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RECENT DEVELOPMENTS IN MATERIALITY TEST OF INSURANCE CONTRACTS

In insurance law the doctrine of disclosure as expounded by the controversial decision of *CTI* v *Oceanus* requires the proposer of an insurance policy to disclose every fact that the underwriter may wish to be aware of during his decision-making process. This has unfortunately been confirmed in the recent House of Lords' decision of *Pan Atlantic Insurance Company Limited* v *Pine Top Insurance Company*. However, some form of reprieve appears to have been granted since the judgment has also stipulated that it must additionally be shown that the particular insured had been induced before there can be any resort to avoidance.

I. INTRODUCTION

THE duty of disclosure as imposed on the insured when applying for an insurance policy has long been castigated by many – judges, lawyers and academics alike.[1] To be fair, however, the original rationale behind it has always been laudable; as the case of *Rozanes* v *Bowen*[2] has pointed out, it is obvious that "...as the underwriter knows nothing, and the man who comes to him knows everything, it is the duty of the assured ... to make a full disclosure to the underwriters without being asked of all the material circumstances."[3] What the critics find objectionable is the way the duty has evolved over the past twenty odd decades – from its rather noble enunciation in the celebrated 1766 case of *Carter* v *Boehm*[4] to the deplorable

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1 See, *eg*, Hasson, *"Uberrima Fides* in Insurance Law – A Critical Evaluation" (1969) 32 Mod Law Rev 617; Harnett, "A Remnant in the Law of Insurance" (1950) 15 Law & Contemp Prob 391; Birds, "The Reform of Insurance Law" [1982] JBL 449; English Law Commission Rep 104 (1980) Cmnd 8064 at paras 3.17-3.22; Australian Law Reform Commission Rep 120 at paras 172, 175 and 183. The insurance contract is an exception to the general contract law that there is no duty on contracting parties to disclose information known exclusively by one of the contracting parties. Other exceptions to this general rule include contracts of partnership and certain family settlement contracts. See also the dictum of May J in *March Cabaret Club* v *London Assurance* [1975] 1 Lloyd's Rep 169 at 175.

2 (1928) 32 Lloyd's Rep 98.

3 *Ibid*, at 102.

4 (1766) 3 Burr 1905; 97 ER 1162. The evolution can be traced in the following articles: Hasson, *supra*, note 1; Brooke, "Materiality in Insurance Contracts", LMCLQ (1985) 437; Clarke, "Failure to Disclose and Failure to Legislate: Is it Material?" [1988] JBL 298; Davis, "The origin of the duty of disclosure under insurance law" (1991) 4 Ins LJ 71.

present-day state of being almost like "an engine of oppression"[5] operating unrelentingly against the hapless insured.

It is not the intention of the present article to trace the evolution of this duty; suffice it to note, as the English Law Commission had observed, that "prior to the case of *Lambert* v *Co-operative Insurance Society (CIS) Ltd*[6] ... there was a line of authorities which suggested that at least in certain classes of insurance the law was ... that the insured was under a duty to disclose only such facts as a *reasonable man* would believe to be material."[7] The *Lambert* case ruled, however, that the proposer of an insurance policy has henceforth to disclose all the "facts which would influence the judgment of a *prudent insurer* in fixing the premium or determining whether he will take the risk,"[8] and in so doing it effectively confirmed that, as in marine insurance, materiality in general (*ie*, non-marine) insurance ought to be viewed through the eyes of the prudent insurer. There has since then been much discontentment over this 'prudent insurer' test. For the marine insurance industry (to which the progenitor *Carter*[9] case and the English Marine Insurance Act 1906 apply), the insured is invariably another company – not unlike the insurer – and there is therefore less excuse for the insured, after having been in the trade for a number of years, not to know what or who is to be construed as the prudent insurer. In contrast, for general insurance the majority of the proposers are private consumers (seeking, for instance, life-assurance or hospitalisation coverage) who may not even be aware that they are under a duty to disclose all material information, let alone be mindful of what facts a prudent insurer will regard as material. Lamentably, this distinction between the consumer and non-consumer regimes has thus far been steadfastly eschewed by the English Law Commission[10] and the courts in England.

