The Doctrine of Utmost Good Faith: Back to Common Law to Move Forward?

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Abstract

The article re-examines the position of the doctrine of utmost good faith in insurance contracts, specifically in the context of insurers' duty. A historical development of the doctrine is undertaken to uncover its actual basis. This is then utilised to examine its development under English jurisdiction, followed by the Australian and American position. The unsatisfactory position of the doctrine as developed by the English courts have resulted in numerous attempts to reform the law, the latest being the on-going efforts by the Law Commissions. The author argues for a return of judicial activism in construing the true meaning of the doctrine to include the element of fairness and reasonable expectation of consumers. This is in line with current advancement of information technology and data management available to the insurance industry. The unique Malaysian position is also highlighted whereby the prudent insurer's test no longer applies to non-disclosure or misrepresentation of material facts. It has been replaced by the reasonable assured's test under section 150(1) of the Insurance Act 1996. The Bank Negara Guidelines which set the standard of good practices for insurers are also referred to as they incorporate the concept of fairness and fair treatment of consumers. The doctrine of utmost good faith thus acquired more depth and meaning when applied equally to insurers as well.

1. Introduction

The birth of the doctrine of utmost good faith rests upon the recognition of the unequal bargaining position of the parties to the insurance contract, that one party has special knowledge of the facts which will be relied upon by the other party to enter into the said contract. If one were to delve deeper, it can be reasonably discerned that at the core of its foundation lies the basic concept of fairness. It is essential that this point is kept in mind whilst traversing the many slippery slopes that have sprung from the doctrine. Efforts to develop the doctrine in the English courts seem to flounder in the judicial hands, giving rise to decisions which are inconsistent and incoherent to the very foundation of the doctrine itself. This article will be highlighting several of these cases to illustrate this point.

The dictum in the case of *Carter* v *Boehm*[2] was made in the context of matters lying within the exclusive knowledge of the insured. The doctrine thus imposes on the party with such special knowledge the obligation to disclose and the duty not to misrepresent in the said instance. Additionally, Lord Mansfield regarded the principle of disclosure as

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[2] (1766) 3 Burr. 1905

"applicable to all contracts and dealings".[3] The principle was to apply to all contracts, not just insurance contracts. This proposition was not followed through in subsequent cases in the nineteenth century which restricted the application of the principle to insurance contracts only. The doctrine that began as a contender for the general rule of contract settled as an exception in insurance contracts.[4]

In tracing the history and the context of its development, the various stages of the evolution which makes the doctrine of utmost good faith what it is today can be identified. It started at a point of inspiration of what it was aspired to be in *Carter v Boehm* and has been evolving till today, protracted though its results may be.[5] The process and the result of this evolution however, differ according to the jurisdiction it grew under. The states of affairs of the doctrine of utmost good faith appear starkly in contrast with one another in the different jurisdictions. This article looks at several highlights in the scope and extent of the application of the doctrine of utmost good faith in the United Kingdom, Australia and the United States of America. A suggestion is then made to explore the possibility of developing a coherent and consistent doctrine of utmost good faith in insurance contract law by falling back on the common law.

2. United Kingdom

The unsatisfactory state of the doctrine in the United Kingdom has been the subject of numerous criticisms.[6] The current ongoing effort of the Law Commissions to propose law reform in the area of insurance law rightly recognised many of the deficiencies of the current state of the law.[7] The doctrine of utmost good faith received a fair share of attention. It was noted by the Commissions that the courts have found it difficult to develop the principles or to adapt to changing economic conditions. The incoherent and inconsistent law, regulations and ombudsman practises have provided the push for yet another effort at law reform, the objective of which is the simplification and

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3 *Ibid.* at p. 1910

4 Frank D. Rose, *Restating insurance contract law: centennial reflections on landmark reform,* Lloyd's Maritime and Commercial Law Quarterly [2006] 458-484, at p. 479.

5 It is acknowledged that there were earlier cases that had begun to lay the ground for the doctrine.

6 R.A. Hasson, *The Doctrine of Uberrima Fides in Insurance Law A Critical Evaluation*, The Modern Law Review, Vol.32, No.6, (Nov. 1969), 615-637; Robert Merkin, *Uberrimae Fidei strikes again,* The Modern Law Review, Vol.139, No.4 (July 1976) 478-482; MD Kirby J, *Marine Insurance: Is the Doctrine of Utmost Good Faith Out of Date?,* (1995) 13 Australian Bar Review 1; Robert Merkin and Colin Croly, *Doubts about Insurance Codes,* Journal of Business Law, 2001, Nov, 587-604; Baris Soyer, *Continuing duty of utmost good faith in insurance contract: still alive?*, Lloyd's Maritime and Commercial Law Quarterly [2003] 498-507; Sir Andrew Longmore, *Good Faith and Breach of Warranty : Are We Moving Forwards or Backwards?*, Lloyd's Maritime and Commercial Law Quarterly [2004] 158-171; John Lowry & Philip Rawlings, *Insurance Law Cases & Materials*, Oxford, Portland Oregon, 2004 at p. 194; Jeffery B. Struckhoff, *The Irony of Ubberimae Fidei: Bad Faith Practices in Marine Insurance*, 29 Tul. Mar. L.J. 287, Summer 2005; Norma J. Hird, *Utmost Good Faith – forward to the past,* Journal of Business Law, 2005, Mar, 257-264; Frank D.Rose, *Restating Insurance Contract Law: Centennial Reflections on Landmark Reform*, Lloyd's Maritime and Commercial Law Quarterly [2006] 458-484; Robert Merkin, *Reforming Insurance Law: Is there a case for reverse transportation?*, A Report for the English and Scottish Law Commissions on the Australia Experience of Insurance Reform, 2006.

7 The Law Commission Consultation Paper No 182 and The Scottish Law Commission Discussion Paper No 134.

modernisation of insurance law. Interestingly, the theme of fairness and reasonable expectation are present throughout the consideration of the Law Commissions.

At present the fate of the doctrine hangs in the balance. In spite of the numerous calls and efforts to reform insurance contract law for the past fifty years, the legislature has not taken up the matter.[8] The courts continue to grapple with the scope and extent of the doctrine whilst acknowledging the one-sidedness of its application, which is inevitable if the doctrine is taken to exist only within the statutory confines of the Marine Insurance Act 1906.[9] Part of the difficulty in providing a more appropriate remedy to the insured is the uncertainty as to the juristic basis of the doctrine.[10] The focus on the mechanics of the doctrine has overshadowed the very basis and substance of the doctrine itself. The neglect or inadvertent oversight of the requirement of fairness coupled with the strict and mechanical application of the doctrine as found in the Marine Insurance Act 1906 has resulted in the current unsatisfactory state of law.[11] This in turn has resulted in numerous decisions with harsh consequences to the insured and which, it is submitted, violate the very basis of the doctrine.

Although section 17 of the Marine Insurance Act 1906 states generally the mutuality of the application of the doctrine in a contract of marine insurance and the effect and available remedy in the event utmost good faith has not been observed by either party, the subsequent sections deal only with the application of the doctrine on the assured at the pre-contract stage.[12] This has had an adverse impact on the natural development of the said doctrine. The doctrine, it is submitted, goes beyond the statutory wordings in the said Act. The doctrine's growth has thus far been capped by confining it to the statutory provisions, without regard to the fact that those provisions only apply to the assured before the contract is concluded. Section 17 has been relied upon to expand the scope and extent of the doctrine but as will be highlighted below, the said provision proved problematic time and again as it appears to limit the remedy to avoidance of the contract. It is perhaps time to go beyond section 17 and to develop the doctrine within the common law and equity, when necessary.

