Article

Non-disclosure in insurance law: a more principled approach

by Ravi Aswani

The author puts forward an option for reform that the English and Scottish Law Commissions might like to consider in their future consultation paper on insurance contract law.

Nearly 100 years ago Fletcher Moulton LJ stated "I am satisfied that few of those who insure have any idea how completely they leave themselves in the hands of the insurers should the latter wish to dispute the policy when it falls in" in *Joel v Law Union and Crown Insurance Company* [1908] 2 KB 863 at p885. His criticism has been repeated on many occasions by others, including for example Staughton LJ who recently stated as follows in *Kausar v Eagle Star Insurance Co Ltd* [2000] Lloyd's Rep IR 154 at p157:

> *"Avoidance for non disclosure is a drastic remedy. It enables the insurer to disclaim liability after, and not before, he has discovered that the risk turns out to be a bad one; it leaves the insured without the protection which he thought he had contracted and paid for. Of course, there are occasions where a dishonest insured meets his just deserts if his insurance is avoided; and the insurer is justly relieved of liability. I do not say that non-disclosure operates only in cases of dishonesty. But I do consider that there should be some restraint in the operation of the doctrine. Avoidance for honest non-disclosure should be confined to plain cases."*

The general complaint is that the insurer who wishes to avoid a policy for non-disclosure is in a very strong position given his right to treat the policy as void from the outset. This article examines the legal position and puts forward a suggestion for reform that might lead to a more balanced and fair position between insurer and insured.

THE PRESENT POSITION IN LAW

Judicial expressions such as the two set out above of concern relating to the onerous duties of disclosure imposed on proposers of insurance policies and to the draconian consequences of falling short of the requirements of those duties are not hard to find. The broad topic of non-disclosure in insurance law has already been considered by distinguished lawyers in the context of reform (namely by committees chaired by Devlin J and by Kerr J) but their recommendations have not been implemented.

The following two settled principles apply in this context. Firstly, the proposer is under a duty at the time of making (or renewing) a policy to disclose to the insurer all material information affecting the risk to be insured. Secondly, the (usual) remedy for non-disclosure is rescission ab initio of the policy at the behest of the insurer. Any doubt that there might have been that rescission ab initio of an insurance policy for non-disclosure operated by act of the party rather than order of the Court was firmly removed by the Court of Appeal in *Brotherton v Aseguradora Colseguros SA (No 2)* [2003] Lloyd's Rep IR 746 (see judgment of Mance LJ at par 27). Thus, the insurer does not need to obtain an order of the Court before being entitled to treat the policy as void – all he needs to do is to tell the insured that the policy is being avoided for non-disclosure.

The scope of the duty can be problematic in practice. Materiality is tested by reference to the prudent insurer. Section 18(2) of the Marine Insurance Act 1906 states that "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." In *Lambert v Co-operative Insurance Society Limited* [1975] 2 Lloyd's Rep 485 Mackenna J giving the leading judgment in the Court of Appeal confirmed that the same test of materiality applied to non-marine insurance (pp488-89). In theory at least, this is an objective test based on what would influence the judgment of the prudent insurer at the time of placing. The proposer is therefore required to disclose matters which he might perfectly genuinely believe would not be of interest to insurers, the problem being particularly acute if the proposer is insuring in a private capacity and has little idea of what the prudent insurer might consider material. This problem is neatly illustrated by the following passage from the judgment of Forbes J in *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440 at p457, col2:

"Now to adopt the objective insurer test and reject the objective proposer is to pose this problem; it follows that any proposer is bound to disclose that which no reasonable proposer would regard as material. As a difficulty this was referred to both by the Law Reform Committee and by the Court of Appeal in Lambert's case. In the course of the trial I wondered whether the problem was rather a theoretical one than a practical one and the answer to the problem was that no reasonable insurer would require disclosure unless it was of something which a reasonable proposer would in fact realise was material. I accordingly canvassed this possibility with some of the insurance witnesses. In the event only one of them was prepared to accept this suggestion; the others to whom I put the point rejected it."

However, good faith on the part of the proposer in not disclosing matters which the prudent insurer would consider material, and the fact that the reasonable proposer would not appreciate materiality, are not valid defences.