The insurer's advantageous position was further fortified by the subsequent case of *Container Transport International (CTI) Inc* v *Oceanus*

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5 *Per* Lord Sumner, *Niger* v *Guardian Assurance Co* (1922) 13 Lloyd's Rep 75 at 82.

6 [1975] 2 Lloyd's Rep 485 (*Lambert*).

7 English Law Commission Rep, *supra*, note 1, at para 3.19. In Scots law, that would appear to be the position with respect to life insurance; see *Samuel Hooper* v *Royal London General Insurance Co Ltd* (1993) SLT 679, and Forte, "The Materiality Test in Insurance" LMCLQ (1993) 557. For a general discussion, see Yeo, "Duty of Disclosure in General Insurance Contracts" [1989] 1 MLJ xlviii.

8 *Supra*, note 6, at 487 and 489. The court in *Lambert* in fact adopted the test in s 18(2) of the (English) Marine Insurance Act 1906.

9 *Supra*, note 4.

10 English Law Commission Rep, *supra*, note 1, at paras 4.34-4.42; *cf* the much bolder views of Australian Law Commission, *supra*, note 1, at paras 180 and 183. The Hong Kong Law Reform Commission's approach to this problem is also commendable; see the Law Reform Commission of Hong Kong, Report on Laws of Insurance (Topic 9) at paras 3.02-3.03 and 3.17-3.19.

Mutual Underwriting Association (Bermuda) Ltd,[11] which has adopted a rather broad interpretation of the clause "...which would influence the judgment of a prudent insurer..." employed in section 18(2) of the (English) Marine Insurance Act 1906. There were, actually, two propositions put forward with regard to the meaning of the word 'influenced': the first maintained that for the insurer to be deemed as having been influenced he must have taken a different course of action from the one he originally intended when he was unaware of the undisclosed fact; the second – advanced by the defendant insurer – contended that all that was needed was for the undisclosed fact to have some *impact* on the insurer's opinion or judgment as a whole and not specifically on his final decision. By ruling for the latter, the *CTI* appellate judges (Kerr LJ, Stephenson LJ and Parker LJ) have presumably broadened the duty because the degree of influence as required by section 18(2) for the non-disclosure rule to be activated appears to be quite minimal, the common perception being that the disclosure need only have an impact on the formation of the prudent insurer's opinion and on his decision-making process (*ie* the 'impact' test *per* Kerr LJ) or that the undisclosed fact could be one which a prudent insurer would want to know or take into account during his decision-making process (*ie*, the 'want to know' test *per* Parker LJ).[12] The insurer need not have to decline the proposal, nor is he required to write the risk on different terms, and yet the fact may still be considered to be material. This spells danger as abuse is all too easy. It is not inconceivable that an unscrupulous insurer may elect to utilise such a rule to claim any remotely related fact as material and, unfortunately, it is not quite apparent what the insured can do to counter this.[13] In an attempt to pre-empt the problem, the proposer can, in all sincerity, seek to disclose all facts known to him but this will still be contingent on his ability to ensure that not a single item, however, insignificant it may seem to him, has been inadvertently left out, for otherwise the insurer may later pounce on such an omission and assiduously assert that under the all-ensnaring *CTI* rule the undisclosed fact has to be deemed as material. Compounding the problem even further is the other ratio of the *CTI* decision, which holds that materiality is to be viewed only through the eyes of a prudent insurer and by this reckoning there is no

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[11] [1984] 1 Lloyd's Rep 476 (*CTI*). Although this is a marine insurance case, the courts have applied the same test of materiality to both general and marine insurance; see *Lambert* v *Co-operative Insurance Society (CIS) Ltd*, *supra*, note 6, and *Highlands Insurance Co* v *Continental Insurance Co* [1987] Lloyd's Rep 109. See also Clarke, *supra*, note 4, for a fuller exposition of the *CTI* case.

[12] These two articulations by Kerr LJ (*ibid*, at 492) and Parker LJ (*ibid*, at 507 and 510-511) have generally been thought to have set the test for materiality in *CTI*.

