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Theme

Non-disclosure of Material Facts

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Introduction

Non-disclosure of material facts

The theme of this Volume has been closely linked with the development of the insurance industry over several centuries.

In general, English law does not require that one contracting party should disclose a fact which may have a material bearing on the other's attitude to a transaction, and yet is outside his knowledge. An exception arises where the nature of the proposed bargain is such that there is likely to be a strong disparity between the two sides; one being presumed to know a great deal about the background of the subject matter to the projected agreement whilst the other will be probably correspondingly uninformed. This imbalance between either side in the respective knowledge of material facts is a feature of contracts *uberrimae fidei*, and of them insurance agreements represent by far the most numerous and important group.

Early in "The Merchant of Venice" when Shylock and Bassanio are discussing Antonio's creditworthiness for guaranteeing a 3,000 ducats loan, Shylock explains his doubts: "Yet his means are in supposition: he hath an argosy bound to Tripolis, another to the Indies; I understand moreover upon the Rialto, he hath a third at Mexico, a fourth for England and other ventures he hath squandered abroad. But ships are but boards, sailors but men: there be land-rats and water-rats, land-thieves and water-thieves—I mean pirates—and then there is the peril of waters, winds and rocks". The progress of such expeditions to distant parts could not be monitored before the earth-shrinking inventions for rapid communication were invented much later. The earliest branch of insurance to develop was marine, and merchants in Antonio's position were much more in a position to have knowledge about the hazards of voyages with which they were concerned than an insurer who completely lacked then the shipping intelligence that can be his in the modern world. Neither were there available in the days of early developments in life and subsequently fire insurance, the convenient and abundant facilities for medical examinations, surveys and the like.

Lord Mansfield in *Carter v Boehm* (1766) 3 Burr 1905 well over 200 years ago spelled out why a duty of disclosure is imposed upon those seeking insurance.

> "Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the assured only; the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his

> knowledge to mislead the underwriter into a belief that the circumstance does not exist. The keeping back of such circumstances is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention, yet still the underwriter is deceived and the policy is void; because the risk run is really different from the risk understood and intended to be run at the time of the agreement... Good faith forbids either party, by conceiving what he privately knows, to draw the other into a bargain from his ignorance of the facts and his believing the contrary."

That is the classic exposition of the principle, and it applies to all forms of insurance. In *London Assurance v Mansel* (1879) 11 CHD, 363, Jessel MR stated:

> "As regards the general principle, I am not prepared to lay down the law as making any difference in substance between one contract of insurance and another. Whether it is life, or fire, or marine insurance, I take it good faith is required in all cases, and though there may be certain circumstances from the peculiar nature of marine insurance, which require to be disclosed, and which do not apply to other contracts of insurance, that is rather, in my opinion, an illustration of the application of the principle than a distinction in principle."

Nevertheless, the idea was mooted that the position with marine business might differ from that in regard to other classes. The rules of disclosure in relation to marine insurance were codified by the Marine Insurance Act 1906, S.18 providing that there must be full disclosure before a contract is concluded of every material circumstance known to the assured, who is deemed to be aware of matters which in the ordinary course of business should be within his knowledge. If he fails to make such disclosure the insurer may avoid the contract. S.18 also defines what facts are material — they are those which would influence the judgment of a prudent insurer in fixing the premium or in determining whether he will take the risk.

In *Lambert v Co-operative Insurance Society Ltd* (p.000) the Court of Appeal affirmed that the rule of disclosure in marine insurance is no different from that in other forms. It also overruled a line of authority in life cases stemming from *Joel v Law Union & Crown* [1908] 2 KB 863 suggesting that a less stringent test, namely whether a reasonable man in the position of a policyholder, knowing of the facts said to be material, would have realised that they were so.