Further, the degree of materiality required assists insurers at the expense of insureds. In *Pan Atlantic Ins Co Ltd v Pine Top Ins Co Ltd* [1995] 1 AC 501 Lord Mustill (with whom Lord Goff and Lord Slynn agreed) made two points. Firstly, the relevant common law principles were mirrored in the provisions of the Marine Insurance Act 1906. Secondly, the words "influence the judgment of a prudent underwriter" in s18(2) of that Act did not require decisive influence, and had such a requirement been intended the word "influence" would have been qualified in the Act: an influence, even if not decisive, was sufficient – p531. The duty extended to "all matters which would have been taken into account by the underwriter when assessing the risk" – p538. Thus, "a circumstance may be material even though a full and accurate disclosure of it would not in itself have had a decisive effect on the prudent underwriter's decision whether to accept the risk and if so at what premium" – p550.

Thus the proposer is obliged to disclose matters which even if disclosed might have led to the insurer agreeing to insure on identical terms, though some alleviation is provided by the inducement requirement considered below.

Where an insured is found to have committed material non-disclosure, the insurer has the right to avoid the policy if he so wishes. The effect of this is rescission ab initio of the policy, and though the insured will be refunded his premium, he cannot compel the insurer to continue the policy (even on different terms). A particularly harsh example of this is provided by the facts of *Mackay v London General Insurance Company Ltd* (1935) 51 Ll L Rep 201. To the question of "Has any office or underwriter refused, cancelled or declined to accept or renew such insurance, or required an increased premium or special condition?" the insured answered "No", but in fact when 18 he had obtained motorcycle insurance subject to a £2 10s excess. To the question of "Have you or your driver ever been convicted or had a motor licence indorsed?" he answered "No" when in fact he had been fined 10s several years before because a nut on the brakes of his motorcycle had become loose. Swift J expressed in poignant terms his considerable regret in confirming the insurer's right to avoid the policy (at p202).

However, since *Pan Atlantic*, it has been clear that "if the misrepresentation or non-disclosure of a material fact did not in fact induce the making of the contract (in the sense in which that expression is used in the general law of misrepresentation) the underwriter is not entitled to rely on it as a ground for avoiding the contract" – per Lord Mustill at p550. Thus the insurer must show that he was induced to write the insurance policy as a result of the non-disclosure. Whilst this seems to offer a sort of safeguard for the insured, unfortunately the insurer will seldom have significant difficulty with this point. Firstly, as pointed out by Halsbury, there may be some cases where "materiality is so obvious" (*Halsbury's Laws of England* (4th edition), volume 31, para1067). But even where this is not the case, the insurer will in the majority of cases be able to provide evidence of inducement either from the underwriter in question, or possibly evidence of market practice from which inducement can be inferred, either of which an insured would find difficult to rebut.

As can be seen then, the position in law relating to an insurer's right to avoid for non-disclosure does appear to be stacked somewhat disproportionately in favour of the insurer at the expense of the insured.

PREVIOUS RECOMMENDATIONS FOR REFORM

Non-disclosure in insurance law was considered in the Fifth Report of the Law Reform Committee (under the chairmanship of Devlin J) (1957) Cmnd 62 and (following a consultation paper) in a Report entitled *Insurance Law: Non-Disclosure and Breaches of Warranty* (under the chairmanship of Kerr J) (1980) Cmnd 8064. Additionally, in 1979 the European Commission proposed a Directive dealing with, *inter alia*, questions of disclosure in insurance law: the Kerr Committee rejected its implementation; and it does not appear that it will be enacted (at least in its present form).

So far as presently material, the Kerr Committee stated as follows. Firstly, the "proportionality" principle embodied in the draft EC Directive (that the insured should pay out only a proportion of the claim, determined by the ratio of the premium charged and the premium that would have been charged but for the non-disclosure) was problematic (paras 4.5 – 4.17). This was largely because the insurer could have reacted to the undisclosed facts in ways other than increasing the premium (para 4.5) and in particular, may have refused to insure the risk at all (para 4.6). Secondly, "The total abolition of any duty of