[13] See also the views of Diamond, "The Law of Marine Insurance – Has It a Future?" (1986) LMCLQ 25 at 33.

need to consider whether or not the particular insurer would have been influenced.

It has been widely acknowledged by many in the insurance industry – in England as well as elsewhere – that the non-disclosure doctrine is very onerous when imposed upon the insured. In fact, a quick review of the insurance cases that have been heard to date readily reveals that there has been a relentless tide of decisions exclusively in the insurer's favour. For a time during the eighties (following the publication of the English Law Commission Report)[14] the insured had entertained the hope of direct parliamentary intervention, but, alas, the political forces of the day smothered whatever glimmer of hope there may have been.[15] One can thus appreciate the rapt anticipation that recently arose after the English Court of Appeal in the case of *Pan Atlantic Insurance Co Ltd* v *Pine Top Insurance Co Ltd*[16] boldly attempted to ameliorate the insured's position by re-casting the *CTI* rule and proposing that the degree of influence required in the materiality test should not be viewed in terms of mere impact but rather in terms of the tendency of the actual risk borne by the insurer to increase. However, the excitement generated by this unexpected development was sadly short-lived, because the attempt at redressing the imbalance was once again dashed when the House of Lords[17] (by a very marginal majority) subsequently chose to reinstate the *CTI* decision.

All is not lost, however. Some reprieve may have been granted to the insured when the House of Lords reversed the other ratio of *CTI*;[18] in addition to proving materiality, one henceforth needs to establish that the particular insurer must have been induced by the non-disclosure into making the contract. Will the supposed reprieve with regard to the inducement requirement be able to serve as any meaningful counterbalance? Is the reinstatement of the *CTI* materiality test by the House of Lords defensible? What are the implications of this *Pan Atlantic* decision for Singapore? Are there any other tenable alternatives to the formidable *CTI* materiality ruling that may be considered? These are issues which need to be addressed and the present article seeks to explore the possible answers to such questions.

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[14] The English Law Commission has recommended a modified version of the standard of materiality, which takes into account the circumstances of the reasonable insured; *supra*, note 1, at para 4.47.

[15] It was initially thought that the English Law Commission's recommendations would be legislated. However, it appears that the insurance lobby successfully quashed the possibility of such parliamentary intervention; see North, "Law Reform, Processes and Problems" (1985) 101 LQR 338 at 349-350.

[16] [1993] 1 Lloyd's Rep 497, (CA); [1992] 1 Lloyd's Rep 101, HCt. See also notes in LMCLQ [1993] 297 and (1993) 109 LQR 513 (*Pan Atlantic*).

[17] [1994] 3 WLR 677, (HL).

[18] This ratio dispensed with the enquiry of the particular insurer's mind.

II. Review of *Pan Atlantic*

A brief review of the *Pan Atlantic* fact situation is required before one can proceed to analyse the decisions of the three courts, *viz*, High Court (Waller J), Court of Appeal (Nicholls VC, Farquharson LJ and Steyn LJ) and House of Lords (Lord Templeman, Lord Goff, Lord Mustill, Lord Slynn and Lord Lloyd). The case revolves around two insurance companies involved in a long-tail business (in which claims are known to take a long time to be advised and settled): Pan Atlantic, the direct insurer for certain liability risks over the period from 1977 to 1982, reinsured its liabilities for this insurance by excess-of-loss reinsurance treaties, and Pine Top became the reinsurer for the latter half of the said period (*ie*, over the 1980, 1981 and 1982 underwriting years).

The dispute centred around the meetings held by Robinson (broker for Pan Atlantic) and O'Keefe (underwriter for Pine Top) during the months of December 1981 and January 1982, for the purpose of negotiating the reinsurance treaty for the 1982 underwriting year. Robinson presented for O'Keefe's inspection two documents purporting to enumerate the losses that had been reported thus far: These were referred to by counsel for both parties as the long record (for the earlier years from 1977 to 1979) and short record (for the more recent years of 1980 and 1981). It was established during the court proceedings that:

(a) although the long record accurately listed all the claims (which were for staggering amounts of losses) Robinson had allegedly presented the two records in such a way as to divert O'Keefe's attention to the short record instead; and

(b) the short record did not include certain additional claims (which, when compared with those of the long record, were for far more modest amounts of losses) that had been lodged with Pan Atlantic just prior to the conclusion of the negotiations.