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8 See Consultation Paper 182 for a chronological account of previous reports, self-regulation and statutory regulation. See also Malcolm Clarke, *Doubts from the dark side – the case against codes,* Journal of Business Law 2001, 605

9 *North Star Shipping Ltd v. Sphere Drake Insurance Plc* 2006] 2 Lloyd's Law Reports 183. Both Waller LJ and Longmore LJ agreed that the law on duty of disclosure and the injustice it entails are in need of legal reform. See para 21 and 54 respectively.

10 Andre Naidoo, David Oughton, *The confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?*, Journal of Business Law 2005, May, 346-371; Norma J. Hird, *Utmost Good Faith – forward to the past,* Journal of Business Law 2005, Mar, 257-264.

11 Sections 17-20.

12 Marine Insurance Act 1906, s. 17 states: "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."

2.1 Misinterpretation of *Carter v Boehm*[13]

The duty of utmost good faith as it stands today places the burden of the duty of disclosure mainly on the insured even though the duty is said to apply to both parties of the contract.[14] Lord Mansfield in the celebrated case of *Carter* has often been cited out of context in the form of the following:[15]

> *The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the under-writer trusts to his representation, and proceeds upon confidence, that he does not keep back any circumstances within his knowledge, to mislead the under-writer into a belief that the circumstances does not exist, and to induce him to estimate the risqué, as if it did not exist.*

A more complete reading of His Lordship's opinion, however, clearly indicated that Lord Mansfield in fact placed the responsibility for obtaining the relevant material information on the insurer:[16]

> *The under-writer knew the insurance was for the governor. He knew the governor must be acquainted with the state of the place. He knew the governor could not disclose it, consistently with his duty. He knew the governor, by insuring, apprehended, at least, the possibility of an attack. With this knowledge, without asking a question, he underwrote. By so doing, he took the knowledge of the state of the place upon himself. It was a matter, as to which he might be informed in various ways: it was not a matter, within the private knowledge of the governor only.*

The insured's duty was in fact conceived as a narrow one. The duty arises only in respect of matters exclusively within his knowledge, matters which cannot otherwise be ascertained and obtained by the insurer through other means. It is for the insurer to ascertain and obtain information on such matters before underwriting. The case was decided in favour of the insured, a fact often overlooked in later cases which applied the duty on the insured.

The insurer's obligation was restated in *Nobel* v *Kennoway* where the underwriter was held to be under an obligation to inform itself of the practice of the trade which it insures.[17] The requirement of fair inquiry and due diligence on the part of the insurer was clearly stated in the case of *Friere* v. *Woodhouse* (1817) where it was said:[18]

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[13] *Supra*, note 1.

[14] The concept of mutuality of the duty of utmost good faith seemed to have suffered an overgrowth for the insured and an almost negligible development for the insurer in England. See text below at 2.4.2.

[15] (1766) 3 Burr. 1905, at p.1909.

[16] *Ibid.* at p. 1915.

[17] (1780) 2 Doug. 510.

[18] 1 Holt N.P. 572, at p.573

What is exclusively known to the assured ought to be communicated; but what the underwriter, by fair inquiry and due diligence, may learn from ordinary sources of information need not be disclosed.

This duty of utmost good faith was refined and narrowed further in *Mayne* v *Walter* where Lord Mansfield added the requirement of fraud before a policy can be avoided by the insurer on the ground that there has been a concealment of circumstances or non-disclosure of material matters.[19] The case concerned the loss of supercargo when the ship was captured by a French privateer. The claim was rejected by the insurer on the ground that the insured did not disclose the existence of a French ordinance that authorizes the seizure of such ships. The case was decided in favour of the insured. This requirement of fraud received support until late nineteenth century.[20]

The insured's duty of disclosure at the end of the eighteenth century and the beginning of the nineteenth century was a narrow one. The insurer had the obligation to discover facts through fair inquiry and to pursue the matter with due diligence before it can rely on the ground of non-disclosure to refuse claims by avoiding the policy. In fact, the non-disclosure must be fraudulent before the policy could be avoided. The doctrine of utmost good faith as stated then was consistent with the basis of the doctrine, i.e. fairness.

2.2 Development in the nineteenth century

However, subsequent cases in the nineteenth century began to distort the doctrine by very general statements which broadened the insured's duty of disclosure considerably. The insured is said to have the duty to disclose every material circumstance within his knowledge.[21] These broad statements in the dictum of those cases were delivered without acknowledging the earlier cases which had laid down the narrow duty of disclosure on the insured. Nor was there appropriate consideration given to the obligation of the insurer to make fair inquiry and to follow through with due diligence. In fact, one of the judges in *Bates* v. *Hewitt* dismiss this crucial facet of the doctrine of utmost good faith by stating that the insurer is not obliged to do so.[22] This 'modified' version of the doctrine of utmost good faith was the one that found its way into the Marine Insurance Act 1906.[23]

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19 Reported in Park, *The Law of Marine Insurances* (1787) at p.220, quoted in R.A. Hasson, *The Doctrine of Uberrima Fides in Insurance Law. A Critical Evaluation*, The Modern Law Review, Vol.32, No.6. (Nov. 1969), 615-637, at p.617.

20 *Hambrough* v. *Mutual Life Insurance Company of N.Y.* (1895) 72 L.T. 140 at 141; *Wheelton* v. *Hardisty* (1852) 2 El. & Bl. 232, at p.273.

21 *Lindenau* v. *Desborough* (1828) 8 B. & C. 586, at p.592; *Bates* v. *Hewitt* (1867) L.R. 2 Q.B. 595, at pp 604-605.

22 *Ibid.* at p. 611.

23 For comments on the codification of the doctrine, see FD Rose, *Informational asymmetry and the myth of good faith: back to basics*, LMCLQ 2007, 2 (May), 181 at pp 202-205.

2.3 Development in the twentieth century

The common law on insurance received the attention of the legislature and was 'codified' via the Marine Insurance Act 1906.[24] The Marine Insurance Act 1906 which has been treated as codifying the law on insurance contracts inadvertently left out crucial aspects of the doctrine of utmost good faith, namely the obligation of the insurer to make fair inquiry and to act with due diligence. The narrow duty of disclosure as refined by the cases following *Carter* was also not reflected in the said legislation. The said codification is in fact a partial codification as it is incomplete and does not deal with every aspect of marine insurance. It is worth noting that the drafter of the Act commented that section 17 stated the general principle because the following sections are not exhaustive.[25] The state of law at that time is not clearly reflected in the provisions of the Marine Insurance Act 1906.[26] A clear example of this is the provisions governing non-disclosure and misrepresentation which provide only for the duty of the assured and his agent despite the clear provision under section 17 of the Marine Insurance Act 1906 with regards to the mutuality of the duty of utmost good faith.[27] This omission has contributed to, if not caused, the current confusion in the scope and extent of the doctrine of utmost good faith.

The trend of broadening the insured's duty of disclosure continued into the twentieth century with the aid of the said statute and established the trend of strict application of the broad duty. In the case of *Joel* v. *Law Union and Crown Insurance,* the Court of Appeal ruled that the insured was under no duty to disclose what he did not know.[28] Conversely, it means that if the insured had the knowledge, the fact that he thought it to be immaterial would not absolve him of the duty to disclose. This is a far cry from the narrow duty established in earlier cases as stated above. Cases in the twentieth century proceeded to apply the broad duty and expanded it further by including the constructive knowledge of the insured, those facts "which in the ordinary course of business [the assured] might reasonably be expected to discover."[29] This is in line with section 18(1) of the Marine Insurance Act 1906.[30] Thus, instead of requiring the insurer to make fair inquiry on the matter, which is in accord with the industry's good practice, the insured is further burdened with the duty to disclose what he ought to know.

