lund University) for providing an inspiring two-year master's programme in maritime law. I also wish to express my gratitude to Assistant Professor Eva Lindell-Frantz (Lund University) for the support and to Professor Rhidian Thomas (University of Swansea) whose lectures raised my interest for marine insurance and inspired me to undertake further examination of the subject at hand.

Maja Robertson
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1 Introduction

1.1 Background

An insurance broker turns to a marine insurance company on behalf of a ship-owner with a wish to enter into a hull and machinery policy. The broker is aware of the fact that rumours have flourished in media indicating that the director of the shipping company was involved in forgery of a promissory note five years ago. Upon confrontation by the broker two days earlier, the director strongly dismissed the rumours, stating that the media reports were based on pure gossip. He also made clear that he has no criminal record, the authorities have brought no charges against him and that he is genuinely innocent of the accusations. The broker therefore ignores the media reports and makes no mention of the accusations at the pre-contractual negotiations with the underwriter who does not seem to have taken any notice of the media reports. The underwriter weighs the size of the premium against the possible risks that he is able to identify based on the information he has obtained and finally decides to issue the policy requested in return for a fair premium.

Five months later, the vessel is involved in a casualty and the ship-owner claims indemnity under the policy. No further evidence affirming the accusations have been brought to light since the pre-contractual negotiations and the director of the shipping company maintains his innocence. The question then arises whether or not the insurer, who now has become aware of the media reports, is contractually bound to indemnify the ship-owner although the allegations were not disclosed prior to the conclusion of the contract.

The marine insurance contract is a contract based on the doctrine of utmost good faith (*uberrimae fidei*), a doctrine that *inter alia* obliges the assured to disclose material information relating to his[1] moral character to the underwriter before the contract is concluded. In cases as the one just described, the assured (or his broker) has to decide whether to disclose the allegations, and thereby risk being rejected or charged a higher premium, or to withhold the media accusations, which he genuinely believes are untrue. There is a fine line between what is included in and what is excluded from the pre-contractual duty of disclosure in these situations and the implications of a wrong decision could be significant.

[1] In cases where the ship-owner is a shipping company, the word “his” here relates to the director of the company or any other person closely connected to the subject matter that thereby is able to influence the moral risk. (See further below, subchapter 4.1).

1.2 Purpose

The purpose of this thesis is to examine the extent to which information relating to moral hazard under English marine insurance contract law must be disclosed to the underwriter before a contract of insurance is concluded. It further aims at examining how the current law balances the prospective assured's interest in not letting allegations of dishonesty influence the insurance contract in a, to him, unfavourable way *vis à vis* the insurer's interest in obtaining as much information as possible about the prospective assured.

The questions that this thesis intends to answer are:

- What factors are considered when determining whether a certain circumstance requires pre-contractual disclosure under the doctrine of utmost good faith?
- At what point in time must the information be disclosed and to whom?
- What is the remedy to an unfulfilled pre-contractual duty of disclosure?
- To what extent must a prospective assured (or his broker) disclose information concerning moral hazard to the underwriter before the contract of insurance is concluded?
- How does the current law on the duty of disclosure balance the interests of the parties respectively (relating to disclosure *vis à vis* obtainment of information) in situations where a false allegation of dishonesty regarding the prospective assured has emerged in media with no formal evidence?

1.3 Delimitation

The scope of the examination is limited to the doctrine of utmost good faith and its inherent duty of pre-contractual disclosure relating to moral hazard from an English marine insurance contract law perspective. The analysis will focus on the specified questions presented in subchapter 1.2 and although several issues relating to the doctrine of utmost good faith in general could serve as topics of further discussion, these will not be analysed in detail unless they relate to the questions posed.

As just mentioned, the focus will be on the pre-contractual duty of disclosure that arises before the contract itself is concluded. Thus, the thesis will not examine the assured's post-contractual duties under the doctrine of utmost good faith or any breach of the obligations arising from the contract of insurance itself. The examination will have a marine insurance perspective and the cases referred to will as far as possible relate to the marine area of insurance law, although non-marine cases will be consulted when necessary. The subject will be approached from an English law

perspective due to the dominance of English law in international maritime law. The prospective assured's duty of disclosure will be of focus, as the insurer most frequently is the one who wants to avoid a policy based on non-disclosure and as the assured most frequently is the one who is in possession of information material for disclosure.[2] The plausible effects to third parties of the prospective assured's breach of the duty will be outside the scope of this thesis. The examination of circumstances concerning the assured's moral character in chapter 4 will be limited to three main categories of information that commonly serve as strong indicators of moral hazard; past criminal convictions, allegations of dishonesty and circumstances in the assured's insurance history that indicate a dishonest or fraudulent character.

1.4 Method and material

The examination will be carried out by way of a judicial dogmatic method, meaning that the law applicable to the subject in question will be described and analysed in order to establish the current legal framework and the possible overarching principles that are applicable to the assured when engaging in pre-contractual negotiations with a marine insurance underwriter. The question relating to the balance of the prospective assured's and the insurer's interests in the existing legal framework will be answered to by way of analytical evaluation of the current legal framework and its consequences to the parties.

Since the subject is approached from an English law perspective, the common law hierarchy of legal sources will be used. This means that the legal sources used will have the following ranking (starting with the one with the highest legal status); enacted legislation, common law (including case law) and authoritative doctrine.[3] Worth noting is that English common law in the field of marine insurance incorporated *lex mercatoria* in the 18th century, which was based on the customs of merchants.[4] All sources used are critically evaluated in order to provide a qualified support for the analysis and the conclusions drawn.

English legislation will be interpreted with a restrictive approach, as is custom in the English legal system, and in the light of case law and authoritative doctrine. The restrictive approach will be subject to *inter alia* "the golden rule", which allows a deviation from the literal approach where it results in an obviously absurd outcome, and "the mischief rule", which allows an interpretation of the legislation in the light of the problem.[5]

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[2] Bennett, H., *The Law of Marine Insurance*, 2nd ed., Oxford University Press Inc., New York, United States, 2006, pp. 120, 163.
[3] Slapper, G., *et al, The English Legal System*, 12th ed., Routledge, New York, 2011, p. 84.
[4] MacDonald Eggers, P., *et al, Good Faith and Insurance Contracts*, 3rd ed., Lloyd's List, London, 2010, pp. 82, 84.
[5] Bogdan, M., *Komparativ Rättskunskap*, 2nd ed. Norstedts Juridik AB, Stockholm, 2003, pp. 130-134; Slapper, G., *et al.*, *supra* note 3, pp. 96, 103-105.

Much of the case law relating to the present subject stem all the way back to the early 1900s or even further. These cases will be referred to in the examination insofar they provide fundamental principles that to this date form part of current law and that the courts still are bound to abide under the doctrine of *stare decisis*.[6] Cases have been distinguished from each other with respect to their specific circumstances in order to sift out the central principles relating to the pre-contractual duties of disclosure. The thesis has a marine insurance law perspective, the cases referred to will therefore as far as possible and as far as it is in line with the purpose of the examination relate to marine insurance law. As the pre-contractual duty of disclosure applies to both marine and non-marine insurance and as the concept of moral hazard mainly developed in cases related to other forms of insurance, non-marine cases will be consulted as well.[7] The specific characteristics of marine insurance will however be highlighted if discrepancies exist. The examination will primarily cite cases whose *ratio decidendi* concern the subject at hand, although some cases will be mentioned where the *obiter dictum* provides a persuasive authority on the present topic.[8] Doctrine by renowned authors will be used as a helpful support in distinguishing, selecting and analysing the cases in respect to the aspects just mentioned.

As there exist doctrine addressing the subject at hand that is up to date and written by renowned authors, there is no need to turn to old or obsolete doctrine, although this would have been possible as no fundamental changes have been made to the doctrine of utmost good faith in recent years. Authoritative doctrine, such as *Arnould's Law of Marine Insurance and Average*[9], which is regularly cited by courts in case law, will provide support for the forthcoming examination.[10]

Although the scope of the thesis is limited to an examination of the pre-contractual duty of disclosure, the contract may serve as a legal basis for the exemption of certain information from the duty of disclosure (for example with regard to warranties, subchapter 3.4).

The thesis will not present a continuous analysis with respect to the specific questions posed in subchapter 1.2. These questions will instead be analysed in depth, followed by possible conclusions, at the end of the thesis (chapter 6). The examination of the legal framework made may thereby serve as a

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[6] Slapper, G., *et al*, *supra* note 3, p. 160.
[7] The Marine Insurance Act 1906 applies to all forms of insurance by analogy. *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 Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 A.C. 501; *Container Transport International Inc.* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178.
[8] Bogdan, M., *supra* note 5, pp. 118-121.
[9] *Arnould's Law of Marine Insurance and Average*, 17th ed., Sweet & Maxwell, London, 2008.
[10] See for example *Brotherton* v. *Aseguradora Coseguros S.A.* [2003] 2 C.L.C. 629, 637; *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 569.

thorough basis for a solid legal analysis, resulting in substantiated conclusions.

1.5 Disposition

This thesis will first approach the characteristics of marine insurance contracts and the parties' different levels of access to information pertaining to the risk, followed by an introduction to the doctrine of utmost good faith, its purpose, legal status and inherent duty of pre-contractual disclosure (chapter 2). The assured's duty to disclose information to the underwriter at the pre-contractual negotiations will be examined in chapter 3, where the framework of what kinds of circumstances that must be disclosed will be examined with reference to, *inter alia*, the concept of materiality, inducement and constructive knowledge. The information excluded from the duty of disclosure will be examined here as well, together with possible remedies available when a breach of the duty has been made. Chapter 4 will focus on the assured's duty to disclose information relating to his moral character. The general notion of moral hazard relating to marine insurance will be defined, followed by a thorough examination of the duty to disclose information relating to previous criminal convictions, allegations of dishonesty and insurance history. Chapter 5 will examine the proposals for law reform made by the Law Commission with regard to the interests of the parties to marine insurance contracts. In chapter 6, the examination will be summarised and analysed with respect to the specific questions posed in subchapter 1.2, followed by substantiated conclusions.

1.6 Definition of terms

For the purpose of the following examination, the term "insurer" will relate to the insurance company that undertakes to indemnify the other party in case of a covered loss. The term "underwriter" will refer to the specific agent that leads the pre-contractual negotiations and issues the insurance policy on behalf of the insurer. The underwriter is appointed by the insurer with the authority to negotiate the conditions and draft the ultimate contract of insurance and does, for the purpose of this thesis, not comprise any local agent whose authority is limited to the obtainment of insurance proposals. The term "assured" will refer to the party seeking cover for a risk (normally a shipping company). At the pre-contractual negotiations, the term "assured" will also include the agent of the assured (typically an insurance broker who is responsible for placing the risk and authorised to insure it on behalf of the assured) and the term will be used interchangeably with the terms "prospective assured" and "proposer" at the pre-contractual stage.

2 The marine insurance contract and the doctrine of utmost good faith (*uberrimae fidei*)

2.1 Specific characteristics of the marine insurance contract

A contract of insurance is a contract by which one party (the insurer), in return for premiums, undertakes to indemnify the other party (the assured) against loss by way of monetary compensation (or any other corresponding compensation) on the happening of a specified but uncertain adverse event.[11] Marine insurance contracts, which will be of focus in the forthcoming examination, specifically handle losses that are incidental to marine adventures, *i.e.* adventures where the insured subject-matter has been exposed to a maritime peril.[12] Thus, a marine insurance contract, by being a speculation on the transfer of a risk from the assured to the insurer, is usually preceded by a careful evaluation of the risk carried out by the latter, heavily based on the information provided by the prospective assured or his broker at the pre-contractual negotiations.[13]

Even though the underwriter might access some information pertaining to the risk, such as public information available, facts known to him in his ordinary course of business and facts accessible through databases and other electronic information systems, it is safe to conclude that there is a disparity in the information available to the two parties respectively.[14] Inevitably, the prospective assured has access to and command of significantly more information pertaining to the risk than the underwriter, information that might be essential for the latter to acquire in order to make a correct evaluation of the risk he is about to underwrite.[15]

The inevitable lack of equality in knowledge between the parties is specific to insurance contracts.[16] The significance of the prospective assured's presentation of information thereby becomes essential, especially in

[11] Clarke, M. A., *The Law of Insurance Contracts,* 5th ed., Informa Law, London, 2006, p. 8.
[12] Inexhaustive examples of "maritime perils" are perils of the seas, jettisons, restraints, detainments, barratry and fire, occurring as a result of the navigation of the sea. Marine Insurance Act 1906, ss. 1, 3.
[13] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909], 97 ER 1162, 1164; MacDonald Eggers, P., *et al*, *supra* note 4, pp. 8, 48.
[14] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909-1911], 97 ER 1162, 1164-1165; MacDonald Eggers, P., *et al*, *supra* note 4, pp. 8, 48.
[15] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909], 97 ER 1162, 1164.
[16] Though, the parties to a guarantee engagement have a similar relationship.

insurance relationships where pre-contractual negotiations and individualised risk evaluations forms the very foundation of the contractual formation, as in the field of marine insurance.[17] The contract of insurance is thereby also highly vulnerable to misrepresentations and withholds of significant information made by the prospective assured, as this type of contract provides an inherent incentive for the proposer to present the risk to the underwriter in a more favourable light, thereby inducing the underwriter to assume the risk or accept a smaller premium. Hence, it lies in the interest of the prospective assured to not having to disclose information that is unfavourable to him or puts him in a bad light, at the same time as the underwriter would want to obtain sufficient information in order to make an accurate evaluation of the risk.[18]

English contract law in general does not offer any duty to volunteer information during contractual negotiations.[19] Insurance contracts, on the other hand, based on their above mentioned specific characteristics, are contracts *uberrimae fidei*, which means that they are subject to the doctrine of utmost good faith. This doctrine imposes a duty[20] on the contracting parties to disclose certain kinds of information to the other party and to not misrepresent the information given.[21]

2.2 The juridical emergence and the rationale behind the doctrine of utmost good faith

It was with the informational asymmetry of the parties in mind that the doctrine of utmost good faith (*uberrimae fidei*) initially was structured and assigned to parties of insurance contracts by Lord Mansfield in the case *Carter* v. *Boehm*[22] in 1766, as a result of the subsumption of mercantile custom and *lex mercatoria* into common law.[23] The case established that a party to any form of contract was prohibited from concealing "what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary"[24], thus, laying down a general rule of

[17] *Edinburgh Assurance Co.* v. *R. L. Burns Corp.* 479 F. Supp. 138, 144-145, (C. D. Cal. 1979), aff'd in part and rev'd in part, 669 F.2d 1259 (9th Cir. 1982); as cited in Schoenbaum, T. J., *The Duty of Utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law*, Journal of Maritime Law and Commerce, Vol 29, No. 1, 1998, pp. 3-4.
[18] Clarke, M. A., *supra* note 11, p. 645.
[19] Rose, F. D., *Marine Insurance Law and Practice*, LLP, London, 2004, p. 67.
[20] The use of the word "duty" is technically not fully accurate. The duties are in fact only conditions for a fully binding contract and contractual enforceability, see *Agnew* v. *Länsförsäkringsbolagens AB* [2001] 1 AC 223, 265-266. The word "duty" is, however, customarily used and is therefore also used in the forthcoming examination.
[21] Bennett, H., *supra* note 2, p. 100.
[22] (1766) 3 Burr 1905, [1909-1911], 97 ER 1162, 1164-1165.
[23] MacDonald Eggers, P., *et al*, *supra* note 4, pp. 82, 84.
[24] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1910], 97 ER 1162, 1164.

good faith. Lord Mansfield furthermore acknowledged that the underwriter is in a position where he relies on the assured (or his broker) to make a presentation of the facts and not to conceal any circumstance in order to mislead and induce the underwriter to estimate the risk differently than if he had been aware of the circumstance in question.[25] Lord Mansfield thereafter made the following statement, by which he intended to oblige the parties to disclose information relating to the risk presented for insurance:

> The keeping back of such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived and the policy is void; because the risque run is really different from the risque understood and intended to be run, at the time of the agreement.[26]

This constituted the very foundation of what came to be referred to as the doctrine of utmost good faith – a strict pre-contractual duty to avoid non-disclosure and misrepresentation of information (no matter if it is done innocently or with fraudulent intent) with the purpose to "prevent fraud, and to encourage good faith" [27].