Pine Top elected to avoid the treaty agreement on these two counts of non-disclosure, and Pan Atlantic thereafter filed the present action in an attempt to recover part of the losses that had been claimed.

In respect of the 1977-1979 losses, all three courts accorded Robinson the benefit of the doubt although his presentation admittedly did not appear to have been made with a view to helping the underwriter come to a proper appreciation of the situation. One would not be far wrong in contending that there was no non-disclosure since the long record was patently available for inspection by O'Keefe who, as an insurance professional of four years standing, should have been aware of the fact that, for long-tail businesses,

it was more important to study the losses and claims records for the earlier years (as the more recent years were, in the language of the industry, immature). Robinson was thus deemed to be, as one of the judges put it, "on the right side of the borderline". In any case, even if non-disclosure could be established, the reinsurer had, by neither inspecting nor making any enquiries, effectively waived disclosure of the facts contained in the documents. Either way, the courts held that for this particular set of losses Robinson was only to be responsible for ensuring that the long record provided a full disclosure, not for teaching or even reminding O'Keefe the importance of studying such a document, and the judges therefore turned their attention to the other matter of Robinson's incomplete disclosure of the 1980-1981 losses in the short record.

III. Non-disclosure in *Pan Atlantic*

The first-instance judgment of Waller J was based on the way he construed the *CTI* rule: The additional 1980-1981 losses would certainly have had an impact on the formation of the prudent insurer's opinion and they should consequently be regarded as material.[19] Counsel for the plaintiff subsequently disputed the correctness of the *CTI* decision, but the Court of Appeal did not really provide an explicit reply to the challenge made. Nevertheless, there was a retreat from the *CTI* materiality ruling as the appellate court sought instead to proffer an alternative interpretation: Steyn LJ took the view that it was a misconception to deduce from the oft-cited case of *CTI* that a fact was deemed as material merely because it was a matter which the prudent insurer would like to take into account when deciding whether or not to accept the proposal and, if so, whether or not any of the terms ought to be modified in the light of such a disclosure.[20] A revised test had in fact been set out in the appellate judgment stipulating that a fact had to relate to an increase in the tendency of risk before it could truly be considered as material (*ie*, the 'increased risk' test);[21] unfortunately, however, it was given short shrift by the House of Lords. This was actually the first time there was such an opportunity to redress a very unfair state of the law but it was, lamentably, passed up with the House of Lords' decision – by a narrow majority of three to two[22] – to endorse *CTI*'s rejection of

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19 *Supra*, note 16, at 113, H Ct.

20 *Supra*, note 12.

21 According to Steyn LJ, the test is whether a prudent underwriter, if he had known the undisclosed facts, would have regarded the risk as increased beyond what was disclosed on the actual presentation (*supra*, note 16, at 505, CA).

22 With Lords Mustill, Goff and Slynn in favour, but with Lords Lloyd and Templeman differing.

the need for a decisive influence in the materiality test and to opt for the lesser standard of impact.

It is submitted that this marginal decision should not be triumphantly hailed as a major victory for the insurer. A survey of the conclusions reached by all eight judges involved in the *Pan Atlantic* case at both Court of Appeal and House of Lords levels reveals that five[23] of these judges retreated from the 'want to know' test of *CTI* and only three[24] remained in support of it. (The first-instance judge, on the other hand, was bound by precedent.) Furthermore, as will be discussed subsequently,[25] there may be some form of consolation prize for the insured, as the House of Lords additionally decided in favour of an inducement requirement and the influence on the particular insurer should henceforth be considered as well.

Of immediate relevance to the dispute at hand are sections 18(2) and 20(2)[26] of the English Marine Insurance Act 1906 which also find application in common-law non-disclosure matters.[27] Although these provisions "... relate the test of materiality to a circumstance which would influence the judgment of a prudent insurer,"[28] their inherent ambivalence is obvious even from the first-instance decision in *CTI*. As a matter of fact, they are susceptible to two, or perhaps three, possible interpretations:

(a) Must it be demonstrated that the undisclosed facts would have led the underwriter to "a difference in decision on accepting or rating the risk" (*ie*, the 'decisive influence' test)?[29]

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[23] *Viz*, the two minority judges in the House of Lords (Lords Lloyd and Templeman) and all three judges in the Court of Appeal.