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[24] 1906 (6 Edw. 7 Ch. 41). The preamble declares the Act to be "An Act to codify the Law relating to Marine Insurance". See FD Rose, *Restating insurance contract law: centennial reflections on landmark reform,* L.M.C.L.Q., 458-484 for the history and origins of the said Act.

[25] *Digest to Marine Insurance,* Chalmers, Sir M.D. (3rd ed., 1907).

[26] See Frank D. Rose, *Restating insurance contract law: centennial reflections on landmark reform*, Lloyd's Maritime and Commercial Law Quarterly [2006] 458-484.

[27] Sections 18-20, MIA 1906.

[28] [1908] 2 K.B. 863 (C.A.) affirming [1908] 2 K.B. 431.

[29] *Australia and New Zealand Bank Ltd* v. *Colonial and Eagle Wharves Ltd* [1960] 2 Lloyd's Rep. 241, at p. 252.

[30] Section 18(1) provides: Subject to the provision 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 a disclosure, the insurer may avoid the contract.

2.4 Current challenges in the application of the doctrine of utmost good faith

There are several serious challenges in the current application of the doctrine of utmost good faith. These include the uncertainty of the scope and extent of the doctrine at the post-contractual stage including fraudulent claims, the mutuality or bilateral nature of the duty, the extent of what must be disclosed by the insured and the harshness of the remedy of avoidance to the insured.

2.4.1 Post-contractual duty of utmost good faith

Due to the general wordings of section 17 of the Marine Insurance Act 1906, its scope and extent has been the subject of various litigation and to date, remain unclear.[31] The slim authority for a post-contractual application of section 17 is found in the case of *The Litsion Pride*.[32] Hirst J. was of the opinion that there was a post-contractual duty of utmost good faith. It is to be noted that much of his reasoning concerning utmost good faith has since been overruled. The Court of Appeal in *The Good* Luck subsequently affirmed that the insurer owed a continuing duty of utmost good faith to the insured but rejected the proposition that this duty is extended to the assignee of the policy.[33] The basis of this post-contractual duty of utmost good faith is the principle of law stated in section 17 of the Marine Insurance Act 1906. This is to be contrasted with the Court of Appeal's position in *Orakpo v. Barclays Insurance Services* where it was held that the breach of post-contractual duty at claims stage by the submission of a fraudulent claim goes to the root of the contract, entitling the insurer to be discharged from further liability under the said contract.[34] This appears to be grounded upon the implied term theory rather than section 17 of the Marine Insurance Act 1906.

The House of Lords in *The Star Sea* proceeded to confirm that the duty of utmost good faith could extend beyond the formation of the contract.[35] The scope and content of the duty of utmost good faith beyond the formation of the contract was, however, not defined. Lord Scott of Foscote nevertheless clarified that the said duty is merely a requirement of honesty. The extent of post-contractual utmost good faith was held to vary according to the stage where it arises. At claims stage, utmost good faith is to be restricted to certain types of conduct. The duty then ends upon commencement of litigation as the rules of court would then apply to the conduct of the parties.

There are numerous questions regarding post-contractual duty of utmost good faith that have not been addressed in the cases mentioned above. Having accepted the existence of post-contractual duty of utmost good faith, the courts must now face the

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31 Section 17, Marine Insurance Act 1906 declares: '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.'

32 *Black King Shipping Corp v. Massie* [1985] 1 Lloyd's Rep 437.

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

34 [1995] LRLR 433.

35 *Manifest Shipping Co. Ltd v.Uni-Polaris Shipping Co. Ltd* [2001] 2 W.L.R. 170, HL; [1997] 1 Lloyd's Rep. 360, CA; [1995] 1 Lloyd's Rep. 651, QBD, hereafter *The Star Sea*.

inevitable questions that follow. Is the legal basis for post-contractual duty of utmost good faith based upon section 17 of the Marine Insurance Act 1906 or an implied term of the insurance contract? Is the doctrine limited to what is expressly stated in the said statutory provision or is section 17 a facet of a larger doctrine of utmost good faith in common law? If so, could the post-contractual utmost good faith be founded on the doctrine beyond section 17?

Besides the uncertainty of the legal basis, the scope of post-contractual utmost good faith remains unclear. Does it include fraudulent claims by the insured? What is the legal basis of the rule governing fraudulent claims under English law? There are overlapping rules which apply to fraudulent claims. These are the common law rule of forfeiture, repudiatory breach of contract and the doctrine of utmost good faith.[36] The remedies available under each rule differ accordingly, from forfeiture, election of discharge of contract to avoidance of policy respectively. Mance LJ proposed in *The Ageon* to treat common law rules governing fraudulent claims as falling outside section 17 of the Marine Insurance Act 1906 whereas Sir Roger Parker in *Orakpo v. Barclays Insurance Services* took the stand on policy grounds and was of the view that a deliberate fraud goes to the root of the contract and should lead to the total loss of benefit even when there is no express term to that effect.[37] Lord Scott in *The Star Sea* recognized the forfeiture rule and doubted the application of section 17 in fraudulent claims.[38] The judicial reluctance to embrace the doctrine of utmost good faith as the governing rule in fraudulent claims appear to be based upon the inappropriate remedy of avoidance and the availability of the forfeiture rule and that of repudiatory breach of contract. As there are no express and specific provisions governing post-contractual duty of utmost good faith, it will be up to the courts to develop and recognize the scope and extent of that duty.

2.4.2 Mutuality of the Doctrine of utmost good faith

As stated earlier, the doctrine of utmost good faith started out as a device to even the scale of information between the insured and the insurer. The essence of the doctrine is the mutuality of the duties between the insurer and the insured under the insurance contract. The development of the doctrine thus far, however, focused mainly on the duty of the insured as provided in sections 18 and 19 of the Marine Insurance Act 1906 and applied in the numerous reported cases. What of the application of the doctrine to the insurer?[39] What about the conduct or misconduct of the insurer such as deliberately delaying the settlement of claim? In practice, the mutuality of the doctrine has not materialised despite the declaration in section 17.[40]

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[36] James Davey, *Unpicking the fraudulent claims jurisdictions in insurance contract law: sympathy for the devil?*, [2006] LMCLQ 223.

[37] [2002] 2 Lloyd's Rep 42 and [1995] 1 LRLR 443 respectively.

[38] [2003] 1 AC 469, at [110] - [111].

[39] The development of the doctrine of utmost good faith in Australia as well as the United States stands in stark contrast to the one-sided application of the doctrine under English law. See text below.

[40] FD Rose, *Informational asymmetry and the myth of good faith: back to basics*, LMCLQ 2007, 2 (May), 181 at p.201.

In *Sprung v. Royal Insurance (UK) Ltd*, the insured claimed damages for late payment and sought to maintain a claim that the insurer had been in breach of contract for failing to accept liability and settle the claim promptly.[41] The delay of three and a half years resulted in the collapse of the insured's business. The Court of Appeal rejected the claim for damages for late payment on the basis that a claim under an insurance contract is a claim for damages for a breach of contract and there is no cause of action in damages for the late payment of damages. With respect, an insurance contract is a *sui generis* contract where the insured agrees to pay the premium for the promise that in the event the risk insured occurs, the insurer agrees to indemnify the insured for the loss as a result of the risk occurring. In a non-indemnity policy, the amount payable is an amount agreed upon. The claim under an insurance contract is not for a breach of contract as the insurer had not breached the contract in any way. The fact that the risk insured materialised is not as a result of insurer's breach of contract. It is an anticipated event. On the contrary, the claim is actually the enforcement of the contract, the carrying out of the promise made upon the formation of the contract. With respect, the Court of Appeal erred in holding that a claim under an insurance contract is a claim for damages for a breach of contract.