The requirements of the common law may be modified by contractual terms between the parties. Usually that is done, the answers

to questions on a proposal form normally being given the status of material facts as between the parties by the usual "basis of the contract" declaration which the proposer signs. Such questions may limit the duty of disclosure, as when a loss experience is sought over a restricted period, but they do equally import a similar significance to information whose only relevance to the risk may be peripheral. The well known case of *Dawsons v Bonnin* [1922] 2AC 413 is an example; a firm covered its motor lorry against third party and fire risks, and inaccurately stated in the proposal form where the vehicle would be garaged. That inaccuracy made no difference to the premium. The lorry was subsequently burnt out in its garage and the claim was rejected. A similar result would be unlikely to arise today in view of the undertaking by members of B.I.A. and of Lloyd's in the Statement of Insurance Practice not to refuse indemnity where a policyholder has failed to disclose a material fact but knowledge of it would not materially have influenced the insurer's judgment in his acceptance or assessment of the risk.

The present law of non-disclosure has been criticised over the last 30 years or so, and some impetus in that direction was given by the *Lambert* case in 1975. Long before then, a Law Reform Committee was invited to consider the subject in 1954 and its views were published in the report on Conditions and Exceptions in Insurance Policies (CMND 62) in 1957. It thought that theoretically the law was open to criticism but it was satisfied that no reputable insurer would rely on a technical defence to defeat an honest policyholder. The Committee did however suggest that if Parliament, contrary to its recommendation, wished to redress the theoretical imbalance of the law, it could legislate for three changes:

(1) No fact should be deemed material unless it would have been considered so by a reasonable insured.

(2) If there were a misstatement of fact by an insured, it should be not held against him where he could prove that it was true to the best of his knowledge and belief.

(3) The intermediary concerned in bringing the parties into contractual relationship should be deemed to be the agent of the insurer. This third recommendation has of course, little relevance to the present theme.

When the present Lord Chancellor directed that certain aspects of insurance law be considered by the Law Commission in 1978 it lead to its report on non-disclosure and breach of warranty (CMND 8064) published in October 1980. The reference was precipitated by the proposed E.E.C. directive on the co-ordination of laws, regulations

and administrative provisions relating to insurance contracts, but there is no doubt that the clearly expressed reluctance of the Lord Justices of Appeal in *Lambert's* case in finding for the insurers played its part.

The consumer movement also was unhappy, despite the Statements of Practice both for long-term and general business. There was the strong academic objection that an insurer should not fittingly act as sole judge in a dispute where theoretically the law gave him an advantage, even if in practice he was scrupulous not to avail himself of it. This despite the fact that a statutory measure, the Rehabilitation of Offenders Act 1974, provided for the alleviation of the duty of disclosure in certain cases.

By the 1974 statute someone proposing for insurance is entitled to withhold from the insurers information about certain convictions which become "spent" after given periods of time, granting a statutory absolution against disclosing such a spent conviction after the rehabilitating period has run. S.7(3) of the Act makes provision for the admission of evidence as to spent convictions before a court if that court be satisfied that justice cannot be done except by admitting it. Although the position was considered by the Court of Appeal in *Reynolds and Anderson v The Phoenix* (see p.39) the law in this area seems at present somewhat uncertain. It becomes a matter of judicial discretion, the only guideline being the criterion that justice in a particular case cannot be done unless the conviction is admitted.

There is nothing in the Rehabilitation of Offenders Act to relieve an obligation for disclosure of alleged crimes which have not led to a conviction nor of wrongdoing committed but with which a proposer has not been charged. There is some conflict in this area between the view of May J in *March Cabaret Club & Casino Ltd v London Assurance* (p.19) and that of Forbes J in the *Reynolds* case (p.58). What is incontrovertible on present law is that subject to the 1974 Act crimes which may be unconnected with the risk proposed, but may have a bearing on moral hazard, must be disclosed. *Woolcott v Excess Insurance Co and Miles Smith Anderson & Game Ltd* (1978) 1 ILR 96 is an instance in point; so is *Roselodge v Castle* [1966] 2 Lloyd's Rep. 113, where cover had been granted under a jeweller's block policy and the insured was subsequently robbed of diamonds. It was decided that the insured should have disclosed that his sales manager some years previously had been convicted in the U.S.A. for smuggling diamonds and jewellery.