[24] *Viz*, the three majority judges in the House of Lords (Lords Mustill, Goff and Slynn).

[25] See *infra*, note 53 *et seq*.

[26] Reproduced below for easy reference are those sections of the (English) Marine Insurance Act 1906 that are relevant to the discussion:

s 18(1) – Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.

s 18(2) – Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

s 20(1) – Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue, the insurer may avoid the contract.

s 20(2) – A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

[27] As has been mentioned earlier (*supra*, notes 8 and 11), the *Lambert* case in fact adopted the marine insurance test of materiality in general insurance.

[28] *Supra*, note 17.

[29] As mooted by Lloyd J in the first-instance decision of *CTI* [1982] 2 Lloyd's Rep 178.

(b) Is a lesser standard of impact on the mind of the insurer or on his decision-making process sufficient? If this be so, then

(i) is it merely something that the insurer would want to know during the decision-making process (*ie*, the 'want to know' test as *per CTI*); *or*

(ii) must the facts have a tendency to increase the risk (*ie*, the 'increased risk' test as *per* Steyn LJ's re-formulation in the appellate judgment)?[30]

It would appear that at the House of Lords the majority – comprising Lords Mustill, Goff and Slynn – favoured option (b)(i): "The duty of disclosure extended to all matters which would have been taken into account by the underwriter when assessing the risk which he was consenting to assume."[31] At the other extreme, the minority – comprising Lords Lloyd and Templeman – completely rejected *CTI* and boldly elected instead for option (a). The majority and minority positions were almost diametrically opposed on practically every basis that could be drawn to support these two disparate interpretations of sections 18(2) and 20(2). Before proceeding with the study of how such a polarization could arise, it ought to be pointed out that all five judges in the House of Lords were nevertheless unanimous in their agreement that there should not be any differences between the definitions of materiality as spelt out in section 18(2) for non-disclosure and section 20(2) for misrepresentation or between the tests of materiality as applied to the marine and non-marine regimes.

In delivering the lead judgment for the majority, Lord Mustill utilised a four-pronged approach to arrive at a decision favouring the lesser-impact standard of option (b)(i), but then countering him on every score was an antithetical response by Lord Lloyd for the minority. The first point dealt with statutory construction: Lord Mustill felt that since the legislature had chosen to leave the word 'influence' in sections 18(2) and 20(2) unadorned – instead of employing more unambiguous phrases like 'decisively influence', 'conclusively influence', 'determine the decision' or some similar terms – there was no basis for others to infer that the influence must be of a decisive nature and, in his opinion, judgment should not be taken to be the final decision but rather the decision-making process. Lord Lloyd, however, took a different stand: The literal construction of section 18(2) "...points to something more than what the prudent insurer would want to know or take into account. At the very least, it points to what the prudent

[30] *Supra*, notes 16 and 21.
[31] *Supra*, note 17, at 702.

insurer would perceive as increasing or tending to increase the risk."[32] Not only did he agree with Steyn LJ on the 'increased risk' test, he also thought that the language went even one stage further and criticised Kerr LJ for having elevated in *CTI* one of the less significant meanings of the word 'judgment' (*ie*, decision-making process) to that of primary status for in the commercial context this word is often used in the sense of the assessment of a situation and not in the sense of the thought process. Of the two observations, it is respectfully submitted that the latter by Lord Lloyd is the more persuasive since section 18(2), in referring to the influence that facts have on the judgment in taking the risk or fixing the premium, ought to be directed at the final critical stage when the decision is being made (*ie*, final decision) instead of at the entire decision-making process which must obviously include the preliminary stage of fact gathering as well as the intermediate stage of information processing.