On the alternative argument that failure of the insurer to indemnify was a breach of the contract itself, Evans LJ was prepared to hold that there was an implied obligation on the insurer to respond promptly to a request from the insured that the damage to the premises should be inspected and the question of repairs considered. However, his Lordship then went on to state that the plaintiff should have proceeded with the repair even though it would breach a term of the contract (that prior consent of insurer must be obtained) as the insurer cannot then rely on insured's breach of contract to deny the claim. It is a peculiar stand to propose as the insured is expected to breach the contract to enable him to claim as the insured is expected to know that that breach is one that the insurer cannot rely upon to deny the claim. In a nutshell, there is essentially no sanction against an insurer who procrastinates in paying indemnity under the policy. Unfortunately, there was no consideration given for the obligation of utmost good faith on the part of the insurer in settling claim in the said case.

There has been considerable reluctance on the part of judges to give recognition and effect to the application of the doctrine of utmost good faith to the insurer, be it at the formation of the contract, during the currency of the contract or at the claims stage.[42] In *The North Star,* the non-disclosed facts were allegations of criminal conduct of the insured which were subsequently held to be unfounded and were therefore immaterial

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[41] [1999] Llyod's Rep IR 111.

[42] *Drake Ins Plc v. Provident Ins Plc* [2003] ECWA Civ 1834, *Brotherton v. Aseguradora Colseguros SA (N0 2)* [2003] ECWA Civ 705, *The Star Sea* [2001] UKHL 1, *North Star Shipping Ltd v. Sphere Drake Ins Plc (The North Star) (No 2)* [2006] ECWA Civ 378; [2006]2 Lloyd's Rep 183. See J Lowry and P Rawlings, *Insurers, Claims and the Boundaries of Good Faith,*(2005) 68 MLR 82 and J Davey, *Materiality, Non-Disclosure and False Allegations: Following the North Star?,* [2006] LMCLQ 517.

to the risk in fact.[43] They were, however, material to the judgment of a prudent insurer as stated in section 18 of the Marine Insurance Act 1906. The insurers were held to be entitled to avoid the contract even though the Court of Appeal readily acknowledged that there is a case for reforming the current law on non-disclosure. An application to amend the notice of appeal to include the argument that the insurers were in breach of a duty of utmost good faith in avoiding the policy was refused as it could not be properly considered without further evidence. Despite the court's acceptance of the *dicta* in *Drake Ins. Plc* that an insurer might be disentitled to rescind for lack of good faith, the issue could not be presented before the court.[44] The insurers' conduct continues to be free from the doctrine of utmost good faith.[45]

In accepting post-contractual utmost good faith, the judges are merely affirming the mutuality of the doctrine of utmost good faith as stated in section 17 of the Marine Insurance Act 1906. However, there are no corresponding provisions applicable to the insurers under the Marine Insurance Act 1906. It has been pointed out that judges are generally reluctant to apply the duty of utmost good faith on insurers.[46] As the situations in which an insurer's duty of utmost good faith is required mainly arise post-contractually, it remains to be seen how soon such a judicial recognition will take place. On the positive side, judicial recognition of insurers' duty of utmost good faith is almost unavoidable. Recent cases have indicated that there are situations in which insurers can and should be expected to behave better.[47] The scope of insurers' duty of utmost good faith can either be recognised by the courts or laid down in statutory form. The former is a continuous process via the development of the doctrine under common law and the latter is dependent entirely on legislative action.

2.4.3 The ever-expanding limits of materiality

Under section 18 of the Marine Insurance Act 1906, the insured are required to volunteer information to the insurer about any 'material circumstance' that would influence the decision of the prudent insurer regarding the risk. Such information must be disclosed even when no questions were posed by the insurer on the said matter. Failure to disclose such matters may result in the insurer avoiding the policy.[48] The fact that it was an innocent misrepresentation or non-disclosure is of no consequence. The strict enforcement of warranties in insurance contracts further facilitates the avoidance of policy on technical grounds. The unsatisfactory state of law is currently being reviewed by the Law Commissions which have concluded that "some principles embodied in the 1906 Act are no longer appropriate to a modern insurance market and do not meet

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43 *Ibid.*

44 *Ibid.* at [11] - [13] and 187-188.

45 See FD Rose, *Informational asymmetry and the myth of good faith: back to basics*, LMCLQ, 2007, 2 (May), 181 at p.212 where the author stated that 'a shift in the perception of the nature of an insurance contract is likely to be necessary before greater duties on the insurer are established'.

46 *Ibid.*

47 M Mills, *Duty of Good Faith: The 'Sleeper' of Insurance Obligations*, (2006) 80 ALJ 576.

48 Sections 18(1) and 20(1), Marine Insurance Act 1906.

policyholders' reasonable expectations".[49] It has been acknowledged that the duty of disclosure may operate as a trap to the insured.[50] Claims have been denied even when the insured had acted honestly and reasonably.

Additionally, the test of materiality is that of the prudent insurer.[51] Hence, the insured is expected to disclose facts which the prudent insurer would deem to be material.[52] It is not surprising that the result of such application of the doctrine has been far from satisfactory. Instead of ensuring that the insurance contract is based on utmost good faith with the aim of balancing the scale of fairness, the broad duty of disclosure of the insured coupled with the test of materiality enable the insurer to avoid the policy on mere technicalities. In addition, the utilization of the basis of contract clause making every answer a warranty has effectively ousted the requirement of materiality of the matter. The insurer therefore only needs to raise the point that a fact had been misrepresented or not disclosed, no matter how immaterial or inconsequential that fact is. The law thus imposes unrealistic and unacceptable burden on those applying for insurance and the insured.

The term 'circumstance' includes any communication made to, or information received by, the insured.[53] What exactly must be disclosed by the insured? From the initial narrow duty of disclosing what is exclusively within the knowledge of the insured, matters which cannot otherwise be ascertained and obtained by the insurer through other means, the current position not only expects the assured to know what a prudent insurer would deem to be material, it also cast the net so wide as to include even allegations or rumours against the insured himself. In *Brotherton v. Aseguradora Colseguros SA and La Previsora SA, Compania de Seguros*, the Court of Appeal held that allegations of criminal conduct which were in fact untrue were material circumstances that must be disclosed.[54] Although in *The Grecia Express,* Colman J mitigated it by holding that it would be contrary to the insurer's obligation of good faith to rely on such non-disclosure to avoid the contract in the face of evidence that such allegations were untrue, this suggested approach was however, rejected by Mance LJ in *Brotherton.*[55]

Similarly in *The North Star,* allegations of dishonesty, criminal charges in Greece and civil proceedings in Panama against the two individuals who controlled the insured

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49 Law Commission and Scottish Law Commission Joint Consultation Paper, Insurance Contracts Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured, Summary, at para. 9.

50 *Ibid.* at para. 9(1).

51 Section 18(2), Marine Insurance Act 1906 provides: 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.

52 This is to be contrasted with the position in Australia which provides for the reasonable assured test under the Insurance Contracts Act 1984. Malaysia has adopted a similar position via section 150(1)(b) of the Insurance Act 1996. Thus, the prudent insurer test does not apply in Malaysia.

53 S.18 (5), MIA 1906.

54 [2003] ECWA Civ 705; [2003] 2 All ER (Comm) 298.