By subjecting the parties to the duty of utmost good faith, the inequality in information pertaining to the risk between the assured (who possesses a substantial knowledge and a more direct connection to the risk) and the underwriter (whose knowledge usually does not amount to much more than to what has been revealed to him by the assured) is levelled. In this way, the prerequisites for a contract based on equal and fair grounds are enhanced.[28]

2.3 The doctrine of utmost good faith and the Marine Insurance Act 1906

The doctrine of utmost good faith has since the seminal statement by Lord Mansfield in 1766 evolved and become the subject of four sections in the Marine Insurance Act 1906 (ss. 17-20), which codify generally accepted and uncontroversial principles applicable to marine insurance.[29] The general

[25] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909], 97 ER 1162, 1164.
[26] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909-1910], 97 ER 1162, 1164. Lord Mansfield emphasized that this duty was a mutual one, applicable not only to the assured but to the underwriter as well; "The policy would equally be void, against the under-writer, if he concealed; as, if he insured a ship on her voyage, which he privately knew to be arrived: and an action would lie to recover the premium", *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909], 97 ER 1162, 1164.
[27] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1911], 97 ER 1162, 1165.
[28] *Greenhill* v. *Federal Insurance Co. Ltd.* [1927] 1 KB 65, 76-77; MacDonald Eggers, P., *et al*, *supra* note 4, pp. 49, 74.
[29] MacDonald Eggers, P., *et al*, *supra* note 4, p. 118. The sections relating to utmost good faith in the Marine Insurance Act 1906 (ss. 17-20) has later been appointed to represent the law of good faith in non-marine insurance contracts as well. See *Pan Atlantic Insurance*

duty of utmost good faith is set out in section 17 of the Marine Insurance Act 1906, a section that clearly rests on the foundation of Lord Mansfield's statements in *Carter* v. *Boehm*[30]. Section 17 is formulated in the following words:

> 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.

Hence, section 17 lays down a mutual duty of utmost good faith to which both of the negotiating parties (the assured as well as the underwriter) are subjected.[31] The duty has, however, more frequently been applied to the assured due to his great access to information pertaining to the risk at the negotiation stage, which exposes him to the duty to a greater extent than the underwriter. Furthermore, as the remedy is avoidance, many cases involve insurers that wish to avoid the policy under the doctrine and thereby avoid having to indemnify the assured for losses.[32] The duty is not contractual, but arises before the contract itself is formed. As was concluded in the case *Bell* v. *Lever Brothers Ltd*.[33], an obligation cannot be derived from the contract if it exists before the actual formation of the contract.[34]

Section 17 is strict in the sense that any failure to fulfil the duty of utmost good faith gives rise to a right of a retrospective avoidance of the entire contract by the other party, no matter how grave the breach of the duty is or even if the non-disclosure was made by way of an honest mistake.[35] Thus, it is not a requirement that the non-disclosure or misrepresentation was made with fraudulent intentions for the other party to obtain the right to avoid the policy. The pre-contractual duty of utmost good faith is, consequently, not just one of honesty or good faith, the duty goes further to comprise a duty of reasonable disclosure, relating to the significance of the information in

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Co. Ltd v. *Pine Top Insurance Co. Ltd.* [1995] 1 A.C. 501, 518 and *Joel* v. *Law Union & Crown Insurance Co.* [1908] 2 K.B. 863, 878.

[30] Rose, F. D., *supra* note 19, p. 71.

[31] Bennett, H. N., *Mapping the Doctrine of Utmost Good Faith in Insurance Contract Law*, 1999, Lloyd's MCLQ 165, p. 166. The reciprocity the duty has been acknowledged since the case *Britton* v. *Royal Insurance Company* (1866) 4 F & F 905, 909 and in several other cases, such as *Leen* v. *Hall* (1923) 16 Ll L Rep. 100, 103 and *Banque Financière de la Cité* v. *Westgate Insurance Co. Ltd.* (also known as *Banque Keyser Ullman SA* v. *Skandia (UK) Insurance Co. Ltd.*) [1990] 1 Q.B. 665, 770. An example of the reciprocity of the duty could be that an underwriter that is insuring a vessel under a voyage policy is obliged to pre-contractually disclose to the ship-owner that the vessel in question already has arrived, if he is aware of such circumstances and the ship-owner is not. (*Carter* v. *Boehm* (1766) 3 Burr 1905; 97 ER 1162).

[32] MacDonald Eggers, P., *et al*, *supra* note 4, pp. 75-76; Bennett, H., *supra* note 2, pp. 120, 163.

[33] [1932] A.C. 161, 227-228.

[34] In the case of *Banque Keyser Ullmann S.A.* v. *Skandia (UK) Insurance Ltd.* [1990] 1 Q.B. 665, 701-702, it was discussed whether the duty of utmost good faith was derived from an implied term of the contract, but this was not supported by the Court of Appeal and the House of Lords, see [1991] A.C. 249, 256.

[35] MacDonald Eggers, P., *et al*, *supra* note 4, p. 37 and Bennett, H. N., *supra* note 31, p. 166. See further below, subchapter 3.5.

question. As shall be seen below (subchapter 3.3) it is only certain kinds of information that this pre-contractual duty applies to, namely *material* information (section 18 (1) Marine Insurance Act 1906). A classification of a certain fact as material and a consequential non-disclosure of that fact does constitute a breach of the duty of utmost good faith, no matter how honest the intentions of the assured were.[36]

The other three sections in the Marine Insurance Act 1906 that governs the doctrine of utmost good faith (sections 18-20) goes deeper into the subject than the more general and introductory section 17 and focus on the assured's obligations towards the insurer under the duty. Section 18 and 19 handle non-disclosure and section 20 misrepresentations. These sections will be analysed in further detail in chapter 3, where the assured's pre-contractual duty to disclose information will be examined.

[36] *Anderson* v. *Pacific Fire and Marine Insurance Company* (1872) L.R. 7 CP 65, 68; *Bates* v. *Hewitt* (1967) L.R. 2 Q.B. 595, 607, MacDonald Eggers, P., *et al*, *supra* note 4, pp. 37-39, 137.

3 The proposer's pre-contractual duty to disclose information

3.1 Non-disclosure

Apart from the introductory and in broader terms formulated duty of utmost good faith set out in section 17 of the Marine Insurance Act 1906, the section is followed by three more detailed duties that only the proposer for the insurance contract (*i.e.* the prospective assured or his placing broker) is subjected to (sections 18-20). This subchapter will mainly focus on the proposer's pro-active duties under the doctrine of utmost good faith, namely the duty to disclose certain information to the underwriter at the negotiation stage.

The assured's duty to disclose information to the underwriter at the pre-contractual stage is set out in section 18 of the Marine Insurance Act 1906. Section 18(1) provides as follows:

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

Thus, the subsection obliges the prospective assured to voluntarily disclose material circumstances[37] that are known to him directly or such information that ought to be within his knowledge under the ordinary course of business. It does furthermore provide that the contract is avoidable by the insurer if the assured does not live up to the duty of disclosure. Such avoidance would consequently leave the insurance policy unenforceable by the assured and the he would, thus, not have any contractual right of compensation in the event of a loss that ordinarily would have been claimable under the policy.

By obliging the prospective assured to disclose information, the underwriter may abstain from making inquiries regarding the assured.[38] To let the underwriter rely on his own inquiries in order to get hold of all of the relevant facts would naturally be far more inefficient than if the proposer, who is in direct possession of the information, simply disclosed it. The duty strictly falls on the prospective assured to pro-actively reveal and not to keep silent about material information. The

[37] The term "circumstance" is defined as "any communication made to, or information received by, the assured" (s. 18(5) Marine Insurance Act 1906).
[38] Rose, F. D., *supra* note 19, p. 73.

underwriter is thereby excused from the work of having to find out the material circumstances himself. The relationship between the two parties in this regard was formulated in the following words by Scrutton LJ in *Greenhill* v. *Federal Insurance Co. Ltd.*[39]; "I have always understood the proper line that an underwriter should take, except in matters that he is bound to know, is absolutely to abstain from asking any questions, and to leave the assured to fulfil his duty of good faith, and make full disclosure of all material facts, without being asked"[40].

The disclosure may be made to any agent of the insurer who has authority to communicate the information to the relevant person within the insurance company. A disclosure may consequently be made to a local agent, but, if so, a reasonable period of time must have elapsed before the information is deemed disclosed due to the internal communication within the company.[41]

It is not only the prospective assured himself that is subjected to the proposer's duty of disclosure. A broker is in practice often used as an agent that handles the pre-contractual negotiations with the underwriter on behalf of the prospective assured.[42] The Marine Insurance Act 1906 has therefore also codified a duty upon the placing broker to disclose not only material information that the assured is in direct possession of, but also material information that is known to the agent himself, either directly or such information he ought to know within his ordinary course of business.[43] The Act also requires the broker to disclose material information that the assured is "bound to disclose"[44] (*i.e.* information that ought to be within the knowledge of the assured as it lies within the ordinary course of his business). This rule comes with the exception of information that comes to the knowledge of the assured too late to be communicated to the broker before the conclusion of the contract.[45]

It is, as have been indicated above, only certain kinds of information that the pre-contractual duty of disclosure applies to, namely *material* circumstances that are known or ought to be known by the proposer in his ordinary course of business.[46] Thus, the Marine Insurance Act 1906 lays down a concept of materiality that delineates the duty of disclosure. The exact meaning of this concept and what kind of information this pertains to will be examined in detail in subchapter 3.3 below.

[39] [1927] 1 KB 65.
[40] *Greenhill* v. *Federal Insurance Co. Ltd.* [1927] 1 KB 65, 85.
[41] Clarke, M. A., *supra* note 11, p. 674.
[42] Rose, F. D., *supra* note 19, p. 73.
[43] Marine Insurance Act 1906, s. 19(a).
[44] *Ibid.*, s. 19(b).
[45] *Ibid.*
[46] Marine Insurance Act 1906, s. 18(1) and (2).

3.2 Misrepresentation

Not only must the proposer to an insurance contract abstain from non-disclosure under the doctrine of utmost good faith in order to provide the underwriter with an opportunity to take an informed decision on whether or not he should underwrite the risk and, if the risk is accepted, the intended size of the premium. The doctrine of utmost good faith does also provide requirements concerning the material information that is given. When the assured (or his broker) communicates the material information to the underwriter at the negotiations, he must abstain from making any misrepresentation by making sure that the representation is correct. This obligation is derived from section 20 of the Marine Insurance Act 1906, whose first paragraph reads as follows:

> 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.

Accordingly, the duty is, as in the case of non-disclosure, limited to a concept of materiality in the sense that it is only *material* representations that must be correct. What the exact meaning of this concept of materiality is will be examined below[47].

A misrepresentation can be defined as a representation of information made verbally, in writing or by conduct of a fact made by the assured (or his broker) which is at variance with the truth to a certain degree, no matter if the misrepresentation was innocently made or not.[48] The misrepresentation relates to a fact, an expectation or a belief communicated to the underwriter.[49] The duty does not oblige the proposer to communicate a "perfect truth"[50] to the underwriter when it comes to representation of facts. However, it is required that the factual statement is "substantially correct"[51], meaning that the difference between the actual truth and the representation should not be material seen from the perspective of a prudent underwriter.[52] A presentation of an expectation or belief, on the other hand, is deemed correct as long as it is made in good faith.[53] It may be difficult to draw a line between a presentation of a fact and a presentation of an expectation or belief, but it can be said that an unambiguous statement most probably

[47] See further, subchapter 3.3.1.
[48] Clarke, M. A., *supra* note 11, pp. 645-646. MacDonald Eggers, P., *et al*, *supra* note 4, p. 136.
[49] Marine Insurance Act 1906, s. 20(3).
[50] Bennett, H., *supra* note 2, p. 152.
[51] Marine Insurance Act 1906, s. 20(4).
[52] *Ibid.*
[53] Marine Insurance Act 1906, s. 20(5). A presented expectation or belief is, thus, "true" under the Marine Insurance Act 1906 as long as the representation is made in good faith, even though the statement later turns out to be untrue.

should be considered as one of fact and that a statement relating to matters outside the assured's control relates to expectation.[54]

3.3 Information included in the duty of disclosure

3.3.1 Materiality

It has been concluded that a proposer for a marine insurance policy (either the prospective assured or his broker) is required to disclose information to the underwriter so that he can take a knowledgeable decision on whether to underwrite the risk or not and, if information is disclosed, to make sure that the facts are not at variance with the truth. However, it is only certain kinds of information these pre-contractual duties apply to, namely *material* information that is known or ought to be known by the proposer in his ordinary course of business.[55] Thus, the Marine Insurance Act 1906 lays down a concept of materiality that delimitates the duty of disclosure as well as the duty to avoid misrepresentation. Lord Mustill held that the rationale behind this delimitating concept of materiality was one of fairness, it was "unfair to the assured to require disclosure of matters which a reasonable underwriter would not have taken into account" [56].

Both section 18(2) and 20(2) of the Marine Insurance Act 1906 offer similar definitions of the term "material", relating to non-disclosure and misrepresentation respectively. A certain circumstance is defined as material, and must consequently be disclosed, if it lives up to the following wording set out in section 18(2) of the Marine Insurance Act 1906:

> 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.

The same wording, but relating to material representations is set out in section 20(2) of the Marine Insurance Act 1906.[57] The law does accordingly set out a qualification; the circumstance in question must influence the judgment of a hypothetical prudent insurer for it to be considered as material.

What exact effect on the prudent underwriter's mind the fact must have in order to be regarded as material was the subject of judicial consideration in

[54] Merkin, R., *Marine Insurance Legislation,* 4th ed., Lloyd's List Group, London, 2010, pp. 33-34.
[55] Marine Insurance Act 1906, ss. 18(1) and 20(1).
[56] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 538.
[57] Marine Insurance Act s. 20(2) reads as follows: "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".

the leading cases *Container Transport International Inc.* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.*[58] and *Pan Atlantic Insurance Co. Ltd.* v. *Pine Top Insurance Co. Ltd.*[59]. In *CTI* v. *Oceanus*, a container leasing company (Container Transport International Inc.) was refused cover by its insurer (Oceanus Mutual) as CTI at the placement of the risk had failed to disclose refusals to renew cover by previous insurers. The insurer thereby wished to avoid the policy under the duty of disclosure. It was held by Lloyd J. at first instance that the concealed fact should be considered material only if an actual disclosure of it would have influenced not only the judgment of a prudent insurer (in accordance with section 18(2) of the Marine Insurance Act 1906), but it should have led to a different final *decision* on whether or not to insure the risk or to charge a higher premium.[60]

The decisive influence test introduced at first instance was, however, overturned in the Court of Appeal[61], where it was stated that the wording "would influence the judgment of a prudent underwriter"[62] instead should be interpreted as whether the circumstance had an impact on the actual *judgment* of the prudent underwriter, that is, the formation of the underwriter's opinion.[63] It was observed that a decisive influence test would be impractical at trial, since the underwriters acting as expert witnesses, and thereby trying to stand in the shoes of a hypothetical prudent insurer, would not be able to objectively determine whether the withheld information ultimately would have led to a different final decision. It was held that "It is not possible to say, save in extreme cases, that prudent underwriters 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"[64]. It was, consequently, enough that the insurer could prove that a prudent insurer would have wanted to consider the withheld fact, *i.e.* that the fact would have influenced the *judgment* of a hypothetical prudent insurer, as opposed to the decisive influence upon him.[65]

The non-marine case *Pan Atlantic Insurance Co. Ltd.* v. *Pine Top Insurance Co. Ltd.*[66] addressed the matter with the reasoning made by the Court of Appeal in *CTI* v. *Oceanus* case as a starting point. One of the main questions asked at the House of Lords was: "must it be shown that full and

[58] [1982] 2 Lloyd's Rep. 178, [1984] 1 Lloyd's Rep. 476. Hereafter referred to as the *CTI* v. *Oceanus* case.
[59] [1993] 1 Lloyd's Rep. 496, [1995] 1 AC 501. Hereafter referred to as the *Pan Atlantic* v. *Pine Top* case.
[60] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178, 188-189.
[61] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1984] 1 Lloyd's Rep. 476.
[62] Marine Insurance Act 1906, s. 18(2).
[63] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1984] 1 Lloyd's Rep. 476, 492.
[64] *Ibid.*, 511.
[65] *Ibid.*, 476.
[66] [1992] 1 Lloyd's Rep. 101, [1993] 1 Lloyd's Rep. 496, [1995] 1 AC 501.

accurate disclosure would have led the prudent underwriter to a different decision on accepting or rating the risk; or is a lesser standard of impact on the mind of the prudent underwriter sufficient; and, if so, what is the lesser standard?"[67].