It is this failure of the average insured to relate what may be a long-forgotten past to a present proposal about a totally different subject matter that seems most to excite public indignation, and it is in that direction that the Law Commission proposed change in regard to all classes of business other than marine, aviation and transport. The

Commission is not against keeping the duty of disclosure, but it would apply a different definition to "material fact". Whilst retaining the test of something that would influence a prudent insurer in deciding on acceptance and if so premium and terms, it must be one either known to the applicant or one that could reasonably be assumed to have been within his knowledge, and one which a reasonable person would disclose to his insurers having regard to the nature and extent of the insurance cover sought and the circumstances under which it is sought.

A number of other recommendations are directed to ensuring that publicity is given about the need for disclosure in regard to proposal and renewal, matters which in general have had attention from the industry some years ago.

Amongst the more recent decisions, *Lambert v Co-Operative* (p.000) must take pride of place. The dispute, whilst it involved a modest enough sum, turned upon an important point of principle. In essence the result was the straightforward application of the fundamental idea expressed some 209 years previously by Lord Mansfield in *Carter v Boehm*. It is obvious from the judgments however that the far-reaching social changes that have taken place during that long interval were regarded by their Lordships as a reason for considering a change in what MacKenna J termed "the unsatisfactory state of the law. (Mrs Lambert) ... is not an underwriter and has presumably no experience in these matters". His Lordship made it clear where his sympathies lay; in the court's view the present law did not operate justly in such a case.

Above all *Lambert's* decision reaffirms that the test of the materiality of any particular fact is not that of a reasonable person seeking insurance, but rather the one adopted by the Privy Council in *Mutual Life Insurance Co of New York v Ontario Metal Products Co Ltd* [1925] AC 344. Giving the Board's judgment Lord Salvesen declared:

> "... it is a question of fact in each case whether, if the matters concealed or misrepresented have been truly disclosed, they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium."

The case under consideration was non-marine; there was no room for argument in the case of marine contracts in view of S.18 of the Marine Insurance Act 1906. Although the statutory test refers to the judgment of a "prudent" rather than a "reasonable" insurer *Lambert's* case makes it clear that it is from the same viewpoint,

namely that of the insurer, that the question of whether information is material or not must be judged.

An alternative, more lenient to the insuring public, seems to have been canvassed in the courts since *Joel v Law Union & Crown Insurance Co* with Fletcher Moulton LJ's reference to making disclosure "to the extent that a reasonable man would have done it...". Judgments in which the small consumer orientated approach has exercised some influence are reviewed by MacKenna J in *Lambert,* but the Court of Appeal make it clear that however a court's natural inclinations may run in a "hard-line" case the test for materiality was clearly in 1975 precisely as it had been laid down by Lord Mansfield in 1766, namely governed by the outlook of the reasonable or prudent underwriter. The two qualifying adjectives seem to have been used interchangeably in the judgments and would seem to rank as synonyms in this context. Certainly a defendant insurer seeking so to qualify his stance in a given set of circumstances would be able to call as expert witnesses underwriters from other parts of the market to establish what would be the likely reaction of a prudent or reasonable insurer.

In *March Cabaret Club & Casino Ltd v The London Assurance* (p.19) May J, only a few months before the Court of Appeal in *Lambert*, ruled that the test of materiality for all types of insurance business is similar, namely whether the fact in question would have influenced the attitude of the careful underwriter and furthermore that duty of disclosure arises from an implied term in the contract of insurance; the duty may be more burdensome upon an insured by the terms of his specific contract with an insurer, but if the usual "basis of the contract" declaration and other features were not present the rule would still operate but at common law level. The case is also of some interest because of the difference from the views of Forbes J in *Reynolds and Anderson v Phoenix Assurance Co Ltd* (p.64) over the point under the Rehabilitation of Offenders Act 1974.