55 *Strive Shipping Corp v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)* [2002] Lloyd's Rep IR 669.

company were not disclosed at the time of application for the war-risks insurance.[56] They were subsequently acquitted and charges were dropped. The Court of Appeal affirmed the finding of the trial judge that the allegations had to be disclosed and that materiality was established. As highlighted by Longmore LJ, so long as the law remains as set out in section 18 of the Marine insurance Act 1906, it is an almost inevitable conclusion.[57] Despite agreeing that the law in this area is in need of reform and is 'capable of producing some serious injustice', both Waller LJ and Longmore LJ were content to leave it to the Law Commissions' call for reform and legislative intervention on the matter.[58]

A point that has not been judicially considered in the said cases on the limits of materiality is the fact that such allegations, rumours or even pending legal proceedings were circumstances that were, in fact, not within the exclusive knowledge of the insured. Such matters can be ascertained and obtained by the insurer either through specific questions in the proposal form or through further inquiry. If at all the matter is material to the consideration of the risk, it is in accord with good practice that specific questions are asked concerning them. It is extraordinary that a person applying for insurance is expected in law to disclose allegations against his own self which may not be true and may have no relevance at all to the application in question.

Whilst it is acknowledged that the prudent insurer's test for materiality can only be changed legislatively, as has been done in Malaysia via section 150(1)(b) of the Insurance Act 1996, there is room for judicial reconsideration of materiality and the doctrine of utmost good faith. In the landmark decision in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd,* the House of Lords introduced the additional requirement of inducement to the test on materiality, purportedly to redress the imbalance between the insured and insurer.[59]

Recent cases which applied this requirement on inducement have demonstrated that insurers can no longer rely solely on the prudent insurer's test to succeed in their rejection of claims as the courts are requiring that the insurers prove, on the balance of probabilities, that he was induced to enter into the contract by a material non-disclosure or misrepresentation.[60] It was stated that there was no presumption of law that an insurer was induced to enter into the contract in such a situation although the facts might allow it to be inferred. To prove inducement, the insurer had to show that the non-disclosure or misrepresentation was an effective cause of his entering into the contract on the terms which he did.[61] Even with direct evidence from the underwriter that if the true position had been disclosed to him he would have imposed a contractual condition, the court

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56 *North Star Shipping Ltd v. Sphere Drake Insurance Plc (The North Star)* [2006] ECWA 378.
57 *Ibid.* at [53].
58 *Ibid.* at [17].
59 [1995] 1 AC 501.
60 *Synergy Health (UK) Ltd v CGU Insurance Plc (t/a Norwich Union)* [2010] EWHC 2583 (Comm); [2011] Lloyd's Rep. I.R. 500; *Lewis v Norwich Union Healthcare Ltd* [2010] Lloyd's Rep. I.R. 198.
61 *Assicurazioni Generali SpA v Arab Insurance Group (BSC)* [2002] EWCA Civ 1642, [2003] 1 W.L.R. 577.

had held that the insurer had failed to show inducement as prove of inducement takes into account other factors such as commercial reasons and previous practices in such matters.[62] Thus, the inducement test may yet be the factor to be used to balance the scale of unfairness that arises out of the prudent insurer's test.

This proves the point that the law in this area is still a work-in-progress and needs to be developed in line with not just the business efficacy of the industry but more importantly, to be in consonance with the basis of the doctrine of the utmost good faith in the context of current climate. With today's advances in information technology and instant communication, it is no longer acceptable to put the whole burden on the shoulders of the insured to disclose every material circumstance to the insurer. The mutuality of the duty ought to be invoked and applied to the insurer as well, not merely recognised and acknowledged without any practical significance.

In the context of Malaysia, the test of materiality is no longer that of the prudent insurer. A proposer is to disclose a matter that he knows to be relevant to the decision of the insurer on whether to accept the risk or not and the rates and terms to be applied.[63] This is a subjective test based on what the particular proposer knows to be relevant. Alternatively, the objective test is that of the reasonable assured test via section 150(1)(b) of the Insurance Act 1996. The question that may be posed is whether the requirement of inducement to the test of materiality which refers to the prudent insurer as introduced by the House of Lords in *Pan Atlantic Insurance Co Ltd* is to be made a requirement to section 150(1) of the Insurance Act 1996? Should Malaysian courts adopt the requirement of inducement in the case of non-disclosure or misrepresentation in an insurance contract when the test under section 150(1)(b) refers to that of the reasonable assured and not the prudent insurer?

In addition, it is to be noted that the Bank Negara Malaysia or the Central Bank has issued Guidelines on Unfair Practices in Insurance Business which specifically prohibits unfair practices and lists down nine practices which are deemed to be unfair.[64] It includes repudiation of liability on grounds of non-disclosure of material fact which the policyholder could not reasonably be expected to have known to be relevant to disclose.[65] The Bank Negara Guidelines on Claims Settlement Practices (Consolidated) emphasises on the prompt and fair settlement of claims by the insurers.[66] The guidelines issued by the Bank Negara are recognised as subsidiary legislation.[67] The concepts of fair dealing and fair treatment of consumers are already put in place by Bank Negara for the insurance industry. It is thus up to the courts to take cognizance of the position

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62 *Synergy Health (UK) Ltd v CGU Insurance Plc (t/a Norwich Union)* [2010] EWHC 2583 (Comm); [2011] Lloyd's Rep. I.R. 500 at para[202].

63 Section 150(1)(a), Insurance Act 1996.

64 BNM.RH/GL/003-6.

65 Ibid., at 5.9.3.

66 BNM/GL/003-6 and BNM/RH/GL 004/17.

67 *Diana Chee Yun Hsai* v *Citibank Berhad* [2009] 5 MLJ 643, at para. 15.

and to incorporate these standards when applying the doctrine of utmost good faith to the insurers. This is where judges in Malaysia can fall back on when applying the said doctrine to disputes in insurance claims. The conduct of insurers and that of his agents and employees are subject to such standards as laid down under the said guidelines. It is submitted that judges in Malaysia can rely on the said guidelines in giving meaning to the scope of insurers' duty under the doctrine of utmost good faith. The applicability of the inducement test introduced in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* to Malaysian cases is highly questionable in the light of the fact that section 150(1) of the Insurance Act 1996 have replaced the prudent insurer's test with that of the reasonable assured.

2.4.4 Inappropriate remedy for the insured

Under section 17, the remedy available for the innocent party when the other party breached the duty of utmost good faith is the avoidance of the contract *ab initio*. This remedy is inappropriate in the case of the insured as he would lose coverage under the policy. This is especially crucial at the post-contractual stage. In *Banque Keyser Ullmann SA v. Skandia (UK) Insurance Co. Ltd*, the trial judge, Steyn J awarded damages to the assured for breach of the said duty.[68] Whilst acknowledging that it was not an implied term of the said contract, the learned judge propounded that justice and policy required that it is necessary to avoid the imbalance and unfairness in the relationship. Alternatively, it was held that the damages is founded in the tort of negligence as the insurer owed a duty of care to the assured. The Court of Appeal affirmed the finding that there was a breach of utmost good faith but reversed the award for damages. It was held that section 17 is an exhaustive statement of the available remedy. Hence, only the remedy of avoidance is available in the event of a breach of the duty of utmost good faith. The House of Lords later affirmed the Court of Appeal's decision but on different grounds. Lord Templeman and Lord Jauncey both commented, albeit *obiter*, that a breach of the said duty does not sound in damages.