The *Pan Atlantic* v. *Pine Top* affirmed the rejection of the decisive influence test made by the Court of Appeal in the *CTI* v. *Oceanus* case, with, *inter alia*, the following reasoning made by Lord Mustill[68], having section 18(2) of the Marine Insurance Act 1906 in mind:

> 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 judgment" is not the same as "change the mind."[69]

The *Pan Atlantic* v. *Pine Top* case also elaborated further on exactly what kind of tests that had to be satisfied in order for the innocent party to gain the legal right to avoid the contract. The court formulated two cumulative tests that to this day still constitute good law and must be satisfied in order to gain a right of avoidance under the duty of utmost good faith, hereafter referred to as "the objective test" and "the subjective test". The objective test adopted refers to the influence on the thought process of a hypothetical prudent insurer, without considering the actual insurer's own subjective views. All circumstances that a hypothetical prudent underwriter would have taken into account while weighing the risk (if he had known them) are material.[70] Apart from this objective test, an additional, subjective test has to be satisfied in order for the insurer to gain the right to avoid the contract. This test is satisfied if the insurer can show that the breach of the duty to disclose material facts made by the proposer actually induced him to enter into the contract, thereby adopting a test that is based on the actual underwriter's subjective perspective.[71]

Worth noting is that the question whether a circumstance or a representation is material is a question of fact[72] and the burden of proving (on the balance of probabilities) a material non-disclosure or misrepresentation falls on the insurer who alleges it. The insurer discharges his burden of proof by proving on the balance of probabilities that the material information in question

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[67] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 521.
[68] The decisive influence test was also rejected by Lord Goff, stating that the "The sub-section does not require that the circumstance in question should have decisive influence on the judgment of the insurer; and I, for my part, can see no basis for reading this requirement into the sub-section", *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 516-517.
[69] *Ibid.*, 531.
[70] *Ibid.*, 527, 538.
[71] *Ibid.*, 517-518, 550.
[72] *Hodgson* v. *Richardson* [1764] 1 W B1 463, 465; *Morrison* v. *Muspratt* [1827] 4 Bing 60, 62; Marine Insurance Act 1906, s. 18(4) and 20(7).

existed at the time of the placement of the risk, that it was known to the assured and that it was withheld. The assured thereby has the benefit of doubt in case the insurer cannot discharge this burden satisfactorily.[73] The duty of disclosure applies to *any* information that is material to the risk presented, whether it be a physical hazard (relating to the physical attributes of the subject-matter insured), moral hazard (relating to the moral character of the assured) or any other kind of information.[74]

3.3.2 The objective test

The objective test answers the question: Would a hypothetical prudent underwriter have been influenced by the information if it had been given to him? The *Pan Atlantic* v. *Pine Top*[75] case confirmed that when establishing the materiality of a circumstance, one must do so from the objective perspective of a hypothetical prudent insurer. The underwriter acting as an expert witness in an avoidance trial must therefore put himself in the shoes of a hypothetical, objective and prudent underwriter when presenting his view on whether a certain circumstance is material or not under section 18(2) or 20(2) of the Marine Insurance Act 1906. A "material circumstance", which consequently must be disclosed to the insurer, is a circumstance that would influence the mind of a hypothetical prudent insurer in weighing the risk and forming his judgment.[76]

Thus, a material circumstance, according to the House of Lords in *Pan Atlantic* v. *Pine Top*, was anything that a prudent underwriter would have wanted to be aware of when forming his judgment. This relatively extensive objective test differed from the more stringent objective test first preferred by the Court of Appeal, where it was held that the insurer seeking to avoid a contract of insurance on the basis of non-disclosure must show that the circumstance in question was one that a prudent underwriter would view as "probably tending to increase the risk"[77]. The more stringent objective test based on increase of risk could be said to be in line with the above mentioned[78] statement of Lord Mansfield in the leading case *Carter* v. *Boehm*[79], proclaiming that the insurer is deceived if "the risque run is really different from the risque understood and intended to be run, at the time of the agreement"[80]. It was, however, the more extensive test that finally prevailed in the House of Lords, a test that was based on the exact wording of section 18(2) of the Marine Insurance Act 1906, without any further

[73] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1994] 2 Lloyd's Rep. 427, 917; Clarke, M. A., *supra* note 11, p. 670.
[74] *Ionides* v. *Pender* (1874) L.R. 9 Q.B. 531, 537-538; Merkin, R., *supra* note 54, pp. 25-26.
[75] [1995] 1 A.C. 501
[76] *Ibid.*, 517.
[77] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1993] 1 Lloyd's Rep. 496, 505.
[78] See subchapter 2.2.
[79] (1766) 3 Burr. 1905.
[80] *Carter* v. *Boehm* (1766) 3 Burr 1905, [1909-1910], 97 ER 1162, 1164.

embellishment of the phrase. The duty comprised all matters that a prudent underwriter would have taken into account when assessing the risk and forming his judgment on whether or not to take on the risk, not only matters that were probable to increase the risk.[81]

3.3.3 The subjective test

The second test that must be satisfied in order for a party to gain the right of avoidance answers the question: Was the actual underwriter influenced by the proposer's non-disclosure to the extent that he was induced to enter the contract? The Marine Insurance Act 1906 does not make any express reference to such a subjective test of actual inducement. It is only the objective test that is articulated in section 18(2) and 20(2) of the Act. General contract law provides that there must be subjective causation between the non-disclosure or misrepresentation and the signing of the contract, *i.e.* an inducement. This general contract law concept has influenced marine insurance contract law in this regard, with the result of a second, subjective test of inducement to be satisfied in order to gain the right of avoidance of the policy.[82]

The question whether inducement to enter into the contract must be proved (on the balance of probabilities) in order to avoid the policy under the doctrine of utmost good faith in insurance contract law has been up for discussion in several cases. The above-mentioned *CTI* v. *Oceanus*[83] case held that no such subjective test had to be met as the Marine Insurance Act 1906 made no such reference, but the House of Lords later overruled this decision in the *Pan Atlantic* v. *Pine Top*[84] case.[85] To rely fully on an objective test (*i.e.* what a hypothetical prudent underwriter would have been influenced by) in order to avoid a policy would be a comparatively low threshold to live up to for the insurer when seeking avoidance. Having decided on the less stringent objective test (a test which was not a "decisive" or an "increase of risk" test, but demanded disclosure of *any* information a prudent underwriter would want to know), the *Pan Atlantic* v. *Pine Top* case made room for a complementing, subjective test that increased the burden on the party seeking avoidance.[86]

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[81] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 538. It has also been held that the presentation of the risk should be such so that it could be said to be "fair", as was concluded in the case of *Marc Rich & Co. AG* v. *Portman* [1997] 1 Lloyd's Rep. 225.
[82] *JEB Fasteners Ltd.* v. *Marks, Bloom & Co.* [1983] 1 All ER 583; *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 513; Merkin, R., *supra* note 54, p. 24.
[83] [1984] 1 Lloyd's Rep. 476.
[84] [1995] 1 AC 501, 502.
[85] *Berger & Light Diffusers Ltd.* v. *Pollock* [1973] 2 Lloyd's Rep. 442 had, prior to the *CTI* v. *Oceanus* case, also held subjective inducement to be required, but this was, thus, overruled in the latter case.
[86] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 517-518.

Although it is not expressly mentioned, the legal legitimacy of such a test stems from section 91(2) of the Marine Insurance Act 1906, stating that "the rules of the common law including law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts of marine insurance". There is no general common law of disclosure (as there is no general pre-contractual duty to disclose material facts) but an analogical interpretation of the general law of misrepresentation, which requires inducement, legitimates the subjective test to be applicable to the duty of misrepresentation in marine insurance contract law as well. Since the line between a misrepresentation and non-disclosure in marine insurance contract law is hard to discern, the need of subjective inducement has been held as applicable to non-disclosure as well.[87]

The duty of disclosure was once adopted to restore the informational balance between the parties and creating a possibility for the innocent party to avoid being bound to a contract that he entered into without full and fair knowledge of material matters. In cases where these undisclosed or misrepresented material matters did not have any (subjective) impact on the actual underwriter and he therefore has suffered no injustice, contractual avoidance is not motivated.[88] The subjective test has therefore become a complement to the objective test, as it makes sure that a policy is not voidable if the non-disclosure or misrepresentation has not caused any harm or injustice. Lord Mustill declared in the *Pan Atlantic* v. *Pine Top* that if the underwriter was not induced to enter into the contract because of the misrepresentation or non-disclosure, then the underwriter was not entitled to rely on it as a ground for avoidance.[89]

It is possible that not just one, but several matters individually create an inducement for the underwriter to enter into the contract and on the ultimate terms. It is however enough that the material fact that was withheld or misrepresented was *a* cause (not necessarily *the only* cause) that the underwriter relied upon when entering into the contract on the present terms.[90] The material non-disclosure or misrepresentation must be actively present in the underwriter's mind as an inducing factor when deciding to enter into the contract for the subjective test to be satisfied.[91]

Unlike the objective test, the subjective test is decisive. That is to say, the non-disclosure or misrepresentation must have induced the underwriter to take the decision to enter into the contract. It is not enough that the material non-disclosure or misrepresentation influences the underwriter in question without any effect on the actual decision. The insurer must prove on the

[87] *Ibid.*, 549; Bennett, H., *supra* note 2, pp. 116-117.
[88] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 542.
[89] *Ibid.*, 550.
[90] *Edgington* v. *Fitzmaurice* (1885) L.R. 29 Ch. D. 459, 481; *Barton* v. *Armstrong* [1976] A.C. 104, 119; Bennett, H., *supra* note 2, p. 117.
[91] *Edgington* v. *Fitzmaurice* (1885) L.R. 29 Ch. D. 459, 483.

balance of probabilities[92] that he would not have decided to enter into the contract at all, or on the present terms, "but for" the effect of that non-disclosure or misrepresentation and that he would not have made the same decision had he been aware of the withheld material facts.[93]

3.3.4 The relationship between the two tests

A recurring issue that has been up for discussion in several cases is whether a fulfilment of the objective test automatically would presume fulfilment of the subjective test, *i.e.* that where the non-disclosed information or the misrepresentation has been proved to be material it is presumed that the underwriter also has been induced to enter into the contract on the present terms.[94] In *Pan Atlantic* v. *Pine Top*[95] it was stated that "the assured will have an uphill task in persuading the court that the withholding or misstatement of circumstances satisfying the test of materiality has made no difference"[96] and that there is a "presumption in favour of a causative effect"[97] between the two tests. Thus, if the insurer could prove on the balance of probabilities that the objective test is satisfied, he would automatically also have proven that the subjective test is satisfied and, as the burden of proof thereby transfers to the assured to prove that no such inducement exist, he would have an uphill task in proving non-inducement due to the presumption.[98] Lord Lloyd did however object and rejected that there would be an automatic legal presumption of inducement and the case law that followed the *Pan Atlantic* v. *Pine Top* has come to the same conclusion.[99] The reasoning behind a rejection of a presumed inducement is that there is no causal connection between the non-disclosure of a circumstance that a hypothetical prudent underwriter would want to know and the actual underwriter's final decision regarding the acceptance of the risk.[100]

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[92] The burden of proof lies on the party seeking to avoid the contract, *i.e.* commonly the insurer. It is not enough that it can be shown that a hypothetical underwriter or an underwriter other than the one that entered the contract would have been induced, as it is a subjective test, inducement of the *actual* underwriter must be shown. See *Lewis* v. *Norwich Union Healthcare Ltd.* [2010] Lloyd's Rep. I.R. 198 and Merkin, R., *supra* note 54, p. 25.
[93] *JEB Fasteners Ltd.* v. *Marks, Bloom & Co.* [1983] 1 All Er. 583, *per* Lord Justice Donaldson; *Brotherton* v. *Aseguradora Colseguros SA & Anor (No 2)* [2003] 2 C.L.C. 629, 646-647; *Assicurazioni Generali SpA* v. *Arab Insurance Group (BSC)* [2003] Lloyd's Rep. I.R. 131.
[94] *St Paul Fire & Marine Insurance Co. (UK) Ltd.* v. *McDonnell Dowell Constructors Ltd.* [1995] 2 Lloyd's Rep. 116; *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501.
[95] [1995] 1 AC 501.
[96] *Ibid.*, 551, *per* Lord Mustill.
[97] *Ibid.*
[98] Clarke, M. A., *supra* note 11, pp. 671-672.
[99] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 568-569, *per* Lord Lloyd. See also *Assicurazioni Generali SpA* v. *Arab Insurance Group (BSC)* [2003] 2 CLC 242, 271.
[100] *Assicurazioni Generali SpA* v. *Arab Insurance Group (BSC)* [2003] 2 CLC 242, 271.

Accordingly, the current law does not offer an automatic legal presumption of inducement when the objective test is satisfied. One exception has, however, been made to cases where the underwriter who entered into the contract on behalf of the insurer is unable to give evidence as to his state of mind when he concluded the contract. In such a case, if there has been a "good reason"[101] for the underwriter not to provide this kind of evidence by not testifying in trial, the insurer could indirectly prove inducement on the balance of probabilities by referring to the same evidence as was presented in order to establish materiality under the objective test.[102] This was the case in *St Paul Fire & Marine Insurance Co. (UK) Ltd.* v. *McDonnell Dowell Constructors Ltd.*[103], where one fully relied on the evidence of materiality that had been provided to satisfy the objective test as one of the underwriters did not provide any evidence of inducement for the reason that the insurer no longer employed him. Thus, under these circumstances, the evidence provided in order to satisfy the objective test could be used as indirect evidence for inducement. Certainly, the chances of succeeding in this regard are dependent on how robust the evidence for materiality is.[104]

Except in the situations referred to above, the objective test (that of materiality to a hypothetical prudent underwriter) and the subjective test (relating to the inducement of the actual underwriter) are to be seen as two separate tests that must be satisfied individually in order to give the insurer a right of avoidance.[105]

3.3.5 Contstructive knowledge

The codified rules on non-disclosure in the Marine Insurance Act 1906 are strict in the sense that they do not only refer to circumstances that are within the assured's actual knowledge, but to circumstances that "in the ordinary course of business, ought to be known by him"[106]. Thus, the assured is deemed to have a presumed, or constructive, knowledge regarding certain material circumstances that are outside his actual, direct knowledge. One example may be material information that increases the risk of moral hazard once the contract of insurance is in force, such as information about past criminal convictions concerning dishonest or fraudulent behaviour of employees closely related to the subject-matter. If it is in the ordinary course

[101] H. Bennett gives the following examples of a "good reason": "The underwriter may be incapable of testifying by reason of ill-health or may, indeed , have died. Alternatively, the underwriter may have left the insurers' employment and not be inclined to assist or subject only to unacceptable conditions", Bennett, H., *supra* note 2, p. 122. Other examples of "good reasons" are if the underwriter cannot be identified or if he cannot recall the pre-contractual negotiations in question, see Rose, F. D., *supra* note 19, p. 85.
[102] Bennett, H., *supra* note 2, p. 122-123; *St Paul Fire& Marine Insurance Co. (UK) Ltd.* v. *McDonnell Dowell Constructors Ltd.* [1995] 2 Lloyd's Rep. 116.
[103] [1995] 2 Lloyd's Rep. 116.
[104] *Smith* v. *Chadwick* (1884) L.R. 9 App. Cas. 187, 196.
[105] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501, 541-542, 549.
[106] Marine Insurance Act 1906, s. 18(1).

of business for the shipping company to acquire information regarding the existence of such criminal history, for example as a precondition for employment, such information could constitute constructive knowledge to the director and thus be require disclosure.[107]