As indicated at p.76 of Volume 2 ILR that part of the judgment in *Reynolds and Anderson v Phoenix Assurance* relating to non-disclosure is included in this volume. It is preceded by a report of a hearing in the Court of Appeal a few months earlier on a preliminary point of law between the same parties over a dispute that arose on a refusal of Forbes J to grant leave to amend the defence in the main action to include an allegation of non-disclosure with which was linked a 1961 conviction. The latter was "spent" because of the 1974 Act, but the court possessed the general discretion under S.7(3) to admit evidence as to it, if not to do so would deny justice between the parties. Forbes J had refused leave to introduce the conviction. The Court of Appeal ruled differently, to the extent of allowing the defence to be amended, but leaving it for Forbes J at the main hearing to use

his judicial discretion to decide when the evidence was introduced what weight should be paid to it. The Court of Appeal decided it was not its function to direct the judge below on that score since that was essentially one of the issues for him to try. Waller LJ was less than enthusiastic in his concurrence with his brethren:

> "I have hesitated as to whether or not I thought I would allow the appeal. In all the circumstances I have come to the conclusion that I would not, although with some hesitation, disagree with the order proposed by my Lords."

A footnote to paragraph 660 of *MacGillivray & Parkington on Insurance Law* (7th Edition) puts it thus:

> "S.7(3) of the Act provides for the admission of evidence as to spent convictions before a court if that court is satisfied that justice cannot be done except by admitting to it. This provision, and the extent to which it affects the insured's duty of disclosure was left uncertain by the Court of Appeal in *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep. 22."

In the event his Lordship decided that an eleven year old conviction involving dishonesty which resulted in a fine was not a material fact which would have affected the judgment of a reasonable or prudent insurer and therefore need not have been disclosed.

Where material information is withheld from an insurer either at inception or on renewal — it is then that the duty of utmost good faith arises — the effect is to render the policy voidable at the insurers' option. Until that option is exercised normally an insurance would continue, and that is the point upon which *Adams v Dunne* (p.69) focusses. A proposal for motor insurance was accepted by dint of withholding material information. The policy was avoidable but the insurers had taken no step to exercise their legal rights to terminate, and in those circumstances the accused was not guilty of the offence alleged of driving without insurance.

It is well settled law that the issue of a policy raises the presumption that everything that led to its inception or renewal is in order. It follows therefore that if thereafter an insurer suggests that a policyholder has breached his duty of utmost good faith, the onus of demonstrating that rests entirely with the office concerned. An insurer could not meet that requirement in *Butcher v Dowlen* (p.75). It was suspected that material information had been withheld about previous motoring convictions, obviously on persuasive grounds, but the defendant had not been able to specify when, where, and the nature of the charges. The Court of Appeal decided in the circum-

stances that in the absence of such details the defence should be struck out as too "speculative", a term recalling the sentence at the beginning of that well known passage in Lord Mansfield's judgment in *Carter v Boehm* "Insurance is a contract upon speculation".

A hitherto unreported decision, *Holly & Holly v The Bradford Insurance Co* (p.83) illustrates another difficulty that insurers may sometimes face. The policyholder stated on a proposal on 15 July 1975 that his car would not be driven by anyone who to his knowledge had been disqualified. The insurance was renewed yearly until July 1977. A change in family circumstances resulted in the insured's son, who had been disqualified, driving in September 1977, something there is no reason to believe the insured had contemplated either at inception or at any subsequent renewal including the most recent. The defendants were not able to establish the true position was otherwise, and so the plaintiff succeeded. It is clear from all three judgments in the Court of Appeal that much of the evidence had been directed to a subordinate point that arose under the Rehabilitation of Offenders At 1974. In the words of Lawton LJ "...the parties were mesmerised by the attractiveness of the point... They forgot that no point of law arises by itself; it only arises on facts." That, respectfully, is a salutary warning to which anyone likely to be involved in litigation could well pay some heed.