The position taken by the Court of Appeal was not contradicted by the House of Lords. This position however, makes no sense in the post-contractual context. It has been widely acknowledged that the remedy of avoidance is in effect of little use to the insured at this stage, or at any stage for that matter.[69] In awarding damages for the breach of the duty of utmost good faith, Steyn J can be said to have created a new cause of action, which may be the answer to the limitation of the doctrine of utmost good faith within section 17. In rejecting to even consider the need to create a tort for the breach

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[68] [1990] 1 QB 665.

[69] However, the insured may still find rescission of the contract sufficient as in *Tan Jin Jeong v Allianz Life Insurance Malaysia Berhad and Anor* [2012] 7 MLJ 179. In this case, the plaintiff successfully sued the insurer and his agent for having sold to him the Investpro policy by way of misrepresention as well as by way of non-disclosure of material fact regarding the feature of the Investpro. The plaintiff's claims to rescind the contract and for a refund of the RM400,000 premiums paid were allowed by the High Court which acknowledged the fact that the policy was a contract made in utmost good faith, requiring full disclosure by both parties.

of utmost good faith, the possibility of developing the post-contractual duty of utmost good faith has been denied.

Despite the availability and clear wordings of section 91(2) of the Marine Insurance Act 1906, English judges have thus far recoil from having to resort to common law but instead relied on section 17 of the Marine Insurance Act 1906 as if it were the ultimate principle of law with regards to the doctrine of utmost good faith.[70] The fact that sections 18, 19 and 20 are clearly restricted to the application of the doctrine to the assured and his agent at the formation of the contract is ignored or overlooked. Yet, the remedy of avoidance for the breach by the insurer is sadly inadequate and inappropriate for the insured. This is the inevitable consequence of tying the legal basis of post-contractual duty of utmost good faith to section 17 of the Marine Insurance Act 1906 and limiting the doctrine to the statutory wordings of the said provision.

Perhaps, lessons can be learned from the development of the doctrine of utmost good faith in Australia and the United States. A look at different jurisdictions will highlight the different paths in which the doctrine has developed particularly in relation to the mutuality of the said doctrine.

3. Australia[71]

The doctrine of utmost good faith applicable in marine insurance is very much similar to the English position.[72] It is stated in the Marine Insurance Act 1909 (Cth) which is in substance identical to the Marine Insurance Act 1906.[73] In general insurance, however, the Australian position has undergone substantive changes via the statutory route,[74] retaining the doctrine of utmost good faith with major modifications.[75] In addition to making utmost good faith an implied term in insurance contracts, section 13 of the Australian Insurance Contracts Act 1984 imposes upon the parties to the contract, the

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70 S.91 (2), MIA 1906 provides: 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.

71 For a good review of the Australian position and comparative analysis with the English position, see Robert Merkins, *Reforming Insurance Law: Is There A Case For Reverse Transportation, A Report For The English And Scottish Law Commissions On The Australian Experience On Insurance Law Reform*, 2007.

72 In January 2000, the Australian Law Reform Commission was asked by the Attorney-General to investigate the operations of the Marine Insurance Act 1909 and to consider various factors in determining whether there is a need to amend the said Act. See *ibid.* at 2.3. The Commission recommended that the Act be retained, but in a reformed state. See ALRC 91, Chapter 3.

73 Marine Insurance Act 1909 (Cth), ss.23-27.

74 For example, the test of materiality is the particular insurer and actual or reasonable insured test as opposed to the prudent insurer's test. See Insurance Contracts Act 1984(Cth), hereafter referred to as ICA, section 21(1). The remedy of avoidance by the insurer for non-disclosure by the insured are also significantly restricted by the requirement of fraud but not when the insurer would have entered into the contract of insurance upon the same terms had there been full disclosure s.28. The proportionality principle is also found in this provision for the remedy of a non-fraudulent breach.

75 A review of the ICA instituted in September 2003 by the Australian Treasury resulted in recommendations were accepted by the Australian government. The said recommendations were then formulated into the Insurance Contracts Amendment Bill 2007 and amendments to the Regulations made under ICA.

obligation to act in utmost good faith towards the other party in respect of any matter arising under or in relation to the insurance contract.[76] Thus, both parties to the contract have the contractual obligation to act in good faith. This allows the insured to claim for damages should the insurer breach this duty.[77]

In *Moss v Sun Alliance Australia Ltd,* the plaintiffs insured their business premises against fire.[78] The property burnt down but the insurer declined to pay under the policy. It harboured a suspicion, proved wrong, that the plaintiffs had started the fire. The plaintiffs had borrowed heavily to buy the property and the delay in receipt of the insurance moneys embarrassed them with their financiers. Without the income from the property or the moneys due under the policy, the insured could not repay their loans and incurred a liability to pay interest for the period during which the insurer delayed payment. The court in *Moss*, apparently relying upon the implied term to act in good faith, allowed damages in addition to interest to compensate the insured for late payment. The court accepted a submission that "prompt admission of liability to meet a sound claim for indemnity and prompt payment is required of an insurer by virtue of its obligation to act with the utmost good faith towards its insured". Under the Insurance Contracts Act 1984, the duty of utmost good faith precedes those of other law and is a paramount duty which is not to be limited.[79] Additionally, this duty of utmost good faith is not to be circumscribed by any term in the insurance contract itself.[80]

The Australian courts have even imposed the duty of good faith on insurers in circumstances where such duty had not been found before. For example, the court in the case of *Ivkovic v. Australian Casualty and Life Ltd*[81] held that the insurer is to act reasonably when determining the insured's qualification for the benefit under the policy. The court took note of the power disparity between the insurer and the insured when it stated:[82]

> There is undeniably something patently invidious about a contractual provision which makes any insured's qualification for the benefit depend entirely upon the formation of a subjective opinion by the insurer in circumstances in which that opinion will directly affect both the interests of the insurer and the insured. I accept that the duty to act reasonably imposed on the insurer by such a provision does encompass a duty to act in good faith and deal fairly with the insured.

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76 Part 11 of the ICA is entitled "The Duty of Utmost Good Faith" and includes sections 12-15. There is, however, no statutory definition of the 'duty of utmost good faith' in the ICA.

77 See *Lomsargis v National Mutual Life Association of Australasia Ltd* [2005] QSC 199 (19 July 2005) at para [41] where the Supreme Court of Queensland reiterated that "A breach of the duty *can* result in a liability for damages, as damages for breach of contract... Because of s 13, a breach of the duty of good faith no longer allows only the remedy of avoidance."

78 (1990) ALR 592.

79 ICA, s.12.

80 *Ibid.* s.14 prohibits a party from relying upon a term of an insurance contract if it is contrary to utmost good faith.

81 (1994) 10 SR (WA) 325.

82 *Ibid.* at p.345.

Thus, the duty of utmost good faith apply to the exercise of discretion by the insurer in determining liability under the insurance contract as the insurer is under a contractual obligation to act in good faith. The courts have in the past decade seemed more willing to develop further the duty of utmost good faith to incorporate the insurer's obligation to act in good faith when settling claims and to have regard to the insured's interests both in the defence of actions against the insured and also their settlement.[83] The Insurance Contracts Act 1984 imposes various statutory duties on insurers, *inter alia* to inform the insured of the consequences of non-disclosure and to notify the insured of any unusual term in advance of the policy being made.[84] Insurers are also under a duty to reach a timely decision on a claim and to settle claims in good faith.[85] It is noteworthy that amendments are in the pipeline for the Act. The statutory provisions under the said Act have significantly applied the doctrine of utmost good faith to the demands of consumer protection and modern day insurance industry practices. The effectiveness of such statutory provisions depends not only on its clarity and details but also on the response of the insurance industry and market. Judges play their role by giving meaning and scope to the said provisions when there is a dispute regarding or in relation to the insurance contracts.