Another example is where material information has come to the knowledge of the assured's office (but has not necessarily come to his direct knowledge) and therefore has been deemed obligatory to disclose. An analogy may be drawn to marine insurance from the scenario manifested in the case of *London General Insurance Co. Ltd.* v. *General Marine Underwriter's Association Ltd.*[108]. The case concerned a reinsurer that had underwritten a cargo risk with an underwriter whose office, not long before the contract was concluded, had received information about a fire casualty at the vessel in which the cargo was carried. The underwriter had no direct knowledge of the casualty, as he had not paid any attention to the casualty slip circulating in his office. The underwriter was however deemed to have constructive knowledge of the casualty before the risk was reinsured and the case established the general principle that once the information had reached the office, it was deemed to be within the knowledge of the assured, even though no direct knowledge existed.[109]

This constructive knowledge also applies to material circumstances that are within the knowledge of the assured's agents that have direct, managerial control of the insured vessel (such as the master) and who, in the ordinary course of business, inform the assured about the risk.[110] The master is employed with the contractual obligation to, *inter alia*, keep its principal informed of essential information relating to the vessel (such as casualties) – information that could influence the judgment of an underwriter at the pre-contractual stage.[111] The underwriter rightfully enters the contract of insurance assuming that the relationship between the master and the assured is well-functioning and he is therefore also entitled to trust that the prospective assured has knowledge (albeit not directly) of material circumstances that the master has direct knowledge of. Every material circumstance that the master is aware of and that he is able to communicate to his principal (the assured) before the insurance contract is concluded, is therefore deemed to be within the knowledge of the assured and must be

[107] *Cf. Insurance Corporation of the Channel Islands Ltd.* v. *The Royal Hotel Ltd.* [1998] Lloyd's Rep. IR 151. A further examination of the subject of moral hazard and its materiality is provided in chapter 4.
[108] [1921] 1 K.B. 104.
[109] The case did however also examine whether also the reinsurer ought to have been aware of the casualty, as the slip had reached his office as well. Due to this, the contract was (with reference made to s. 18(3) (b) of the Marine Insurance Act 1906) deemed not avoidable by the reinsurer. It was however established that knowledge existed once the information had reached the office of a party, no matter if the party himself had direct knowledge of it or not. *London General Insurance Co.* v. *General Marine Underwriters Association* [1921] 1 K.B. 104.
[110] *Proudfoot* v. *Montefiore* (1867) L.R. 12 Q.B. 511; *Blackburn, Low & Co.* v. *Vigors* (1887) L.R. 12 App. Cas. 531, 540; *Arnould's Law of Marine Insurance and Average, supra* note 9, p. 617; Bennett, H., *supra* note 2, p. 147.
[111] *Blackburn, Low & Co.* v. *Vigors* (1887) LR 12 App. Cas. 531, 540.

disclosed to the underwriter. Without such a constructive knowledge, the principal (*i.e.* the assured) would be able to instruct his agent to remain silent about material information that the underwriter would want to know, without any implications to the assured.[112]

The knowledge of some agents is, however, excluded. The knowledge of agents with limited authority relating to facts and relating to their "common understanding of their form of employment"[113] is not to be regarded as the knowledge of the assured. As concluded in the 17th edition of *Arnould's Law of Marine Insurance and Average*[114]; "The agent whose knowledge is deemed to be that of his principal must be one to whom the principal looks for information concerning the property insured"[115]. It is up to the insurer, being the one who alleges it, to prove that there has been a non-disclosure of material information that the assured was aware of and that the knowledge of the agent is to be seen as the knowledge of the assured.[116]

It should be mentioned that Nelsonian knowledge, *i.e.* information that the assured wilfully has turned a blind eye to, is deemed included in the knowledge of the assured as well.[117] The assured is, however, not required to undertake any investigations in order to get hold of information outside his knowledge, unless the investigations are part of the ordinary course of business.[118] It is up to the insurer, who alleges it, to prove that the investigations are part of the ordinary course of business.[119]

Whether the concept "ordinary course of business" is to be judged subjectively or objectively is a question whose answer has not been entirely clear. In the case *PCW Syndicates* v. *PCW Reinsurers*[120], the concept was held to be subjective in the sense that one must take the specific assured and his specific business into consideration. The assured might not have the same informational relationship with his agents as other assureds do and might therefore have a different "ordinary course of business" than other assureds do, *i.e.* the specific assured might not rely on his agents to the same extent as other assureds do when it comes to obtaining material information.[121] This was not wholly in line with the decision in the case *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.*[122] (*The Dora*). This case favoured a more objective perspective, as the court held that

[112] *Proudfoot* v. *Montefiore* (1867) L.R. 12 Q.B. 511, 521-522; *Arnould's Law of Marine Insurance and Average, supra* note 9, 2008, p. 622.
[113] *Blackburn, Low & Co.* v. *Vigors* (1887) LR 12 App. Cas. 531, 538.
[114] *Arnould's Law of Marine Insurance and Average, supra* note 9, p. 620.
[115] *Ibid.*, p. 620.
[116] Clarke, M. A., *supra* note 11, p. 670; MacDonald Eggers, P., *et al*, *supra* note 4, p. 559.
[117] *Simner* v. *New India Assurance Co. Ltd.* [1995] L.R.L.R. 240; *ERC Frankona Reinsurance* v. *American National Insurance Co.* [2006] Lloyd's Rep. I.R. 157; *Arnould's Law of Marine Insurance and Average, supra* note 9, p. 626.
[118] *Arnould's Law of Marine Insurance and Average, supra* note 9, p. 626.
[119] Clarke, M. A., *supra* note 11, p. 670.
[120] [1996] 1 Lloyd's Rep. 241.
[121] *P.C.W. Syndicates* v. *P.C.W. Reinsurers* [1996] 1 Lloyd's Rep. 241, 254. See also *Arnould's Law of Marine Insurance and Average, supra* note 9, pp. 628, 630.
[122] [1989] 1 Lloyd's Rep. 69.

investigations concerning previous criminal records of the skipper should be a part of the assured's ordinary course of business, as they generally are, although such investigations never had been a part of the ordinary course of the specific business.[123]

The editors in the 17th edition of *Arnould's Law of Marine Insurance and Average*[124] does however conclude that what ought to be known by the assured in the ordinary course of business is to be seen both from a subjective and an objective point of view. Subjective in the sense that one must base it on the class of which the specific assured is a member, and objective in the sense that one thereafter must establish whether the circumstances would be included the ordinary course of business of a hypothetical prudent assured of that very class.[125]

3.3.6 The duration of the pre-contractual duty of disclosure

The pre-contractual duty to abstain from non-disclosure and misrepresentation ends when the contract of insurance is concluded and the insurer, thus, has assumed the risk. The correctness of a misrepresentation or the establishment of a non-disclosure and its materiality is therefore to be judged with reference to its status at the conclusion of the contract, even though the circumstance in question would not be regarded as material at a later point in time.[126]

The wide formulation of section 17 of the Marine Insurance Act 1906 allows a wide application. The general duty of utmost good faith does not cease to apply after the conclusion of the contract; in fact, several cases have established that there is a post-contractual duty of utmost good faith, inherent in the general language of section 17.[127] The language of the subsequent provisions of the Marine Insurance Act 1906, sections 18-20, does however limit the application of the mentioned sections to the pre-contractual negotiations, as they expressly refer to disclosure and material representations "before the contract is concluded"[128]. Once both parties are bound by the contract, the provisions on disclosure and representations in section 18 and 20 of the Act are no longer applicable.[129]

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[123] *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* [1989] 1 Lloyd's Rep. 69, 95.
[124] *Arnould's Law of Marine Insurance and Average, supra* note 9, pp. 627-630. The editors being: Gilman, J., Merkin, R., Blanchard, C., Cooke, J., Hopkins, P. and Templeman, M.
[125] *Ibid.*, pp. 627-630.
[126] *Brotherton* v. *Aseguradora Colseguros S.A. (No. 2)* [2003] 2 C.L.C. 629, 629-630.
[127] See for example *Black King Shipping Corporation and Wayang (Panama) S.A.* v. *Mark Ranald Massie* (*The Litison Pride*) [1985] 1 Lloyd's Rep. 437; *Manifest Shipping Co. Ltd.* v. *Uni-Polaris Insurance Co. Ltd.* (*The Star Sea*) [2001] WLR 170 and *K/S Merc-Scandia XXXXII* v. *Lloyd's Underwriters* (*The Mercandian Continent*) [2001] 2 Lloyd's Rep. 563.
[128] Marine Insurance Act 1906, ss. 18(1), 20(1).
[129] *Cory* v. *Patton* (1872) L.R. 7 Q.B. 304, 308-309.

The contract is deemed concluded upon acceptance of the assured's proposal, traditionally when the underwriter, irrespective of whether the policy has been issued, signs the slip.[130] The conclusion of a contract of insurance is however dependant on the particular circumstances in each case and the time of acceptance could therefore vary. An insurance contract could for example be deemed concluded when the insurer is bound by the assured's proposal by equity or honour and no longer has a possibility to alter the terms or reject the risk.[131] Up until the conclusion – or renewal[132] – of the contract, the assured may correct or withdraw any misstatement and disclose information that has not yet been disclosed. The breach of the duty of disclosure is thereby repaired, provided that the correction is presented in a fair way and comes to the knowledge of the underwriter. The rationale for this is that before the contract is in force and deemed *pacta sunt servanda*, the parties may alter the terms and the underwriter still has the possibility to choose whether he will take on the risk or not based on the disclosed information.[133]

3.4 Information excluded from the duty of disclosure

This subsection will, in order to establish the limits to the duty of disclosure, touch upon what kinds of circumstances the assured or his broker is allowed to withhold from the underwriter at the pre-contractual stage without violating the duty of utmost good faith. The Marine Insurance Act 1906, section 18(3), states four kinds of circumstances that may be withheld; circumstances that lessen the risk, circumstances that are known (or presumed to be known) to the insurer, circumstances that have been waived by the insurer and, finally, circumstances that are "superfluous to disclose by reason of express or implied warranty"[134]. The burden of proving that a withheld circumstance qualifies as an exemption included in section 18(3) falls on the assured after the insurer has discharged his initial burden of proof by showing on the balance of probabilities that the circumstance

[130] Marine Insurance Act 1906, s. 21. The signing of the slip may signify evidence of a contract of insurance, but unless a policy is issued (either at signing or afterwards) it is in principle not admissible as evidence, see Marine Insurance Act 1906, s. 22. The production of such a policy is however not always a precondition for an action under a contract of marine insurance in practice, see *Eide UK Ltd.* v. *Lowndes Lambert Group Ltd.* [1999] Q.B. 199, 207-208.

[131] *Canning* v. *Farquhar* (1886) L.R. 16 Q.B.D. 727, 730-732; MacDonald Eggers, P., *et al*, *supra* note 4, p. 53.

[132] *Lambert* v. *Co-operative Insurance Society Ltd.* [1975] 2 Lloyd's Rep. 485, 487; *Graham* v. *Western Australian Insurance Company Ltd.* (1931) Ll.L. Rep. 64, 66.

[133] Marine Insurance Act 1906, s. 20(6); *Commonwealth Insurance Co. of Vancouver* v. *Groupe Sprinks S.A.* [1983] 1 Lloyd's Rep. 67, 79-80; Goodacre, J. K., *Marine Insurance Claims*, 3rd ed., Witherby & Co. Ltd., London, 1996, p. 64; Bennett, H., *supra* note 2, pp. 125-126, 152.

[134] Marine Insurance Act 1906, s. 18(3).

existed at the time of placement of the risk, that it was known to the assured and that it was withheld.[135]

The fact that circumstances that diminish the risk are excluded from the assured's duty of disclosure is rather logical, seen from the perspective of each of the parties respectively. A concealment of such a circumstance would not harm the insurer, in fact, it would rather give him an advantage, since he then might have agreed on a higher premium than he would have and he has accepted a risk that is lower than what he first thought. This exception is advantageous for the proposer to the insurance contract as well, as it narrows down the applicability of the duty of disclosure and lessens the scope of facts that must be disclosed by him.[136]

It is also rather logical why circumstances that are within the direct knowledge of the underwriter (thus, is present in the underwriter's mind at the time of the presentation) do not need to be disclosed by the assured. Since the underwriter already is aware of the facts, he may consider them when making his judgment of whether or not to assume the risk. The Marine Insurance Act 1906, section 18(3) does also concern presumed knowledge of the underwriter, which includes circumstances that are of common knowledge and circumstances that the underwriter ought to know in the ordinary course of his business. Whether a fact is of common notoriety depends on to what extent it is available to the public and whether a reasonably competent underwriter would be aware of such a fact.[137] Common notoriety relates to either politics (such as war, terrorism etc.) or nature (such as hurricanes and earthquakes).[138] Lord Mansfield stated as follows in the leading case *Carter* v. *Boehm*[139]:

> The under-writer is bound to know every cause which may occasion natural perils; as, the difficulty of the voyage—the kind of seasons—the probability of lightning, hurricanes, earthquakes, &c. He is bound to know every cause which may occasion political perils; from the ruptures of States from war, and the various operations of it. He is bound to know the probability of safety, from the continuance or return of peace; from the imbecility of the enemy, through the weakness of their counsels, or their want of strength.

Circumstances that are of common notoriety are not only global events, but facts that are of common knowledge or common public record. The spectrum of circumstances included in this exception in section 18(3) (b) is naturally increased by the underwriter's accessibility to information via the

[135] Clarke, M. A., *supra* note 11, p. 670.
[136] MacDonald Eggers, P., *et al, supra* note 4, p. 191. See also, for example, *Carter* v. *Boehm* (1766) 3 Burr. 1905 [1910], 97 ER 1162, 1165.
[137] *Canadian Indemnity Co.* v. *Canadian Johns-Manville Co.* [1990] 2 SCR 549, as cited in MacDonald Eggers, P., *et al, supra* note 4, p. 194.
[138] *Carter* v. *Boehm* (1766) 3 Burr. 1905 [1910], 97 ER 1162, 1165; *Leen* v. *Hall* (1923) 16 Ll. L. Rep. 100, 102-103.
[139] (1766) 3 Burr. 1905 [1910], 97 ER 1162, 1165.

internet and other electronic networks.[140] When it comes to circumstances that the underwriter in the ordinary course of his business ought to know, this refers to facts and risks that are present in the general usages of the trade in question. An underwriter for a marine insurance contract is, for example, deemed aware of general facts and customs pertaining to the international marine trade, nature of a vessel and its cargo in the specific trade. Whether or not a certain circumstance is deemed to be within the knowledge of the underwriter or not is to be judged upon the facts and the context of each case.[141]

Excluded from the duty of disclosure are also circumstances that have been waived by the insurer, either expressly (for example by stating that he does not require disclosure of the fact in question) or impliedly (this could for example relate to the asking of some questions in an application form, but not others).[142] An implied waiver may for example exist if the underwriter has provided the prospective assured with questions that have been formulated in a way that it "implies necessarily that the underwriter requires only information touching upon a particular subject or falling within a defined compass, then there has been a waiver of his right to disclosure of all other matters"[143]. Questions regarding circumstances from a particular period of time may serve as a waiver of a disclosure of circumstances that relate to other time periods. The existence of a waiver is largely based on a valuation of the specific facts of each case and with reference to the type of policy, the proposal form and the class of facts asked. The questions are interpreted from a perspective of a reasonable man and whether he, when reading the proposal form, would consider a that the insurer had restricted his right to obtain all material information. Commercial insurance does not offer the same support as consumer insurance, where ambiguous questions formulated by the underwriter are interpreted against him. There are nevertheless several guidelines that the insurance industry has agreed on, such as the Financial Services Authority's regulation, ICOBS, which establishes that the questions asked by the insurer in a proposal form should be interpreted as being those that he consider material and information that is not asked for is thereby waived.[144]

The last exception from the duty of disclosure under section 18(3) of the Marine Insurance Act 1906 relates to information that is superfluous due to an express or implied warranty. Implied warranties are not written expressly in the contract, but the insurer may nevertheless rely on implied warranties in respect of the vessel's seaworthiness (in case of a voyage policy), the legality of the adventure insured and a proper documentation of the vessel in cases where there is an express warranty of neutrality.[145] It is, for example,