The pivotal point on which *Adams v Dunne* (p.69) turned arose many years earlier in *West v National Insurance Union Ltd* (p.89). There had been a non-disclosure inasmuch as the full value of household goods and effects insured by Mr West was not disclosed despite the undertaking by him to the contrary. The result was that when the true state of affairs was discovered the policy could be avoided by the insurers at their option. They decided to treat it as valid but rejected a claim. The Court of Appeal regarded such a course as legally inconsistent. Having opted to affirm the insurance the company was estopped from relying upon the breach of utmost good faith which would have sustained a decision to repudiate the policy to justify a rejection of the claim although payment in respect thereof would necessarily be limited by the restricted sum insured.

Finally *Cox v The Orion Insurance Co Ltd* (p.97) is surely a case in which popular sentiment would wholeheartedly support the unanimous view of the Court of Appeal that the insurers were not liable, a clearly misleading account of the circumstances in which the claim arose having been given to them. In the county court below although the defendants had argued that there had been a non-disclosure of material facts concerning the accident, the county court judge had taken a different view and found for the motorist despite a specific condition in the policy requiring prompt notification and the supply of detailed particulars of any accident, loss or damage. The Court of

Appeal thought that Mr Cox was in breach of this condition, the observance and fulfilment of which was fundamental to liability arising out of the policy. The insured had not given detailed particulars of the accident in which he was involved but had described an entirely different accident. Donaldson LJ suggested that such conditions:

> "... no doubt require to be construed with a reasonable degree of benevolence; but, even so construing this condition, I am quite clear that it does not entitle the assured to give particulars of a different occurrence which is precisely what he did."

All in all the cases selected show how deeply the principle of utmost good faith with its requirements for the full disclosure of material facts is entrenched in insurance law in its present form. The position has not really altered very much in the past two centuries. *Lambert v Co-operative Insurance Society Ltd* confirms that, and removed an idea that had been given occasional countenance in the courts that the test of materiality was to be applied from the point of view of the reasonable insured. If the duty weighs heavily upon the insuring public, the burden of proof on insurers alleging a breach is correspondingly high, as *Butcher v Dowlen* (p.75) and *Holly and Holly v The Bradford Insurance Co Ltd* (p.83) show. It is over questions of moral hazard that an "ordinary" policyholder, basically honest in intent, may not realise the full extent of the duty, as the Court thought was the case in regard to Mrs Lambert. Certainly it appears likely that as a result of the Law Commission's recent recommendations eventually some modification of the duty of utmost good faith may come about.

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BRENDA JOAN LAMBERT v CO-OPERATIVE INSURANCE SOCIETY Ltd

22 January 1975 *Court of Appeal*

Cairns and Lawton LJJ
MacKenna J

Mrs Lambert took out an "all risks" policy with the defendants in April 1963 to cover items of jewellery, some of which belonged to her husband and some to herself. The proposal form on which the contract was based had not asked if she, her husband, or any other member of her family had previous convictions, and she disclosed no information in that respect. She knew her husband had previously been convicted of receiving stolen cigarettes. The policy was renewed for some years, and an application was made to continue it in the usual way in March 1972.

In December 1971 Mr Lambert received a second conviction for two theft offences and was sentenced to 15 months imprisonment. His wife did not disclose that upon her application for renewal in the following March. During the then current insurance period some of the insured items were lost or stolen and Mrs Lambert's claim was rejected on the grounds that she did not disclose her husband's first conviction at inception and, further or alternatively, the second at renewal in 1972.

HELD

At first instance (his Honour Judge Ranking) that the plaintiff's claim failed because of non-disclosure.

On appeal, the decision was upheld because:

(1) There was no obvious reason why the requirements for disclosure in marine insurance should differ from those in other classes.

(2) An insured was under the same duty of disclosure at renewal as at inception of a policy.

(3) Information that was material had to be disclosed, and the test of materiality was whether it would influence the mind of a prudent insurer.