The second point dealt with the practical difficulty faced by the insured when seeking to determine what constituted decisive influence. At the time of applying for a policy, the proposer (who could not be presumed to be well educated, let alone be acquainted with the workings of the insurance industry) would have to decide which facts to disclose. There might be potential pitfalls and yet more often than not the proposer would be left without any recourse to proper advice on how the duty of disclosure could best be discharged. This led Lord Mustill to the following conclusion: "I am bound to say that in all but the most obvious cases the 'decisive influence' test faces them [the prospective assured and his broker] with an almost impossible task. How can they tell whether the proper disclosure would turn the scale? By contrast, if all they have to consider is whether the materials are such that a prudent underwriter would take them into account the test is perfectly workable."[33] In a similar vein, Lord Goff reasoned that while "...it is not unreasonable to expect that an insured who is aware of and understands his duty of disclosure should be able to identify those circumstances within his knowledge which would have an impact on the mind of the insurer when considering whether to accept the risk and if so on what terms he should do ... it appears to me to be unrealistic to expect him to be able to identify a particular circumstance which would have a decisive effect."[34] It could be argued, however, that these considerations might only be of academic value. One would, first of all, already be hard pressed to find a lay insured who is aware of his duty to disclose

[32] *Ibid*, at 721.
[33] *Ibid*, at 696.
[34] *Ibid*, at 682.

material facts prior to the conclusion of the contract;[35] it is thus impractical then to suppose that such a person (when taking out, for instance, a life policy) could distinguish between the different tests of materiality and in fact benefit from a change of the test to be applied. Even if this supposition were valid, the insured would almost certainly prefer to opt for the 'decisive influence' test, which is arguably more difficult to administer and struggle with the need of having to determine what would decisively influence the insurer, rather than be saddled with the *CTI* test, which is purportedly simpler to understand, but known to be more prejudicial to his own position. Besides, Lord Lloyd was not convinced that the 'want to know' test was that simple to administer as he felt that "what the prudent insurer would have wanted to know is as nebulous and ill-defined as the alternative ['decisive influence' test] is precise and clear cut."[36]

Another practical problem that was highlighted by Lord Mustill related to the difficulty faced by the court in weighing expert evidence:

> "If there are, say, six items of information bearing on the risk, it will in many cases be easy to say that all of them ought to be disclosed. Yet if the narrower interpretation advanced by *Pan Atlantic* is right, it would be necessary for the assured and the broker to decide in advance whether any of them would in itself be enough to turn the scale, and the answer might logically be that none of them were. This answer must be absurd."[37]

Curiously enough, Lord Lloyd did not appear to be daunted by the alleged formidability of the task; he was of the opinion that, on the contrary, the 'decisive influence' test was well defined and easily applied. Instead, he aptly countered by pointing out that for the 'want to know' test "...five experienced and prudent underwriters are just as likely – in my view more likely – to disagree about what they want to know as about what they would have done ... [and] ... wherever the line is drawn, there would always be expert witnesses prepared to give evidence on either side."[38] Naturally, the final responsibility for weighing the evidence (especially conflicting expert testimony) has to rest with the court – one of the court's regular duties anyway. Hence, there should not be any great difficulty on this particular score.

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[35] Although the proposal form may contain warnings that the insured needs to disclose material information, the significance of such warnings may not be totally obvious to the insured, let alone its scope and contents.

[36] *Supra*, note 17, at 720.

[37] *Ibid*, at 696.

[38] *Ibid*, at 720.

The third point dealt with policy considerations. While acknowledging that the *CTI* decision had proven to be almost universally unpopular, the majority judges felt that there was no unanimity about what was wrong with it; they appeared not to have recognised that the two central themes of many of the criticisms pertained to the unfairness of the 'want to know' test (with the onerous standard it imposed on the hapless insured) as well as to the actual pedigree of the *CTI* case.[39] The minority judges, on the other hand, maintained that it would be good policy to apply the more stringent difference-in-decision approach as "...it does something to mitigate the harshness of the all-or-nothing approach which disfigures this branch of the law;"[40] as had been noted by Lord Templeman, "...the law is already sufficiently tender to insurers who seek to avoid contracts for innocent non-disclosure and it is not unfair to require insurers to show that they have suffered as a result of non-disclosure."[41]

Yet another claim of the majority was that the criticisms levelled thus far against *CTI* were, in any event, irrelevant since they called for a reform of the law and matters touching on policy considerations (both of which were beyond the ambit of the courts). There is no doubt that defects in statutory law have to be redressed by Parliament if the law is already crystal clear, but, in this case where the legal position is ambivalent – as reflected in the polarized interpretations of section 18(2) of the (English) Marine Insurance Act 1906 – policy considerations can be employed to tilt the balance. As a matter of fact, one would have thought that the policy considerations in the doctrine of non-disclosure are loaded in the insured's favour and point towards a more stringent test of materiality.