[140] MacDonald Eggers, P., *et al*, *supra* note 4, p. 195.
[141] *Glencore Intrernational A.G.* v. *Alpina Insurance Co. Ltd.* [2004] 1 Lloyd's Rep. 111, 124; *Arnould's Law of Marine Insurance and Average*, *supra* note 9, pp. 678, 682.
[142] *Arnould's Law of Marine Insurance and Average*, *supra* note 9, p. 696; MacDonald Eggers, P., *et al*, *supra* note 4, pp. 204-206.
[143] MacDonald Eggers, P., *et al*, *supra* note 4, p. 207.
[144] *Ibid.*, pp. 206-210.
[145] Marine Insurance Act 1906, ss. 36, 39, 41.

not necessary for the assured under a hull and machinery voyage policy to disclose a ship's unseaworthiness as the policy includes an implied warranty of seaworthiness.[146] Another example can be drawn from the case *Gan Insurance Co. Ltd.* v. *Tai Ping Insurance Co. Ltd.*[147] where an express warranty that there was adequate fire-fighting equipment onboard a vessel was included in the policy, and so it was not necessary to disclose the status of the actual fire-fighting equipment. The rationale behind the exemption of warranties in the duty of disclosure is that the underwriter may rely on a warranty that guarantees the existence or truth of a fact and will thus not need to obtain such information by the assured.[148]

3.5 Remedy

The remedy available for the innocent party if the duty of utmost good faith has not been met is avoidance of the contract.[149] It is stated explicitly in section 18(1) of the Marine Insurance Act 1906 that the insurer may avoid the contract of insurance if the assured has not fulfilled his pre-contractual duty of disclosure. The same applies to material misrepresentations (see section 20(1)). The avoidance for non-disclosure is retrospective, which means that the innocent party has a right to avoid the contract *ab initio.*[150] The remedy for the breach was described by Lord Hobhouse in *Manifest Shipping Co. Ltd.* v. *Uni-Polaris Insurance Co. Ltd.* (*The Star Sea*)[151] in the following words:

> It enables the aggrieved party to rescind the contract ab initio. Thus he totally nullifies the contract. Everything done under the contract is liable to be undone. If any adjustment of the parties' financial positions is to take place, it is done under the law of restitution not under the law of contract.[152]

If the innocent party chooses to avoid the contract, the parties are put in the same position as they were in before the contract was concluded. Thus, the assured is not entitled to any insurance cover, instead, all premiums paid are recoverable by him (provided that the non-disclosure or misrepresentation was not fraudulent) and all indemnifications paid to the assured are recoverable by the insurer.[153] The remedy is strict in the sense that it does not matter whether the breach of the duty of utmost good faith was innocent or fraudulent, the avoidance affects the whole contract, not just a part of it. The assured has thereby a strict responsibility in providing the underwriter

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[146] *Arnould's Law of Marine Insurance and Average, supra* note 9, p. 700.
[147] [2001] 1 Lloyd's Rep. I.R. 291, 304.
[148] MacDonald Eggers, P., *et al, supra* note 4, p. 221.
[149] Marine Insurance Act 1906, s. 17.
[150] *Cornhill Insurance Co. Ltd.* v. *L. & B. Assenheim* [1937] 58 Ll.L.Rep. 27, 31; *Manifest Shipping Co. Ltd.* v. *Uni-Polaris Insurance Co. Ltd.* (*The Star Sea*) [2003] 1 A.C. 469, 494.
[151] [2003] 1 A.C. 469.
[152] *Manifest Shipping Co. Ltd.* v. *Uni-Polaris Insurance Co. Ltd.* (*The Star Sea*) [2003] 1 A.C. 469, 494.
[153] *Cornhill Insurance Co. Ltd.* v. *L. & B. Assenheim* [1937] 58 Ll.L.Rep. 27, 31.

with the information he can expect to acquire.[154] For these reasons, avoidance is often an adequate remedy for the insurer, who is liberated from all liability under the contract retrospectively. The right of mutual restitution does naturally also work in favour of an assured that has made a non-fraudulent breach, since he then has a right to recover the premiums paid. It might however seem dramatic that the assured ends up with no cover at all even though the non-disclosure was made by honest mistake, especially since a breach of the duty of disclosure usually comes to light where a loss already has occurred and a claim has been made against the insurer.[155]

General contract law provides a possibility for the court, in case of misrepresentation, to take into account the absence of fraudulent intentions of the breach and, where the misrepresentation is entirely innocent, one may consider a proportionate amount of damages instead of a rescission of the entire contract.[156] A possibility to interpret the provision of the Misrepresentation Act 1967 by analogy to misrepresentations (and especially non-disclosure) in the context of marine insurance is, however, problematic since the right of rescission and the right of avoidance is two technically different remedies.[157] Proportionate damages have not yet been offered as an alternative in English insurance contract law and the rightful remedy is avoidance of the entire contract together with restitution of the premiums.[158]

In case an insurer has suffered a loss by relying on a fraudulent or negligent misrepresentation, the insurer may claim damages in order to put him in the same position as he would have been in if no misrepresentation had been made and consequently no insurance policy had been issued. Such claims for damages are however not so common in practice as the plausible loss to the insurer for relying on the deceit normally is covered by the remedy of avoidance and the right to retain the premiums in cases where the assured has been fraudulent. Non-disclosure does however not provide the insurer with a right to claim damages for a consequential loss, even if it was deliberate, as deceit requires a positive misrepresentation and a breach of the duty of utmost good faith does not constitute a basis for tort.[159]

As have been concluded in subchapter 3.3.6, the materiality of a fact is judged with reference to the time when the risk was placed. Consequently,

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[154] *Pan Atlantic* v. *Pine Top* [1993] 1 Lloyd's Rep. 496, 506.
[155] *Kausar* v. *Eagle Star Insurance Co. Ltd.* [2000] Lloyd's Rep. I.R. 154, 157.
[156] Misrepresentation Act 1967, s. 2(2).
[157] Bennett, H., *supra* note 2, p. 163.
[158] *Banque Financière de la Cite S. A.* v. *Westgate Insurance Co. Ltd.* (*sub nom Banque Keyser Ullman S.A.* v. *Skandia (UK) Insurance Co. Ltd.)* [1991] 2 A.C. 249, 264, 280. See also *Heilbut, Symons & Co.* v. *Buckleton* [1913] A.C. 30, 51.
[159] Clarke, M. A., *supra* note 11, pp. 724-725; The Law Commission of England and Wales, *Consultation Paper No. 182, Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured*, pp. 26-27, 32-33, http://lawcommission.justice.gov.uk/docs/cp182_ICL_Misrep_Non-disclosure_Breach_of_Warranty.pdf.

the right of avoidance remains, even if a fact that was material at placement later turns out immaterial.[160]

The insurer is entitled to a reasonable period of time that is determined with reference to the facts of each case (starting from the moment he became aware of the breach) within which he may form his decision of whether to avoid the policy or not. A passive delay that extends outside the reasonable period of time does however not automatically amount to an affirmation of the contract or revoke the insurer's right of avoidance. The insurer is entitled to postpone the decision on whether or not to avoid the contract as long as he likes, but the more the "reasonable time"-period is exceeded, the more likely it is that the passivity may be used as evidence contributing to the determination of the contract as affirmed.[161]

[160] *Brotherton* v. *Aseguradora Colseguros S.A. (No. 2)* [2003] 2 C.L.C. 629, 629-630. See also subchapter 3.3.6.
[161] *Arnould's Law of Marine Insurance and Average*, *supra* note 9, pp. 589-591.

4 Moral hazard

4.1 The notion of moral hazard

As have been concluded above[162] the pre-contractual duty of utmost good faith comprises a duty to inform the underwriter of any circumstance that is material to the judgment of a prudent insurer.[163] One category of circumstances that this duty applies to is so-called physical hazards. Such circumstances relate to the particular subject-matter insured (for example, cargo or the vessel) and its physical attributes. Another category is often referred to as "moral hazards" and it is this category that will be of focus hereinafter.[164]

Moral hazards are risks that relate to the assured's moral character and his propensity of acting in a way that would increase the risk that is about to be insured.[165] Any fact concerning moral hazard that would affect the judgment of a prudent underwriter, but has been withheld, opens up for a lawful avoidance of the contract by the insurer in accordance with the doctrine of utmost good faith, unless the non-disclosure cannot be proven on the balance of probabilities to have induced the underwriter to enter into the contract.[166]

It may be noted that the mere existence of an insurance policy does, in theory, create an incentive for the assured to act fraudulently by for example making an exaggerated or false claim once the contract of insurance is in force. The assured could be tempted to fabricate a fictional loss that is recoverable under the policy and that can be proven on the balance of probabilities, and thereby collect his compensation from the insurer. Moral hazard constitutes the risk of such dishonest behaviour by the assured once the insurance policy is in force, a behaviour that obviously increases the risk of a loss that the insurer ultimately must compensate. For this reason, a hypothetical prudent underwriter would most likely want to be disclosed information indicating whether the assured has a history or a propensity of acting dishonestly.[167]

The moral hazard relates to the human aspects of the risk and where the assured constitutes a shipping company this may relate to the moral character of, *inter alia*, the director, agents of the assured or the master of the vessel. Any person that is closely related to the insured interest and able

[162] See subchapter 3.3.1.
[163] *Ionides* v. *Pender* (1874) L.R. 9 Q.B. 531, 537-538.
[164] Merkin, R., *supra* note 54, pp. 25-26.
[165] *Reynolds* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440, 456; MacDonald Eggers, P., *et al*, *supra* note 4, p. 413; Bennett, H., *supra* note 2, p. 127.
[166] *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.* [2006] 1 C.L.C. 606, 614.
[167] *Insurance Corporation of the Channel Islands Ltd.* v. *the Royal Hotel Ltd.* [1998] Lloyd's Rep. I.R. 151; *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* (*The* Dora) [1989] 1 Lloyd's Rep. 69, 95-96; MacDonald Eggers, P., *et al*, *supra* note 4, p. 413.

to cause a loss covered by the policy due to fraudulent behaviour is part of the assured's moral hazard.[168] The moral hazard may also relate to facts that, if known to the underwriter, would make him take the view that "the proposers were undesirable persons with whom to have contractual relations"[169].

Several functions of the marine insurance market reduce the risk of moral hazard. The deductibles do, to some extent, impede moral hazards by making the assured a co-insurer. By not over-insuring property, the underwriter may reduce the assured's incentive to make exaggerated or false claims. In addition, the legal right of avoidance, as set out in sections 17-20 of the Marine Insurance Act 1906, naturally lowers the incentive for the assured to withhold material information relating to moral hazard at the negotiations, since such avoidance would leave the assured with no compensation at all in case of a loss. The Act also constitutes a way for insurers to protect themselves against being held as a party to a contract where material information indicating an increased probability of post-contractual insurance fraud has been withheld.[170]

Any matter that concerns the moral credibility of the assured relating to honesty or good faith may be material for disclosure. It is clear that even where the assured has an intention to defraud the insurer at the time of the negotiations, such dishonest intentions must be disclosed.[171] Another more obvious example is previous criminal convictions indicating dishonest behaviour.[172] The question does, however, arise as to whether all criminal convictions are included in the duty of disclosure and where the line is drawn between the assured's reluctance of allowing past actions affect the his conditions negatively and the underwriter's desire to obtain as much information as possible so that a precise assessment of the moral hazard can be made. This question is even more complicated in cases where the information relates to allegations of dishonesty, allegations that might not even be true. Are such unfounded allegations material for disclosure and, thus, allowed to influence the judgement of a prudent insurer? The following examination will centre around the following categories of information that concern moral hazard and their materiality: criminal convictions, allegations of dishonesty and insurance history.

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[168] *Markel International Insurance Co. Ltd.* v. *La Republica Compania Argentina de Seguros* [2004] EWHC 1826; *Regina Fur Company Ltd.* v. *Bossom* [1957] 2 Lloyd's Rep. 466; *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* (*The Dora*) [1989] 1 Lloyd's Rep. 69; MacDonald Eggers, P., *et al*, *supra* note 4, p. 413.

[169] *Locker & Woolf Ltd.* v. *Western Australian Insurance Co.* [1936] 1 K.B. 408, 414.

[170] *Arnould's Law of Marine Insurance and Average, supra* note 9, p. 654; Rose, F. D., *supra* note 19, p. 78.

[171] Although it may not be very likely that the assured would make such a disclosure, since it obviously would go against his intentions - if disclosed, the assured probably no longer has the intention to defraud the insurer. *Rivaz* v. *Gerussi Brothers & Company* (1880) 6 Q.B.D. 222, 229, as cited in MacDonald Eggers, P., *et al*, *supra* note 4, p. 414.

[172] *Regina Fur Company Ltd.* v. *Bossom* [1957] 2 Lloyd's Rep. 466.

4.2 Information concerning moral hazard and its materiality

4.2.1 Criminal convictions

Information regarding past criminal convictions may be material for disclosure as they may indicate whether the assured (or any other person closely related to the insured interest and able to cause a loss due to fraudulent behaviour) has a tendency to engage in dishonest or fraudulent activities. Such dishonest behaviour may affect the risk of loss under the policy and thereby also the judgment of the prudent insurer in determining whether to take the risk and, if so, in return for what premium. The assured is however not required to disclose every single conviction he has been sentenced for in the past in order to satisfy the duty of disclosure.[173] Several principles that establish limitations to the materiality of past criminal convictions can be discerned from case law. These will be examined in the following.

The non-marine case *Regina Fur Company Ltd.* v. *Bossom*[174] illustrates the potential materiality that past criminal convictions may have. In this case, the assured company had failed to inform the underwriter of the fact that its director had a criminal history in that he 20 years earlier had been convicted of possessing stolen property. When the assured company later on claimed compensation under the policy for a theft of property, the question came up of whether or not the insurer had a right to avoid the policy under the Marine Insurance Act 1906 due to the withheld information. The court held that although the offence had been committed many years earlier, the materiality of the conviction was increased by its relevance to the risk. Thus, it was established that the criminal conviction that indicated moral hazard was a fact that was material to a prudent underwriter's judgment in determining whether he should underwrite the risk and for what premium.[175]

Although the criminal conviction in the case of *Regina Fur Company* v. *Bossom* was material, one cannot conclude that every criminal conviction of an assured automatically is deemed material and consequently requires disclosure. To deem every illegality in the assured's past material, no matter how trivial or distant, is neither efficient nor motivated from an underwriter's perspective. This was established in the case *Corcos* v. *De Rougemont*[176], where the court concluded that, although the underwriter should obtain information relating to the assured's past convictions in order for him to be able to ascertain the character of the assured, the assured cannot be obliged to disclose "any breach of the law with regard to

[173] *Corcos* v. *De Rougemont* (1925) 23 Ll.L. Rep. 164, 167; *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* (*The Dora*) [1989] 1 Lloyd's Rep. 69.
[174] [1957] 2 Lloyd's Rep. 466.
[175] *Ibid.*
[176] (1925) 23 Ll.L. Rep. 164.

anything"[177]. Thus, it may be concluded that there are limits to the materiality of past criminal convictions, but what are the exact characteristics a conviction must have in order to influence the judgment of a prudent insurer?