L. Lewis QC, V. Levene and M. Lambert appeared on behalf of Mrs Lambert, instructed by Hatten Asplin Channer & Glenny
C. Fawcett QC and B. de Speville appeared for the Co-operative Insurance Society, instructed by Mr W. R. Kirk

Commentary
The point at issue in this case was the extent of an insured's duty of disclosure. Both sides agreed that such a duty did exist but differed as to its degree. Mrs Lambert submitted that her obligation was to reveal such circumstances as a reasonable person might expect would influence the judgment of a prudent underwriter. Her insurers however contended that it was incumbent upon her to make them aware of every fact which would influence the attitude of a prudent underwriter in determining whether the business was acceptable and if so at what rate.

It would have been surprising had the Court of Appeal not found unanimously for the defendants since the case would seem to demand a clear-cut application of the principles so authoritatively stated by Lord Mansfield in *Carter v Boehm*, principles which lie at the foundation of present insurance law, and which have been applied steadily over the years in cases where a question of the extent of the duty of utmost good faith arises. Some of those cases are referred to in the judgment in *Lambert*, including *Ionides and Another v Pender* (1874) LR 9 QB 531 where the authority of Mr Justice Blackburn was given to the following statement:

> "It is perfectly well established that the law as to a contract of insurance differs from that as to other contracts, and that a concealment of a material fact, although made without any fraudulent intention, vitiates the policy."

Other factors lend support to the decision and include the statement of the law by the Law Reform Committee in its 1957 report in which the eminent lawyers concerned declared it to be "well settled law" that duty of disclosure of material facts applies to all classes of insurance and is concerned always with whether a fact not disclosed is material to the risk, not whether the insured, reasonably or otherwise, believed or understood it to be so. Then the court referred to a statutory definition of "material" in S. 10(5) of the 1934 Road Traffic

Act, a definition not repeated in the current Act of 1972, in which it was stated that the meaning was "of such a nature as to influence the judgment of a prudent insurer in determining whether he would take the risk and if so at what premium and on what conditions".

Additionally there is S.18(2) of the Marine Insurance Act 1906 quoted in MacKenna J's judgment which made it clear that a similar test for materiality as was laid down for motor insurance in the 1934 Act already applied to marine business. There was no distinction between the various classes of insurance, the same criteria for materiality applying equally to them all. The 1906 Act S.18 had merely set out for marine risks the existing common law rule which was of universal application and which is a tenet of the general law and does not require an expressed term or condition of an insurance contract to give rise to it. In *Lambert's* case condition 2 of the policy expressly provided that a contract should be void should there be an omission to state any fact material for estimating the risk, but had the document been silent on the point it would not have affected the outcome of the case.

Why then had Mrs Lambert decided to raise the appeal if the adverse decision made at first instance seemed inevitable? Perhaps because over the years occasionally other tests had been applied to define the boundaries of the duty of disclosure. *Lambert's* case confirmed the standard was that of a reasonable or prudent insurer. MacKenna J considered three other possible rules which might be applied:

(1) Such facts only as a particular insured believes to be material.

(2) Such facts as a reasonable insured believes to be material.

(3) Such facts as the particular insurer regards as material.

Of these three it was the second, the "reasonable insured" test that seemed to have a measure of judicial support, deriving mainly from the judgment of Fletcher Moulton LJ in *Joel v Law Union & Crown* [1908] 2 KB 863, and later influencing McNair J in *Roselodge v Castle Ltd* [1966] 2 Lloyd's Rep. 113. It was also urged on Mrs Lambert's behalf that in *Anglo-African Merchants Ltd and Another v Bayley and Others* [1970] 1 QB 311 there is a short passage from the judgment of Megaw J from which it might be deduced that the "reasonable insured" test was also being applied.

Lambert's case dispels any doubts that the test is to be made from the stand-point of the reasonable underwriter rather than from that of the reasonable insured, and that being so the policyholder was bound to fail. All three members of the Court of Appeal came to that view, but with a strongly expressed reluctance, and in the end it may

come to pass that whilst Mrs Lambert lost her battle for £311 she paved the way for a change in the law on the point by which the insurance consumer may find himself more favourably placed than he has been throughout the last two centuries.