The latest significant case in which section 13 was raised and considered is *CGU Insurance Limited v. AMP Financial Planning Pty Ltd.*[86] The complex case involved the denial of liability by the insurer, after a protracted communication regarding the settlement of claims by investors arising out of the misconduct of two financial advisers who were the insured's representatives. Although the High Court of Australia allowed the appeal of the insurer by a majority decision, all five judges accepted the wider view of the requirement of utmost good faith as opposed to limiting it to dishonest conduct. Both Gleeson CJ and Crennan J agreed that utmost good faith may require an insurer to act with due regard to the legitimate interests of an insured, as well as to its own interests. It was elaborated that an insurer's statutory obligation of utmost good faith 'may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured'.[87] A timely response by the insurer to a claim for indemnity may well fall within this obligation. It was pointed out however, that the Insurance Contracts Act 1984 does not empower a court to make a finding of liability against an insurer as a punitive sanction for not acting in good faith. Callinan and Heydon JJ both held that even if there had been a breach of the obligation on the part of the insurer, it would not entitle the insured to relief.[88]

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83 See *Renard Construction (ME) Pty Ltd v. Minister for Public Works* (1992) 26 N.S.W.L.R. 234; *Hughes Aircraft Systems v. Airservices Australia* (1997) 146 ALR 1; *Alcatel Australia Ltd v. Scarcella* (1998) 44 NSWLR 349 where the duty of good faith was accepted as implied by law in all contracts.

84 ICA, s.22 and s.37 respectively.

85 *Ibid.* s.41. See *Dumitrov v SC Johnson & Son Superannuation Pty Ltd* [2006] NSWSC 1372; *McArthur v Mercantile Life Insurance Co Ltd* [2002] 2 Qd R 197.

86 [2007] HCA 36 (29 August 2007).

87 *Ibid.* at para [15].

88 The two reasons given were that the insured did not rely on the Senior Counsel clause and that the insured had expeditiously settled the claims for its own reasons.

However, Kirby J (dissenting) asserted that the broad view of utmost good faith sets the correct, desirable and lawful standard for the efficient, reasonably prompt, candid and business-like processing of claims for insurance indemnity in Australia.[89] The criteria of dishonesty, caprice and unreasonableness were held to express more accurately the ambit of what constitutes a breach of section 13 of the Act.[90] The underlying principle is that both parties to the insurance contracts owe each other an affirmative duty of utmost good faith in equal reciprocity. It obliges an insurer to make up its mind to either accept or deny indemnity to the insured. The insurer's conduct of delaying its denial of liability until after the insured had settled the claims, almost two years after the first notification of the possibility of liability was held by Kirby J to be a breach of utmost good faith. To hold otherwise, as did the majority, 'sends quite the wrong signal to Australian insurers concerning their obligations under the Act in their dealings with insureds'. Thus, despite the general agreement with regards to the broader view of the duty of utmost good faith in section 13, the judges were of differing opinions regarding whether the conduct of the insurer amounted to a breach of utmost good faith and the consequence of the breach by the insurer. Even in the statutory form of section 13, the doctrine of utmost good faith continues to challenge judges in its application, ambit and consequence of its breach.

4. United States of America

The doctrine of utmost good faith was adopted in the United States and was initially applied to all insurance contracts.[91] In the early nineteenth century, the doctrine of utmost good faith was adopted in the case of *McLanahan v Universal Insurance Co.*[92] The doctrine was not adopted in totality as it was qualified with two important exceptions. The court rejected the 'extreme diligence' under English law and earlier American cases and introduced the element of 'due and reasonable diligence' which is a question of fact to be determined by the jury. The second exception concerned the determination of materiality. It was held that it is a question of fact, a departure from the prudent insurer's test.

One of the first cases to elaborate on the obligation of the insurer to faithfully settle the claims of its policyholders is *Richards v. New-Hampshire Ins. Co.*[93] The Supreme Court in the case of *Insurance Co. v Dunham*[94] then established that marine insurance contracts came under the jurisdiction of federal admiralty and was therefore governed by the federal maritime law. The doctrine of utmost good faith reached the Supreme Court the second time in *Sun Mutual Insurance Co. v. Ocean Insurance Co.* where the

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89 *Ibid.* at para [139].

90 *Ibid.* at para [131].

91 See Gerace and Sandow, *Ubberimae Fidei and All-Risk Policies: Revival of a Historic Defense*, (1986) Insurance Counsel Journal, January, 154; Harnett, *The Doctrine of Concealment: A Remnant in the Law of Insurance*, (1950) 15 Law & Contemp. Prob. 391.

92 26 U.S.(1 Pet.) 170,1998 AMC 285 (1828).

93 43 N.H. 263 (1861).

94 78 U.S. 1, 1997 AMC 2394 (1870).

non-disclosure of the double charter and an existing insurance were held to be material facts.[95] The court proceeded to state that the duty was violated even without the intent to deceive.[96] The doctrine was subsequently applied in numerous marine insurance cases by most of the United States federal courts.[97]

The American position saw a divergence from the English common law with a combined statutory and judicial approach. Statutory intervention was at state's level. Recognising the disparity of the bargaining power between the parties and the harshness of the remedy of avoidance, the state legislatures invariably limit the application of the doctrine of utmost good faith. The inequities of the remedy of avoidance for the breach of warranties, misrepresentations or non-disclosures were acknowledged. These statutes ensure that insurers do not rely on technical breaches to avoid policies, provide legal remedies for the enforcement of the insurance contracts and also regulate insurers for bad faith practices.[98] Considerable modifications to the doctrine were effected via states legislation to discourage technical and unnecessary warranties.[99] Presently, all 50 states in the United States have some form of statutory good faith and fair dealing obligation imposed on the insurer for the benefit of the insured.[100] Bad faith and concealment sprung up in place of utmost good faith. In spite of such legislation, maritime contracts continued to be governed by federal maritime law.

A departure began when a state legislation was held to be applicable instead of the federal maritime law. In the case of *Wilburn Boat Co. v. Fireman's Fund Insurance Co.*, the Supreme Court applied the state law instead of federal maritime law.[101] Despite acknowledging that the policy was a maritime contract and therefore subject to the federal admiralty jurisdiction, the court held that in the absence of a federal statute, a judicially established federal admiralty rule, or a compelling need for uniformity in federal admiralty law, state law governs marine insurance contracts.[102] This completely ignored the well-established federal admiralty rule of strict compliance of express warranties in a marine insurance policy. In justifying the departure from the established rule, the court reasoned that it does not follow that every term in a maritime contract can

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95 107 U.S. (17 Otto) 485 (1883).

96 *Ibid.* at p.510.

97 See Thomas J. Schoenbaum, *The Duty of Utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law*, 29 Journal of Maritime Law & Commerce, 1, at 9.

98 Jeffery B. Struckoff, *The Irony of Uberrimae Fidei: Bad Faith Practices in Marine Insurance*, 29 Tulane Maritime Law Journal, Summer, 2005, 287, at p.298. See also William R. Vance, *The History of the Development of the Warranty in Insurance Law*, 20 Yale Law Journal 523.

99 For example, additional requirements such as 'intent to deceive' and that the said misrepresentation or non-disclosed fact materially contributed to the acceptance of the risk are imposed. See *inter alia*, Louisiana Revised Statute 22:619 and California Insurance Code 10380 (Deering 1996).