Whether a certain conviction is material or not ultimately depends on the facts of each case and the materiality of a past conviction is a "question of degree"[178]. The conviction must however, as a general principle, relate to the honesty or good faith of the assured and thereby indicate a moral hazard that is material to a prudent underwriter. Past illegalities, such as certain traffic offences, that are technical in their nature and do not relate to the moral credibility of the assured have a lower degree of materiality in relation to moral hazard.[179]

Case law indicate that an underwriter trying to avoid a policy based on non-disclosure of a minor or distant[180] conviction may have trouble proving, on the balance of probabilities, that the awareness of such a conviction would influence the judgment of a prudent insurer.[181] In the case *Reynolds and Anderson* v. *Phoenix Assurance Co. Ltd.*[182] a conviction for a comparatively trivial offence (handling of stolen goods worth £ 10-12) that had taken place 11 years prior to the conclusion of the insurance contract was held immaterial by the court based on the time that had elapsed and the nature of the offence.[183]

The connection between the nature of the illegality and the risk that is about to be insured has also been held as an important factor when determining whether a conviction is material or not. A leading case on this topic is *Roselodge Ltd.* v. *Castle*[184], a case where the assured (a company active in the diamond market) withheld information relating to past criminal convictions of the director as well as the sales manager. The director had been convicted for bribing a police officer, while the sales manager had been convicted for smuggling diamonds into the United States. When a claim under the all risks policy arose concerning a robbery of diamonds, the insurer refused to pay compensation based on the fact that the convictions had not been disclosed prior to the conclusion of the contract. The court established that when determining the materiality of a past conviction, regard is given to the fact that there is a direct connection between the crime committed and the risk insured. The director's conviction was held to be immaterial to a prudent underwriter as it had "no direct relation to trading as

[177] *Corcos* v. *De Rougemont* (1925) 23 Ll.L. Rep. 164, 167.
[178] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178, 188.
[179] Marine Insurance Act 1906 s. 18(4), 20(7); *Roselodge Ltd.* v. *Castle* [1966] 2 Lloyd's Rep. 113, 133; MacDonald Eggers, P., *et al*, *supra* note 4, p. 414.
[180] *I.e.* distant with regard to the time elapsed.
[181] *Corcos* v. *De Rougemont* (1925) 23 Ll.L. Rep. 164; *Reynolds and Anderson* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440.
[182] [1978] 2 Lloyd's Rep. 440.
[183] *Reynolds and Anderson* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440.
[184] [1966] 2 Lloyd's Rep. 113.

a diamond merchant"[185]. The sales manager's conviction, which concerned smuggling of diamonds, did however relate to the risk insured and the withheld conviction was deemed material.[186] A close connection between the offence and the plausible loss under the policy is likely to increase the chances for the insurer to prove, on the balance of probabilities, that the conviction is a material fact due to its indication of moral hazard as this would imply an increased likelihood of a fulfilment of the objective and subjective test.[187]

The convicted person's position within the company has also been held as an important factor when determining whether the non-disclosure of a conviction is material or not. This was confirmed by Lloyd, J. in the case *Container Transport International Inc.* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.*[188], who stated as follows:

> If the conviction was trivial, or unconnected with the subject matter of the insurance, or if the crime was committed long ago, or in the case of a company by a relatively junior employee, it will generally be regarded as immaterial; but not so if the conviction was recent, or the crime committed by a more senior employee such as a sales manager.[189]

Although information concerning a criminal conviction would be deemed as material with respect to the moral hazard under the Marine Insurance Act 1906, it may nevertheless be exempted from the duty of disclosure if the conviction is considered as "spent" under the Rehabilitation of Offenders Act 1974. The Act, which is intended to encourage rehabilitation of convicted persons, classifies a conviction as "spent" once a pre-determined amount of years have passed (the rehabilitation period[190]) without any further re-conviction. Once the conviction is classified as spent, the assured is permitted to withhold information about the conviction itself as well as the conduct constituting the offence from the underwriter. A pre-condition is however that the rehabilitation period has expired prior to the conclusion of the insurance contract.[191]

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[185] *Roselodge Ltd.* v. *Castle* [1966] 2 Lloyd's Rep. 113, 132.
[186] *Ibid.*, 133.
[187] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501.
[188] [1982] 2 Lloyd's Rep. 178.
[189] *Ibid.*, 199.
[190] The length of the rehabilitation period is determined with respect to the type of sentence. Inexhaustible examples of sentences and their rehabilitation periods are: Imprisonment for a term longer than six months, but less than thirty months, gives rise to a rehabilitation period of ten years. Imprisonment for a term no longer than six months, requires a rehabilitation period of seven years. A sentence of detention in respect of a conviction in disciplinary proceedings gives rise to a five year rehabilitation period. (Rehabilitation of Offenders Act 1974, s. 5.).
[191] Rehabilitation of Offenders Act 1974, s. 4; *Arnould's Law of Marine Insurance and Average*, *supra* note 9, p. 703; Goodacre, J. K., *supra* note 133, p. 66; MacDonald Eggers, P., *et al*, *supra* note 4, p. 418.

A past criminal conviction of a prospective assured might be, depending on the nature of the crime, an important indicator of the assured's tendency to engage in dishonest or fraudulent activities. It is however not the criminal conviction itself that is of essence. Dishonest or fraudulent behaviour that has not yet come to the authorities' attention and that the assured therefore has not been convicted for is just as material, as well as planned offences that have not yet been committed. Thus, it is the dishonest character of the assured that may affect the underwriter's assessment of the risk and thereby influence his judgment on whether to issue an insurance policy or not. There is therefore no need for a criminal conviction for the behaviour to be material under the duty of disclosure, but the conviction may serve as strong evidence of such behaviour.[192] This was demonstrated in the case *Insurance Corporation of the Channel Islands Ltd.* v. *The Royal Hotel Ltd.*[193] where the prospective assured's contemplation of defrauding his bank was held as material to the judgment of a prudent insurer, even though the assured had not been convicted for it. The assured had prepared false invoices in order to appear to be in a solid financial position in case the bank demanded such information to be presented. Although the assured never got the opportunity to use the invoices, the mere contemplation of defrauding the bank was held as material and consequently required disclosure under the doctrine of utmost good faith. It can, thus, be concluded that the convictions work as indicators or evidence to the underwriter of a dishonest character, but it is the dishonest behaviour itself that is material and not whether the authorities have managed to prosecute and convict the assured.[194]

4.2.2 Allegations of dishonesty

4.2.2.1 General introduction

The assured might be obliged under the doctrine of utmost good faith to disclose certain allegations of dishonesty that have been made against him or any person that is closely connected to the subject-matter insured and able to cause a loss due to fraudulent behaviour.[195] Such allegations may be material to the judgment of a prudent underwriter as they might raise doubts as to the probity of the assured and the risk related to moral hazard.[196] To unrestrictedly bind the assured to an allegation that is completely unfounded and that is outside of his control might however seem harsh seen from the assured's perspective. Such a requirement would imply that the assured would be bound to disclose allegations made by any one, on any grounds, and the underwriter would (to the assured's detriment) take these into consideration when assessing the risk, perhaps without being able to

[192] *Insurance Corporation of the Channel Islands Ltd.* v. *The Royal Hotel Ltd.* [1998] Lloyd's Rep. IR 151; MacDonald Eggers, P., *et al, supra* note 4, p. 417.
[193] [1998] Lloyd's Rep. IR 151.
[194] *Insurance Corporation of the Channel Islands Ltd.* v. *The Royal Hotel Ltd.* [1998] Lloyd's Rep. IR 151.
[195] *Brotherton* v. *Aseguradora Coseguros S.A.* [2003] 2 C.L.C. 629.
[196] *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* (*The Dora*) [1989] 1 Lloyd's Rep. 69, 95.

appreciate the inaccuracy of the allegations. Certain limits and guiding principles regarding the materiality of different kinds of allegations of dishonesty (ranging from criminal charges made by public authorities to rumours and gossip) may however be discerned in case law and doctrine and these will be examined in the present subchapter.[197]

4.2.2.2 Criminal charges

Criminal charges pertaining to dishonesty that are unsettled at the time of the placement of the risk constitute information that is material to the underwriter's assessment of the moral hazard and does therefore require disclosure. This was established in the case *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* (*The Dora*)[198], where it was held that the underwriter should be informed of facts that cast doubt as to the risk (such as formal charges) and not only facts that affect the risk.[199]

The question of whether formal charges requires disclosure was subject for discussion in the cases *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*)[200] and *Brotherton* v. *Aseguradora Coseguros S.A.*[201]. In *The Grecia Express*, the assured had withheld the fact that a charge had been made against him, accusing him of fraudulently scuttling a vessel. The assured did not disclose this fact to the underwriter at the pre-contractual negotiations since he was of the view that there was no evidence supporting it. In the avoidance proceedings, the insurer insisted that the formal charge was material for disclosure under the doctrine of utmost good faith as it raised doubt as to the risk related to moral hazard. The court held that the charge was serious and material based on the fact that the accusation came from public authorities and concerned a criminal offence. One did therefore conclude that the underwriter ought to have been provided with the information so that he could have investigated the allegation and taken it into consideration when assessing the risk.[202]

It should be noted that the fraudulent behaviour upon which formal charges are based still requires disclosure although the charges have been dropped prior to the conclusion of the contract if the assured in fact did commit the crime. Thus, as concluded in subchapter 4.2.1 with regard to criminal convictions, it is not the charges *per se* that are significant, the actual guilt remains material even though the assured has been formally acquitted. The discrepancy between the actual truth and what can be proven in court does therefore not affect the materiality since a formal acquittal does not

[197] *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.* [2006] Lloyd's Rep. I.R. 519, [15]-[20]; MacDonald Eggers, P., *et al, supra* note 4, p. 418.
[198] [1989] 1 Lloyd's Rep. 69.
[199] *Ibid.*, 93. See also *March Cabaret Club & Casino Ltd.* v. *London Assurance* [1975] 1 Lloyd's Rep. 169, 177.
[200] [2002] 2 Lloyd's Rep. 88.
[201] [2003] 2 C.L.C. 629.
[202] *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*) [2002] 2 Lloyd's Rep. 88; Lyde, B., *et al, Reinsurance Practice and the Law*, Informa, London, 2009, pp. 187-188.

automatically relieve the assured from the duty of disclosure, unless the assured actually is innocent.[203]

4.2.2.3 Untrue allegations

The Grecia Express[204] established that in case an insurer avoided a policy on the grounds that the assured had not disclosed a pending charge, a court could overturn the avoidance at trial if the allegation could be proven as incorrect. Thus, the assured would be given an opportunity to prove that the charges were unfounded in the avoidance proceedings and, if he succeeded, the insurer would not be entitled to avoid the contract under the doctrine of utmost good faith. It was held that "an assured is under no duty to disclose facts merely because they are objectively suspicious as to his own wrong-doing when he knows that the suggested facts do not exist"[205].[206]

The *Brotherton*-case[207] did however overrule the reasoning in the *Grecia Express* and established that the materiality of a certain fact was to be determined with reference to the time of placement and not with reference to the time of avoidance. Thus, an insurer was entitled to avoid a policy if the undisclosed allegations were material at the time of placement, regardless of whether they at a later point in time would turn out to be unfounded. The court could not overturn such avoidance retrospectively based on the fact that the allegations later could be proven to be false. Mance, LJ. concluded that allowing the assured to withhold information at the negotiations and later resist avoidance by insisting on a trial to establish the truth would be undesirable and imply high costs.[208]

In the case *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.*[209], the assured had failed to disclose the fact that there were, *inter alia*, four separate criminal proceedings pending against the beneficial owners of the assured at the time of placement, all of which were related to fraud. Although the assured honestly believed that the allegations were groundless at the time of the placement and although three of the four proceedings had been withdrawn or dismissed at the time of the loss, the criminal proceedings were still held to be material facts that required disclosure. In accordance with the court's reasoning in the *Brotherton* case[210], the *North Star* case established that one could not allow exculpatory evidence to

[203] *March Cabaret Club & Casino Ltd.* v. *London Assurance* [1975] 1 Lloyd's Rep. 169, 177; *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*) [2002] 2 Lloyd's Rep. 88, 129-139; Rose, F. D., *supra* note 19, pp. 78-79.
[204] *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*) [2002] 2 Lloyd's Rep. 88.
[205] *Ibid.*, 133.
[206] *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*) [2002] 2 Lloyd's Rep. 88; Lyde, B., *et al*, *supra* note 202, pp. 187-188.
[207] [2003] 2 C.L.C. 629.
[208] *Brotherton* v. *Aseguradora Coseguros S.A.* [2003] 2 C.L.C. 629, 656.
[209] [2005] Lloyd's Rep. I.R. 404; [2006] Lloyd's Rep. I.R. 519.
[210] [2003] 2 C.L.C. 629.

excuse a non-disclosure of a material fact retrospectively. If such exculpatory evidence existed at the time of placement, the assured should have informed the underwriter of those facts pre-contractually so that the underwriter would be given an opportunity to examine them together with the allegations and form his decision based on all facts.[211]

In the Court of Appeal[212], Waller, LJ. reasoned on the position of the assured in situations as in the present case, *i.e.* where the assured is falsely accused by a credible source, obliged to reveal this allegation to the underwriter and directed to disclose exculpatory evidence (if there is any) in order to, if possible, convince the underwriter that the allegation in fact is false. Waller, LJ. stated the following:

> I do not myself see it as a practical answer to say that exculpatory material can be produced, because unless the material is such as to prove beyond peradventure that the allegation is false, in which event the allegation seems to me no longer material, an underwriter is not likely to be prepared to take time sorting out the strength or otherwise of the allegation. In many instances he would be likely to take the view there is no smoke without fire and turn the placement down or at the very least rate the policy to take account of the allegation.[213]

Accordingly, Waller, LJ. questioned the effect of providing the underwriter with exculpatory evidence supporting the assured's innocence. Unless the assured was able to prove that he is completely innocent (in which case there then in fact would not exist an allegation of substance requiring disclosure), the underwriter, with reference to the allegation, would likely judge the assured to his disadvantage.[214] Waller, LJ. furthermore concluded that "it is unreal to contemplate as a general proposition that underwriters as expert witnesses would ever give evidence that a prudent underwriter would not take into account in assessing the risk or the terms of the insurance a recent allegation of serious dishonesty the truth or falsity of which has yet to be determined, even if it is quite unconnected with insurance or the risk being insured."[215]. An allegation may seem immaterial to the risk seen from the assured's perspective since he knows for a fact that the allegation is false and that it thereby does not form evidence of a higher risk of moral hazard. However, the underwriter does not know the truth and it is, as stated by Waller, LJ., highly likely that he would want to take the allegation into account, whether it be true or false.[216]

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[211] *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.* [2005] 2 Lloyd's Rep. 76, 209; Lyde, B., *et al, supra* note 202, p. 188.
[212] *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.* [2006] Lloyd's Rep. I.R. 519, [15]-[20].
[213] *Ibid.*, [17].
[214] *Ibid.*
[215] *Ibid.*, [19].
[216] *Ibid.*, [19]; MacDonald Eggers, P., *et al, supra* note 4, p. 420.