The fourth point dealt with the relevance of the authorities put forward by both camps to support their own interpretations. Of the cases cited, the most relevant twentieth-century authority was that of the Privy Council decision in the case of *Mutual Life Insurance Co* v *Ontario Metal Products*.[42] Once again, the House of Lords was sharply divided: Although there was unanimous agreement that the *Mutual Life* case did favour the 'decisive influence' test, the majority relegated the import of the holding by regarding it as merely *obiter dictum* (despite the minority's counter-assertion that it should be treated as *ratio decidendi* instead). To help bolster their stands, the majority turned to the writings of some nineteenth-century jurists, whereas the minority drew attention to the decisions of various nineteenth-century cases. It would probably be fair to infer from this that one could indeed find support in these earlier authorities for either interpretation:

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39 See the articles referred to *supra*, in notes 1, 4 and 13.

40 *Supra*, note 17, at 722.

41 *Ibid*, at 681.

42 [1925] AC 344.

nevertheless, there have recently been some persuasive arguments endorsing the 'decisive influence' test.

IV. Alternative Perspective from *Barclay Holdings*

It is unfortunate that the House of Lords chose to endorse *CTI*'s materiality test, since this approach was in fact severely criticised by the New South Wales Court of Appeal in *Barclay Holdings (Australia) Pte Ltd* v *British National Insurance Co.*[43] This Australian case may offer some helpful alternative insight, as it asserted that the test of materiality should always be applied in conjunction with another principle of law, *viz*, that the facts ought to be "... located in the web of their surrounding circumstances which explain their true significance."[44]

The case itself revolved around the refusal by the insurer, British National Insurance, to pay up on a fire policy on the grounds that the insured, Barclay Holdings, had failed to disclose two allegedly material facts – the fire loss claimed by Barclay Holdings two years ago against their previous insurer, MLC Fire & General Insurance, and the refusal by MLC Fire & General Insurance some months later of a proposal which was actually supposed to be a renewal of the earlier fire policy that Barclay Holdings had with this previous insurer. At first sight, it seemed that the insurer would have wanted to know of the two undisclosed facts. Closer examination showed otherwise for it was established that the investigation into the previous loss did not uncover any evidence of *mala fides* and that the refusal to renew the policy was based solely on administrative reasons which did not reflect any moral hazards, and hence the appellate judges held that the undisclosed facts were not material after all the circumstances had been made known. Interestingly enough, the 'increased risk' test proposed by Steyn LJ in the Court of Appeal in the *Pan Atlantic* case could also have been applied here: The full circumstances revealed that these two undisclosed facts did not tend to increase the risk (or moral hazard), and the proper inference therefore should be that they were not material.

It is instructive to analyse at this juncture the rather novel approach adopted by Glass JA, one of the appellate judges in the Australian case. In his opinion, the test may also be considered from the perspective of timing.[45] A distinction can – and, in fact, should – be drawn between an initial point in time when the underwriter conducts his risk investigations and the final point in time when he decides whether or not to accept the

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[43] 8 NSWLR (1987) 514 (*Barclay Holdings*).
[44] *Ibid*, at 523.
[45] *Ibid*.

risk and, if so, at what premium and on what terms. The following scenario serves as a useful illustration:

Stage 1 – Faced with the proposal for the first time, the underwriter would naturally wish to know everything possible about the risks involved. His appetite for information at this initial stage could even be regarded as insatiable, and it would thus be inappropriate to assess materiality through the eyes of an underwriter who is in such a frame of mind.