100 See *e.g.* Fla Stat. 624.155 (authorizing civil actions against insurers for bad faith) and Fla Stat. 626.9541 (defining unfair methods of competition and unfair or deceptive practices by insurers).

101 348 U.S. 310, 1955 AMC 467 (1955).

102 *Ibid.* at 314-316, 1955 AMC at 471-473.

only be controlled by federal admiralty rule.[103] Under Texas law, breach of an express warranty does not void the policy, unless the breach contributes to the loss. The Supreme Court in recognising the harshness of the remedy of avoidance under the federal rule applied the state law instead.

Thus, the subsequent development of the doctrine of utmost good faith in the American soil started to take its own distinct journey via the judicial application of statutory modification of the doctrine at state level. In addition to giving force to the statutory modification, the courts went one step further in redefining utmost good faith.[104] A distinction was made between marine and non-marine insurance and a reformulation of the scope of the duty of utmost good faith was accordingly made. For the former, the insured is only required to disclose material facts known to him.[105] In non-marine insurance where the buyer is not as sophisticated and knowledgeable as the buyer in a marine insurance, the rule is not as strict. The insurer was recognised as being in a better position with adequate questionnaires and inspection opportunities and was expected to make an inquiry of any matter considered material.[106] In *Stecker v. American Home Fire Assurance Co.*, the insured failed to disclose his previous conviction and the insurer rejected the claim.[107] The court held that if the insurer makes no inquiry on that fact, then concealment, short of actual fraud, does not void the policy.[108]

Although the starting point of the divergence is based on the questionable decision of the Supreme Court in *Wilburn Boat Co. v. Fireman's Fund Insurance Co.*, subsequent cases followed suit and applied the relevant provisions in the respective state legislation.[109] Since then, state legislation has been applied and this had had the effect of mitigating the harshness of the application of the doctrine of good faith as found in the English position. The provision governing bad faith practices is an offshoot of the doctrine of utmost good faith and is a distinctly American development. Focus is on curbing the bad practices in the insurance industry. This practical approach has resulted in the development of procedural fairness at various stages of the life of an insurance contract. In a sense, it is the development of the duty of utmost good faith on the part of insurers, a development which takes into account the practices of insurers and ensures that such practices are not to the detriment of the insured.

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103 *Ibid.* at 313, 1955 AMC at 470-471.

104 *In re Balfour MacLaine International Ltd.*, 873 F. Supp. 862 (S.D.N.Y. 1995), aff'd, 85 F. 3d 68, 74, 1996 AMC 2266 (2d Cir. 1996). The ruling of the court in this case has also been criticized as having gone against precedent under the American admiralty law. See Thomas J. Shoenbaum, *The Duty of utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law*, 29 Journal of Maritime Law & Commerce, 1 at 12.

105 *American Employer's Insurance Co. v. Cable* 108 F. 2d 225 (5th Cir. 1939), *Gulf Stream Ltd v. Reliance Insurance Co.* 409 F. 2d 974 (5th Cir. 1969).

106 *Blair v. National Security Insurance Co.* 126 F. 2d 955 (3d Cir. 1942).

107 299 N.Y. 1 (1949).

108 *Ibid,* at p.8. The term 'concealment' is used in place of non-disclosure in the American context.

109 *Supra.* Footnote 99.

Examples of statutory provisions modifying the application of utmost good faith in insurance contracts are provisions governing claims handling and settlement practices. These are mostly derived from the National Association of Insurance Commissioners' Model Unfair Claims Practices Act.[110] Breach of any of these provisions is a cause of action for a bad faith claim.[111] A successful bad faith claim may receive not only compensatory but also punitive damages, both of which may be beyond what is due under the policy and is usually a substantial amount as it is a jury award.[112] Policy terms which give insurers the unrestricted authority to settle or litigate claims have been challenged since the early 1900s.[113] Courts in the United States have routinely imposed an obligation on the insurers to consider the interests of the insureds and this obligation has been variedly termed as a duty to exercise 'due care' to protect the interests of the insured, to act in 'good faith' with regard to the interests of the insured or to avoid rejecting settlement offers in 'bad faith'.[114] The exact scope of this obligation varies from state to state.

5. Conclusion

Having looked at the statutory modification and development of the doctrine of utmost good faith in both Australia and the United States of America, the different paths in which the doctrine has developed in relation to the mutuality of the said doctrine can be clearly seen. The American position has taken a completely unique path by venturing into bad faith actions to control the practices in the insurance industry in addition to the legislative intervention at state level. The debilitating effect of jury awards against insurers act as an effective enforcement to the statutory requirements of the modified good faith and bad faith claims. It is highly unlikely that the doctrine under the English common law will take this path. The current exercise of looking into reform of insurance law by the Law Commissions in fact made references to the Australian position instead.

It is submitted that a viable alternative is to go beyond section 17 of the Marine Insurance Act 1906 and develop the doctrine in common law to complement the position stated in the said statute. As the statutory provisions are clearly inadequate to deal with

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110 Anahid Gharakhanian & Jonathan F. Bank, *U.S. Bad Faith Claims*, International Insurance Law Review 1998, 20.

111 Historically, a bad faith claim was limited to common law causes of action e.g. refusal to defend and failure to settle an underlying claim within policy limits that later resulted in a judgment in excess of policy limits.

112 *Hendrick v. Sentry Insurance Co.* No. 96-1281000-90 (Tarrant County, Texas Dist. Ct 1993) – in this case the insurer denied a $20,000 underinsured motorist claim. The jury awarded compensatory damages of $2.17m and punitive damages of $100m. See also *Amoco Chemical Co. v. Certain Underwriters at Lloyd's*, 1996 W.L. 407855 (Cal. 1996) where the jury awarded $35m in compensatory damages and $385m in punitive damages. The Court of Appeal subsequently reduced the punitive damages to $71m on the ground that one of the jury instructions was wrong and prejudicial.

113 One of the earliest cases imposing limitations on the insurer's discretion in settlement is *Brassil v. Maryland Casualty Co.*, 210 N.Y. 235, 104 N.E. 622 (1914).

114 See Robert E.Keeton & Alan I. Widiss, Insurance Law: A Guide to Fundamental Principles, Legal Doctrines and Commercial Practices 876 (1988) at 880-83 for citations to cases stating each formulation.

the various circumstances pertaining to the application of the doctrine to the insurer and also at the post-contractual stage, the way forward is for judges to develop the doctrine into a coherent and cohesive doctrine, in line with current good insurance industry's practices and the reasonable expectations of consumers. These themes are present in both the Australian and American jurisdictions. A proper understanding of earlier cases and a reaffirmation of fairness as the foundation of the doctrine may well realign the future development of the doctrine, without having to wait for statutory intervention. Returning to the realm of the common law to further develop the doctrine of utmost good faith is a viable and logical step forward. Important though the current exercise of the Law Commissions may be, it must not be an excuse not to develop the doctrine of utmost good faith under the common law. This avenue is currently available to judges who really need not wait for legislative action on the matter as it may prove a lengthy wait, even if not in vain.

In the context of Malaysia, this is particularly relevant as section 150(1)(b) of the Insurance Act 1996 has replaced the prudent insurer's test with the reasonable assured's test. The challenge for Malaysian judges is to develop the doctrine of utmost good faith in line with the best practices of an insurer as stated under the relevant Bank Negara's guidelines such as the Guidelines on Unfair Practices in Insurance Business and Guidelines on Claims Settlement Practices (Consolidated).[115]

[115] BNM/GL/003-6 and BNM/RH/GL 004/17. For a further discussion on this point, see Nurjaanah @ Chew Li Hua, "Reformulating Insurers' Duty", [2013] 1 MLJ.