4.2.2.4 The substantiality of an allegation

The court in the *Brotherton*[217] case reasoned on the materiality of different kinds of allegations. The claimants (reinsurers of a bank's policy) argued that the reinsured (the bank) had withheld information regarding several media reports alleging the bank's president of, *inter alia*, corruption and irregular loans, circumstances that the authorities had started to investigate. It was concluded that when determining the materiality of a specific allegation, the court had to "take a realistic and even a robust view about what constitutes 'intelligence' which is material for disclosure as distinct from loose or idle rumours which are immaterial"[218]. The media allegations in the present case were held to be facts of "intelligence" and they were thereby material for disclosure as they included "specific matters involving a suspension of an identified person, the reason for the suspension and the involvement of the authorities"[219]. Thus, in accordance with the ruling in the *Grecia Express*[220], the involvement of the authorities contributed to the classification of a media allegation as "intelligence". The suggestion that the allegations were to be regarded as "loose or idle rumours" was dismissed by the court with the following reasoning:

> Were the reports "loose" or "idle" rumours or gossip? Plainly not. The reports themselves do not have the appearance of tittle tattle and gossip. […] Even if one took a cynical view about the quality of news reporting in the Press and Television, whether in Colombia or elsewhere, it would be an extreme position to conclude that everything in the newspapers was wrong or could be dismissed with a pinch of salt. This was reporting of what appeared to be hard fact.[221]

In conclusion, it can be established that the court made a distinction between loose or idle rumours and intelligence that was of substance and reality seen from an objective perspective. Allegations that had the former character would not be considered as material and the assured would be entitled to withhold the allegation from the underwriter at the negotiations. If it, on the other hand, was to be regarded as intelligence based on hard facts (for example allegations made by authorities), such non-disclosure would be actionable and the underwriter would be entitled to avoid the contract.[222]

The *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.*[223] also confirmed that old allegations or allegations of not so serious dishonesty

[217] [2003] 2 C.L.C. 629.
[218] *Ibid.*, 654-655.
[219] *Brotherton* v. *Aseguradora Coseguros S.A.* [2003] EWHC 1741 (comm), 34, [2003] Lloyd's Rep. I.R. 762.
[220] *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*) [2002] 2 Lloyd's Rep. 88.
[221] *Brotherton* v. *Aseguradora Coseguros S.A.* [2003] EWHC 1741 (comm), 34, [2003] Lloyd's Rep. I.R. 762.
[222] *Ibid.*
[223] [2006] Lloyd's Rep. I.R. 519.

would be less material to the judgment of a hypothetical prudent underwriter (as in the case of past criminal convictions).[224]

4.2.3 Insurance history

Information pertaining to the prospective assured's insurance history may be material to a prudent underwriter when contemplating the issuing of a marine insurance policy. It is mainly three categories of facts relating to the assured's insurance history that will be of focus in the present subchapter, namely the assured's claims history, past breaches of the duty of utmost good faith and past cancellations of insurance policies. By obtaining information regarding the assured's claims history, the underwriter may not only assess the physical hazard more accurately (for example, the sustainability and quality of the subject-matter insured), but also the moral hazard, provided that the claims history indicates that the assured has acted fraudulently or dishonestly with previous insurers when claiming under a policy.[225] Information concerning past breaches of the duty of utmost good faith has a clear connection to the moral hazard and may be material as such information shows the assured's tendency to act dishonestly in relation to his insurers.[226]

If the prospective assured's claims history indicates dishonest behaviour with other insurers, this may be a material fact that should be open for consideration to a prudent underwriter. It may, for example, indicate whether the management of the ship owning company is likely to act dishonestly or fraudulently once the insurance contract is in force.[227]

Past breaches of the doctrine of utmost good faith may also be material to a prudent underwriter. If the prospective assured has been guilty of a material non-disclosure or misrepresentation prior to the negotiations with the present underwriter, such information is likely to be material and valuable to an underwriter when it comes to determining the moral hazard.[228] The insurers in the case *Container Transport International Inc.* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.*[229] were seeking avoidance of the insurance policy based on these exact grounds. The assured was alleged of having withheld information to the underwriter regarding a previous non-disclosure to a Lloyd's underwriter. The court held that the non-disclosure to the Lloyd's underwriter had not been material and the present insurers had consequently no right to avoid the contract on those grounds. Although the insurers had no success, the court confirmed that "the

[224] *North Star Shipping Ltd.* v. *Sphere Drake Insurance Plc.* [2006] Lloyd's Rep. I.R. 519, [19].
[225] MacDonald Eggers, P., *et al, supra* note 4, p. 440.
[226] *Deutche Rückversicherung Aktiengeselleschaft* v. *Walbrook Insurance Co. Ltd. Group Josi Reinsurance Co. S.A.* [1995] Lloyd's Rep. 153, 164.
[227] MacDonald Eggers, P., *et al, supra* note 4, p. 440-441.
[228] *Deutche Rückversicherung Aktiengeselleschaft* v. *Walbrook Insurance Co. Ltd. Group Josi Reinsurance Co. S.A.* [1995] Lloyd's Rep. 153, 164.
[229] [1982] 2 Lloyd's Rep. 178.

insurer is entitled to know all facts which throw doubt on the business integrity of the assured at the time the insurance is placed"[230], *i.e.* not only obvious facts related to the moral hazard, such as previous convictions.[231] Another example where such past non-disclosures may be material is in cases where many underwriters have subscribed to the insurance policy and the assured has been guilty of material non-disclosure to the leading underwriter, but thereafter withheld this information to the underwriters that subsequently subscribed to the policy.[232]

Other examples of facts related to the assured's insurance history that may indicate moral hazard and thereby throw doubt to the business integrity of the assured are past cancellations of policies (in case such cancellation was made by the insurer due to the dishonest behaviour of the assured) and refusals by previous underwriters to cover the risk. Past refusals by other underwriters may however not be as material in marine insurance as in non-marine insurance, as it is custom that the brokers active in the marine insurance market approaches many underwriters (for example at Lloyd's market) and often seek to find several subscribers to the risk. A full disclosure of which underwriters that have been approached and what they have said would be impractical and is therefore not likely to be as material as in non-marine insurance.[233]

[230] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178, 198-199.
[231] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178.
[232] *Aneco Reinsurance Underwriting Ltd.* v. *Johnson & Higgins Ltd.* [1998] 1 Lloyd's Rep. 565.
[233] *Hamilton & Co.* v. *Eagle Star & British Dominions Insurance Co. Ltd.* [1924] 19 Ll. L. Rep. 242, 245; *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178, 198-199; MacDonald Eggers, P., *et al*, *supra* note 4, pp. 442-443.

5 Reform proposals

The position of the assured *vis à vis* the insurer has been highlighted in case law.[234] It has been held that the insurer is in a beneficial position, as a fulfilment of the duty of disclosure favours him, as well as a breach of the duty of disclosure, since he then is entitled to full avoidance of the contract with retrospective effect, even if the breach was innocent and has not made any substantial impact on the terms of the contract. This aspect should be viewed in contrast with the importance of a duty of disclosure in marine insurance contract law, a duty that forms the very basis of a functioning insurance industry in that the insurer is able to rely on the information provided and thereby make an accurate assessment of the risk.[235]

The tension between these two aspects, the interests of the assured *vis à vis* the interests of the insurers in obtaining information, has caused the Law Commission of England and Wales to formulate a reform proposal regarding business insurance (in which marine insurance is included), although it is the consumer insurance that has been of particular focus. The Law Commission published its Consultation Paper No. 182 on *Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured*[236], where it was suggested that the materiality of a certain circumstance should be determined with reference to what a "reasonable insured" in his circumstances would consider as material to the judgment of the insurer. This was due to the fact that many businesses, small ones in particular, would not be able to objectively assess what information would influence the judgment of a hypothetical prudent insurer. The Law Commission also held that the duty of disclosure may operate as a trap to assureds that are unaware that they have a duty to disclose and that it may not be obvious to them that they are obliged to provide the underwriter with information without being asked. In current law, the assured may be denied claims although he has acted with good faith if he, for example, has misunderstood a question asked by the underwriter and "reasonably thinks that a piece of information is not relevant to the insurer"[237]. The Law Commission suggested that an insurer should not have a right to avoid the policy if the assured acted honestly and reasonably. Fraudulent non-disclosures or misrepresentations were however suggested to be avoidable in full. The insurer was entitled to defend a claim against an assured that had made a negligent breach of the duty of disclosure, provided that the insurer

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[234] See for example *Container Transport International Inc.* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178, 187-188.
[235] MacDonald Eggers, P., *et al*, *supra* note 4, p. 104.
[236] The Consultation Paper was a result of a collaboration with the Scottish Law Commission.
[237] The Law Commission of England and Wales, *Reforming Insurance Contract Law, A Summary of Responses to Consultation Paper: Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (Law Com No 182)*, p. 3, http://lawcommission.justice.gov.uk/docs/cp182_ICL_summary_of_responses_business.pdf.

would not have been bound to indemnify the assured for the loss in question had the circumstance been disclosed pre-contractually.[238]

The main purpose of the reform proposal was to provide a legal framework that protects businesses that are not well acquainted with insurance, corresponds to the legitimate expectations of the parties (based on generally accepted standards within the industry) and ensures the international competitiveness of UK insurance law.[239]

The effects of the reform proposal concerning commercial insurance have not been as far-reaching as in consumer insurance. The reform proposal was met with reluctance by the insurance industry, which held that there was no need for extra protection of businesses, as they should be able to protect themselves without law reform. The insurance brokers and buyers of insurance were however clearly supportive of the proposals for reform.[240]

The International Group of P&I Clubs did not support the reform proposals as it held that marine insurance should be subject to different rules as this specific type of insurance was to be distinguished from other forms of commercial insurance due to its "specialised nature and the general advanced level of knowledge and commercial sophistication of insured and insurers"[241]. The International Group of P&I clubs also held that there existed enough judicial precedent in relation to the Marine Insurance Act 1906 in order to provide sufficient support to the assureds seeking marine insurance.[242]

The Consumer Insurance (Disclosure and Representations) Act 2012 has received Royal Assent in 2012 and will come into force in the near future.[243] The reform proposal concerning business insurance is however still under review and a third consultation on business insurance is in progress but yet to be published.[244]

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[238] *Ibid.;* MacDonald Eggers, P., *et al*, *supra* note 4, p. 113.
[239] The Law Commission of England and Wales, *Consultation Paper No. 182, Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured,* p 18, http://lawcommission.justice.gov.uk/docs/cp182_ICL_Misrep_Non-disclosure_Breach_of_Warranty.pdf.
[240] The Law Commission of England and Wales, *Reforming Insurance Contract Law, A Summary of Responses to Consultation Paper: Insurance Contract Law: Misrepresentation, Non-disclosure and Breach of Warranty by the Insured (Law Com No 182),* p 6, http://lawcommission.justice.gov.uk/docs/cp182_ICL_summary_of_responses_business.pdf.
[241] *Ibid.*, p. 30.
[242] *Ibid.*
[243] The Law Commission of England and Wales, http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm.
[244] *Ibid.;* Burling, J., *et al, Research Handbook on International Insurance Law and Regulation,* Edward Elgar Publishing Ltd., United Kingdom, 2011, p. 60.

6 Conclusion

What factors are considered when determining whether a certain circumstance requires pre-contractual disclosure under the doctrine of utmost good faith?

It is concluded that the prospective assured (or his broker) is subject to a pre-contractual duty to disclose information under the doctrine of utmost good faith, a doctrine that developed in case law and subsequently was codified in the Marine Insurance Act 1906.[245] The duty levels the informational asymmetry of the parties by obliging the proposer to disclose sufficient and correct information to the underwriter so that he can take an informed decision on whether to underwrite the risk or not. It is furthermore concluded that only certain kinds of information that are subjected to the duty. Whether or not a certain circumstance requires pre-contractual disclosure is determined by way of two cumulative tests; the objective test and the subjective test. The objective test is satisfied if it can be proven on the balance of probabilities that the circumstance in question is material to the judgment of a hypothetical prudent insurer in fixing the premium or determining whether to underwrite the risk.[246] The subjective test is satisfied if the non-disclosure in question has induced the specific underwriter to enter into the contract.[247]

The information included in the duty of disclosure is not confined to circumstances that the assured is in direct knowledge of, it extends to material circumstances that are within his constructive knowledge, *i.e.* information that he ought to know in the ordinary course of business.[248] Certain kinds of circumstances are expressly excluded from the duty of disclosure in the Marine Insurance Act 1906, section18(3), namely circumstances that lessen the risk, circumstances known to the insurer, circumstances that have been waived by the insurer and circumstances that are superfluous to disclose as they are part of a warranty.

The duty requires the assured to pro-actively volunteer information to the underwriter and the underwriter is excused from the work of asking any questions or reminding the assured of his duty. As the remedy for a breach of the duty is avoidance, the underwriter may in theory sit back and wait for the assured to fulfil his duty without asking any guiding questions or making any insinuations of what circumstances might be material. If the assured (who might not be as well acquainted with insurance as the underwriter) does not manage to fulfil the duty, the insurer has been caused no harm as he then may choose to avoid the policy in full in case a large claim arises in the future. The non-disclosure may then be used as an "ace

[245] *Carter* v. *Boehm* (1766) 3 Burr 1905, 97 ER 1162; Marine Insurance Act 1906, ss. 17-20.
[246] Marine Insurance Act 1906, s. 18(2).
[247] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501.
[248] Marine Insurance Act 1906, s. 18(1).

up the sleeve" of the insurer and an easy way out if a claim that is too large for the taste of the insurer occurs. Certainly, this is a cynical example of what the duty may imply in theory. Many insurers would perhaps due to good will and reputation want to be careful with such behaviour and rather work in favour of a full disclosure in order to establish a solid contractual relationship, but there is room for legal reform with this theoretical scenario in mind. Especially since there is no time limit to when an avoidance may be claimed. A circumstance that the insurer is aware of at the time of the negotiations does not require disclosure and does therefore not provide a basis for avoidance, but to prove that the insurer was aware of an undisclosed fact may in many cases be an impossible task for the assured. To then allow such cynical behaviour on behalf of the insurer, albeit only in theory, does not rhyme well with the purpose of the doctrine of utmost good faith, which is to provide a solid basis for a fair contract.

The fact that the Court of Appeal in the *CTI* v. *Oceanus*-case[249] rejected the notion that objective test was to be seen as a decisive influence test clearly favours the insurer. The threshold for the definition of a circumstance as "material" was lowered, as it was enough that the circumstance in question had an influence on the *judgment* of a prudent insurer. Such a test broadens the scope of circumstances that requires disclosure and it may also make it even more difficult for the assured to exclude materiality of certain circumstances as almost anything could be said to influence the judgment of a prudent insurer. The *Pan Atlantic*-case[250] did weigh up this extensive test by introducing the subjective test, but the fact that the assured will have trouble sifting out the immaterial circumstances under the objective test remains. The test is extensive and complicated to apply for a subjective party. This is certainly so in cases where the assured is a smaller shipping company that does not employ an experienced insurance broker and has limited routine or knowledge about the insurance industry. The prospective assured is subjected to making a rather complicated assessment of the materiality of certain facts in order to determine the need for disclosure, an assessment that may be difficult to make even for a legally experienced person.

At what point in time must the information be disclosed and to whom?

The assured (or his broker) must have fulfilled the pre-contractual duty of disclosure by the time the contract of insurance is concluded. Thus, disclosure of material information may be made from the moment the underwriter is approached and the negotiations start until the moment the contract is concluded and the risk is placed. Any misrepresentation may be corrected until the moment of conclusion. It follows that the materiality of a certain circumstance must be determined with reference to the time of

[249] *Container Transport International Inc* v. *Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1982] 2 Lloyd's Rep. 178.
[250] *Pan Atlantic Insurance Co.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 AC 501.

placement of the risk, as the assured has a possibility to correct the information up until that very point.[251]

At what moment the contract of marine insurance is concluded depends on the facts of each case, but in marine insurance contract law this is traditionally when the underwriter has signed the slip and, thus, accepted the assured's proposal.[252]

It is concluded that the information is deemed disclosed as soon as the underwriter, or any other agent of the insurer that has authority to communicate the information to the right person, has received the information and a reasonable period of time has elapsed within which the communication may be made. With today's technology, it is likely that such communication will be made in a rather rapid manner.

What is the remedy to an unfulfilled pre-contractual duty of disclosure?

The Marine Insurance Act 1906 offers a remedy that is strict in the sense that it does not depend on what the proposer's subjective reasons for the breach of the duty are – the remedy remains the same. If both the objective and subjective test have been satisfied, and the underwriter, thus, was induced to enter into the contract due to the non-disclosure of a material fact, the underwriter may avoid the contract retrospectively.[253] This means that the whole contract is avoidable, not just a part of it, and the parties are put in the same position as they were in before the conclusion of the contract. Thus, all indemnifications paid to the assured are recoverable by the insurer and all premiums paid are recoverable by the assured (unless the breach was fraudulently made).[254]

The law does not provide any proportionate remedy based on the intentions of the assured when he committed the breach of the duty – the only remedy available under English law is avoidance of the contract in full. Considering that the question of avoidance often arise when a claim for indemnity is directed to the insurer as a result of a loss that is recoverable under the policy, such avoidance may imply a heavy fall for the assured who ends up with no cover at all and, furthermore, has to repay any previous indemnification under the policy. Thus, a total avoidance may have dramatic economic consequences to the assured, but it is nevertheless the only remedy available under current law, even in cases where the non-disclosure in question was innocently made. It may seem disproportionate to allow an avoidance of the entire contract in cases where the assured has made an honest mistake when making his representation of the facts, especially in cases where the only result of a fulfilment of the duty would have been a higher premium and not a refusal of cover.

[251] Marine Insurance Act 1906, ss. 18, 20.
[252] *Ibid.*, s. 21.
[253] *Ibid.*, ss. 18(1), 20(1).
[254] *Cornhill Insurance Co. Ltd.* v. *L. & B. Assenheim* [1937] 58 Ll.L.Rep. 27, 31.

To introduce a proportionate remedy that allows an amount of damages to be paid instead of an avoidance of the whole contract (as is possible in cases of misrepresentation in general contract law) would perhaps be reasonable in cases where the breach of the duty was not made with fraudulent intentions. If the underwriter still would have assumed the risk but for a higher premium if the fact in question had been presented, it would be reasonable to let the assured pay damages that at minimum cover the difference between the actual premium paid and the higher premium that the underwriter would have agreed on if the fact had been presented. An avoidance of the entire contract would perhaps be more justified in situations where the assured had withheld information with fraudulent intentions or where the underwriter would have refused cover had he been aware of the withheld information. However, as the inherent disparity of information between the parties to an insurance contract provides a strong incentive for the assured to withhold information in order to be able to agree on conditions that are more favourable to him, the damages offered must be serious and noticeable to the assured. It would not be enough that the damages only cover the difference between the actual premium and the correct premium, as the assured then would not have anything to lose by concealing material facts. Without a serious remedy, the duty of disclosure would be undermined and the insurers would be powerless at the negotiations, which probably is the reason why full avoidance remains the only remedy available under English insurance contract law. It is however submitted that a more proportionate remedy that strikes a fairer balance in respect to the assured's perspective should be introduced in English marine insurance law.

To what extent must a prospective assured (or his broker) disclose information concerning moral hazard to the underwriter before the contract of insurance is concluded?

The duty of disclosure extends to material matters concerning the assured's moral character, such as past criminal convictions that indicate his propensity of acting dishonestly and that may give the underwriter an indication of whether the assured's character would add to the risk of loss once the insurance contract is in force. Thus, the duty comprises the human aspects of the risk and relates to any person closely connected to the assured and the insured interest and able to cause a loss under the policy due to fraudulent behaviour, such as the director of the company or the master of the vessel.

It is concluded that when it comes to past criminal convictions, not all convictions are material for disclosure. It is ultimately up to the court to objectively decide, based on the facts of each case, whether a certain conviction is material to the judgment of a hypothetical prudent insurer or not and the exact criterions a conviction must live up to in order to be material for disclosure are not always clear. The conviction in question must however relate to the honesty or good faith of the assured and thereby indicate moral hazard. It is concluded, based on the examination of case law

and doctrine, that an insurer may have difficulties in proving that minor convictions or offences that were committed many years earlier would influence the judgment of a prudent insurer. Moreover, if there is a clear connection between the fraudulent nature of the offence and the risk insured, the conviction is more likely to be material. Another aspect to take into account when determining the materiality of a criminal conviction with regard to moral hazard is the position of the convicted person within the assured company. A conviction by a senior employee would be regarded as more material than a similar conviction by a junior employee, perhaps due to the fact that the senior employee has a higher influence on the business than a junior employee. Convictions that are "spent" under the Rehabilitation of Offenders Act 1974 are excluded from the duty of disclosure.

It is not necessary that the person in question has been convicted of the fraudulent behaviour for it to be material, although a conviction may serve as strong evidence to an underwriter of an increased moral hazard. Perhaps undetected dishonesty could be said to be even more material than if the assured had been convicted for it, as it may indicate that the assured is too skilful at his fraudulent behaviour to even get caught by the authorities, which could imply that he is likely to be more successful in defrauding the insurer. It is perhaps not likely that the assured would disclose such undetected dishonesty, but the information could nevertheless be material under the duty of disclosure.

It is concluded that the assured is obliged to disclose any substantial allegation of dishonesty directed against him to the underwriter. Criminal charges indicating a fraudulent character are likely to be held as material to the judgment of a prudent insurer as they are allegations of substance and cast doubt as to the risk.[255] The *Brotherton* case[256] established that an allegation must be classified as "intelligence", and not just "loose or idle rumours", in order to be material. The exact criterions for a classification of an allegation as "intelligence" are rather vague, but the term indicates that the allegation in question is of substance and springs from a credible source. If the source of the allegation is public authorities, it is much more likely to be classified as intelligence than if it springs from, for example, media alone. It is concluded that the decision of whether a certain allegation is to be classified as "intelligence" is ultimately left to the court to decide, based on a "realistic" and "robust" view.[257] The vague definition of what constitutes intelligence hardly contributes to an increased awareness among prospective assureds about what must be disclosed. The ship-owner, who is unlikely to have the same amount of experience as the underwriter is thereby to an extent left to fumble in the dark when it comes to assessing the materiality of an allegation. The examination in the present thesis of the

[255] *Inversiones Manria S.A.* v. *Sphere Drake Insurance Co. Plc.* (*The Dora*) [1989] 1 Lloyd's Rep. 69, 93; *Strive Shipping Corporation & Another* v. *Hellenic Mutual War Risks Association* (*The Grecia Express*) [2002] 2 Lloyd's Rep. 88.
[256] *Brotherton* v. *Aseguradora Coseguros* [2003] 2 C.L.C. 629, 654-655.
[257] *Ibid.*

factors that have been taken into consideration in case law may contribute to a clearer overview, but it is ultimately an assessment of the specific circumstances of each case that determines the materiality of a certain fact and such assessment may be difficult for an inexperienced ship-owner to make. An experienced placing broker may provide help, but an objective evaluation is always difficult for a subjective party to make. This consequently leads to unpredictability seen from the perspective of shipping companies wishing to insure their risks. Unpredictability is hardly a positive feature in any field of law as it creates insecurities, which may lead to undesirable consequences for the parties involved that go outside the purpose of the law. It is therefore desirable that a clearer and more detailed definition of what factors that are to be considered and what influence they have on the assessment of the "substance" of an allegation is established in English law.

It is concluded that the correctness of the allegation does not affect the materiality. Even allegations that the assured knows are untrue must be disclosed if they are material at the time of placement. An avoidance of the contract based on a non-disclosure of false allegations that fulfil the objective and subjective test is in line with the doctrine of utmost good faith and cannot be reversed retrospectively due to its incorrectness. Thus, an allegation that is of substance, but inaccurate, is material for disclosure and will most likely result in a negative influence on the conditions of the contract seen from the assured's perspective, if the underwriter decides to assume the risk at all. It may seem unfair to the assured that an incorrect allegation should be allowed consideration by the underwriter, but the underwriter, who is unaware of the accuracy of the allegation, should be given the option to examine the truth of the allegation. Certainly, this aspect may complicate an inexperienced ship-owner's objective assessment of whether a certain allegation is of substance and therefore material for disclosure even more, as he knows, from a subjective point of view, that it is untrue and he may therefore automatically find the source of the allegation less credible.

Other categories of information that relate to moral hazard and that may be material to the judgment of a prudent insurer is claims history, past breaches of the duty of utmost good faith and past cancellations of insurance policies, if these indicate that the assured has a tendency to engage in fraudulent or dishonest behaviour.

The extent to which an assured (or his broker) must disclose information concerning moral hazard to the underwriter is, thus, to a large extent determined with reference to the facts of each case. Although the aspects just mentioned represent important factors that have been taken into consideration in case law when classifying information as "material", it is not submitted that a certain circumstance automatically is deemed "material" if one or several of these factors are met. Materiality may only be determined based on an objective overall assessment, an assessment that

may be difficult for an assured, or even an experienced placing broker, to make.

A few concluding remarks shall be made in connection to the fictional scenario described in the introduction of this thesis (subchapter 1.1), where allegations of forgery that had taken place five years earlier flourished in media concerning the director of the shipping company. The question arising from that scenario was whether the insurer was contractually bound to indemnify the assured, although the underwriter had not been informed of the media allegations. The factors that are essential for the determination of the materiality of the allegations are, firstly, whether the allegations were to be considered as "intelligence". Considering that the authorities had pressed no formal charges against the director, it is likely that the allegations in question would be classified as "loose" or "idle" rumours, which do not require disclosure. This would however depend on the character of the allegations and the source of which they came from. If the ultimate source of the allegations is media alone, it is likely that they are to be considered as rumours rather than "intelligence". If media, on the other hand, has obtained the information from another source, one has to evaluate the credibility of that source in order to determine the substance of the allegation. It is however clear that if the allegation was of common notoriety and therefore presumed to be known by the underwriter, it does not require disclosure. Secondly, if the allegations were considered to be of substance, one must take the nature of the offence into consideration. A forgery is however, relating to its relevance to moral hazard and its connection to the risk insured, likely to be material even though the offence took place five years earlier. Thirdly, it should be noted that whether or not the allegations turn out to be true after the negotiations is irrelevant to the question of materiality, as the materiality of the allegation is determined with reference to the time of placement.

The insurer in the fictional scenario may consequently avoid the contract if the allegations are material under the objective test with reference to the just mentioned factors and if the actual underwriter was induced, in accordance with the subjective test, to enter into the present contract due to the non-disclosure. It can however be concluded that the materiality of such allegations is hard to pre-determine from an objective perspective, as it requires an objective evaluation of the credibility of the source together with an overall assessment of the specific facts of the case in order to determine whether the allegations would influence the judgment of a hypothetical prudent insurer.

How does the current law on the duty of disclosure balance the interests of the parties respectively (relating to disclosure vis à vis obtainment of information) in situations where a false allegation of dishonesty regarding the prospective assured has emerged in media with no formal evidence?

A pre-contractual disclosure of an allegation indicating a dishonest or fraudulent character of any person related to the assured and the subject-

matter is naturally never favourable to the assured. Such disclosure is likely to influence the conditions of the contract to his detriment, either by a higher premium due to the increased risk or, in the worst case, a refusal of cover. The insurer, on the other hand, would certainly want to obtain as much information as possible regarding the assured's moral character and the potential moral hazard that it may imply. One may question whether a full disclosure of a person's moral character is in line with article 8 of the European Convention for the Protection of Human Rights and Fundamental Freedoms, 1950, in cases where the shipping company is required to disclose certain personal information about the moral integrity of employees. Certainly, information connected to the person's family life must be exempted from disclosure.

The disclosure of sufficient information is nonetheless essential for a fair contract based on equality in knowledge between the parties, as the assured otherwise would be in an advantageous position due to his access of information pertaining to the risk and the underwriter would have an impossible task in assessing the risk accurately. However, a problem does arise concerning allegations that, for example, flourish in media but are supported by little or no formal evidence. As concluded above, several factors may guide the assured or his broker in the assessment of whether a certain allegation is material for disclosure, but these factors are rather vague and the materiality is ultimately a question of an objective assessment of the facts of each case, an assessment that may be difficult for a subjective party to make.

In cases where the materiality of an untrue allegation of dishonesty is uncertain, perhaps due to the difficulties in determining the substance of the allegation or the credibility of the source from an objective perspective, the result would probably be that the assured would disclose the allegation in order to minimise the risk of a future avoidance of the policy. It is hard to predetermine whether such allegation would be considered as material for disclosure at trial and this uncertainty is likely to favour the insurer, as the assured in many cases would want to disclose the allegation as a preventative measure. The assured is then directed to provide the underwriter with exculpatory material in order to convince him of the inaccuracy of the allegation and thereby lessen the negative impact on the conditions of the contract. It is however concluded that unless innocence can be proven by the assured (in which case there would not exist a material allegation), the underwriter is likely to take the allegation into account and the contractual conditions would consequently not be as beneficial to the assured as would have been the case if the untrue allegation was never disclosed. In extreme cases, the assured might not be able to obtain cover for the risk at all, from any insurer, which could lead to a situation where he cannot continue with his business. Consequently, the insurer is likely to be favoured by the uncertainty that the question of materiality implies, even in cases where the allegation in question is groundless and, thus, should not even exist.

The insurer will benefit from a fulfilment of the duty of disclosure, as he then is provided with all information needed in order to make an accurate assessment of the risk. The insurer will however also benefit from a breach of the duty that is discovered post-contractually, since he then is entitled to choose whether to affirm the contract or to avoid it in full with retrospective effect, recover all indemnifications paid and leave the assured with no insurance cover, irrespective of the intentions of the assured at the time of the breach. This could be done although the circumstance in question, for example a groundless allegation, in truth would not have indicated any actual impact on the risk of loss due to its inaccuracy and although the underwriter undoubtedly would have taken on the risk even if he had been informed of the allegation in question, save perhaps for a higher premium.

A legal framework that preserves the duty of disclosure is essential for a functioning marine insurance market, as insurers are bound to depend on the assured's disclosure of information as a result of the unequal access to material information between the parties. It is important not to erode the duty, as it would be untenable for the insurer to enter into contracts of insurance without being able to trust that all circumstances that may influence the risk have been disclosed and that rigorous remedies are available in case of a material non-disclosure. To have a rigorous remedy is furthermore of importance to the general collective of policyholders who are affected economically if new policyholders obtain cover without a full disclosure of their risks, as this would increase the actual risk of loss under the policy and thereby imply an increase of premiums for the collective as a whole. A rigorous remedy would discourage the new policyholders from withholding the information and would compensate the insurer so that the collective of policyholders would not be affected by a higher premium. A total contractual avoidance may however, in situations where the breach was innocently made and the insurer with all certainty would have assumed the risk if the information had been disclosed, constitute a rather dramatic and disproportionate remedy. Together with the uncertainty that the assessment of the materiality of certain kinds of allegations may imply, it is submitted that the interests of the insurer have been protected to a sufficient degree, whereas the assured is put in a rather precarious position.

The Law Commission has proposed a reform of the materiality test, which would imply that the perspective of a reasonable assured is to be taken into account when determining the influence to the judgment of the insurer. Such a test could perhaps push the insurers to reveal what circumstances they consider material. The reform proposal furthermore opens up for remedies that allow consideration to the intentions of the assured. The insurance business has been reluctant to such law reform, arguing that the current law is sufficient and that shipowners should be able to assess materiality in accordance with the current objective test. It is however submitted that this is not always the case and that a law reform in line with the one presented by the Law Commission would encourage a more balanced contractual relationship and provide remedies that are based on the intentions of the assured at the time of the breach. It is not motivated to have a legal system

where the assured (who usually is not legally trained in the area of moral hazard and marine insurance) is required to make a an objective assessment of the materiality of a certain allegation of dishonesty, as such assessments may imply major difficulties even for an objective and legally trained person. That an honest mistake in making such an assessment would allow the insurer to enjoy such a strict remedy as a total avoidance of the contract and full recovery of previous indemnifications does simply not constitute a proportionate and desirable law, especially with regard to cases where a disclosure only would have made a minor impact on the contractual terms. The prospective assured is very much left without firm legal guidelines when it comes to objectively assessing the substance, and thereby also the materiality, of certain allegations of dishonesty indicating moral hazard and further legal development is therefore desired in this area. A reform of the objective test in line with the Law Commission's reform proposal would certainly facilitate the prospective assured's pre-contractual assessment, but the proposal has been met with reluctance by the insurance industry and until a reform indeed has been made, the difficulties in assessing the materiality of certain allegations of dishonesty remain.

Supplement A

Relevant provisions of the Marine Insurance Act 1906

17 Insurance is uberrimæ 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 of 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.

21 When contract is deemed to be concluded.

A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract.

22 Contract must be embodied in policy.

Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act. The policy may be executed and issued either at the time when the contract is concluded, or afterwards.

36 Warranty of neutrality.

(1) Where insurable property, whether ship or goods, is expressly warranted neutral, there is an implied condition that the property shall have a neutral character at the commencement of the risk, and

that, so far as the assured can control the matter, its neutral character shall be preserved during the risk.

(2) Where a ship is expressly warranted "neutral" there is also an implied condition that, so far as the assured can control the matter, she shall be properly documented, that is to say, that she shall carry the necessary papers to establish her neutrality, and that she shall not falsify or suppress her papers, or use simulated papers. If any loss occurs through breach of this condition, the insurer may avoid the contract.

39 Warranty of seaworthiness of ship.

(1) In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured.

(2) Where the policy attaches while the ship is in port, there is also an implied warranty that she shall, at the commencement of the risk, be reasonably fit to encounter the ordinary perils of the port.

(3) Where the policy relates to a voyage which is performed in different stages, during which the ship requires different kinds of or further preparation or equipment, there is an implied warranty that at the commencement of each stage the ship is seaworthy in respect of such preparation or equipment for the purposes of that stage.

(4) A ship is deemed to be seaworthy when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure insured.

(5) In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness.

41 Warranty of legality.

There is an implied warranty that the adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

91 Savings.

(1) Nothing in this Act, or in any repeal effected thereby, shall affect—

(a)The provisions of the Stamp Act 1891, or any enactment for the time being in force relating to the revenue;

(b)The provisions of the Companies Act 1862, or any enactment amending or substituted for the same;

(c)The provisions of any statute not expressly repealed by this Act.

(2) The rules of the common law including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts of marine insurance.

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