Stage 2 – After having amassed the information, he would then have to sieve through the data, some to be discarded as being of peripheral or no significance and the rest to be retained as being of relevance to the proposal. At this stage he might even shortlist some points for further investigation.

Stage 3 – After having adequately apprised himself of all the relevant information, he would finally be in a position to make a proper assessment of the risks and thereafter come to a decision on the proposal before him. According to Glass JA's ruling, the duty of disclosure should be restricted to those facts that are of interest to the insurer at this critical decision-making stage.

It should be pointed out that there is actually no explicit mention of timing in section 18(2) of the (English) Marine Insurance Act 1906. Nevertheless, it is submitted that the introduction by Glass JA of this element of timing certainly helps to sweep away some of the confusion over how the materiality test is to be administered: Whereas the notoriously oppressive approach of *CTI* stipulates that the relevance of the facts should be determined whilst the underwriter is still conducting risk investigations, the more enlightened approach of *Barclay Holdings* requires the assessment of materiality only when the underwriter is making his decision. As Forbes J so aptly commented in the case of *Reynolds* v *Phoenix Assurance Co*,[46] "...the insurer's thirst for knowledge, however understandable, is not the criterion."[47] In fact, it can even be maintained that section 18(2) also lends support to Glass JA's ruling: In referring to the influence that facts have on the judgment in taking the risk or in fixing the premium, this section is arguably directed only at the final critical stage (*ie*, when the decision is being made) and not at

[46] [1978] 2 Lloyd's Rep 440 (the *Reynolds* case).
[47] *Ibid*, at 458.

the earlier preparatory stages (*ie,* when the facts are being gathered and processed).

The *Reynolds* case[48] is similar to *Barclay Holdings*, in that it too involved a fire policy in which the insurer sought to deny the claim lodged by the insured in respect of certain losses caused by a recent fire, by contending that the insured had failed to disclose in the application for the fire policy his previous conviction for having received stolen goods some ten years ago. This is indeed unfair. How the supposedly prudent underwriter is able to assert that a totally unrelated fact can be regarded as material is beyond the comprehension of many; yet, in accordance with the *CTI* ruling, the insurer stands a fairly good chance of winning because there is no requirement for the court to address the question of whether or not the particular fact has actually been taken into consideration by the insurer at the critical decision-making stage. It was therefore fitting for Forbes J to take a strong stand against the insurer in the *Reynolds* case. Other cases that also stand out boldly against the preponderance of harsh decisions include the following: *Roselodge Ltd* v *Castle*[49] in which McNair J dismissed the insurer's attempt at avoiding an all-risks diamond policy, after having found that the previous conviction of the insured company's director for bribing the police some twenty years ago bore "... no direct relation to trading as a diamond merchant";[50] *Ewer* v *National Employers' Mutual General Insurance Association Ltd*[51] in which MacKinnon J rejected the insurer's proposition that all previous claims had to be disclosed; and *Becker* v *Marshall*[52] in which Scrutton LJ stated that "...the question of date must arise, amount must arise, and the circumstances of the loss must arise"[53] in determining whether previous losses ought to be disclosed.

V. Other Comments

(i) *Particular or Prudent Insurer*

Returning to the *Pan Atlantic* case, one notes that some form of concession now appears to have been granted to the insured as it was unanimously decided in that case that, in addition to proving materiality, there exists the requirement of demonstrating that the non-disclosure or misrepresentation induced the making of the policy – either as a whole or on the terms

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48 *Supra*, note 46.
49 [1966] 2 Lloyd's Rep 113.
50 *Ibid*, at 132.
51 [1937] 2 All ER 193 at 202.
52 (1922) 11 Lloyd's Rep 413.
53 *Ibid*, at 414.

agreed upon – before the contract can be vitiated. In so doing, the House of Lords effectively reversed the other ratio of *CTI*, which had been taken as having dispensed with the necessity of examining the influence on the particular insurer once the test of materiality as viewed through the prudent insurer was satisfied. Apart from this *CTI* authority, the other ground for the dispensation of inducement arises from the wording of sections 17, 18(1) and 20(1) of the (English) Marine Insurance Act 1906, which specify that, if good faith is not observed, the insurer "... may avoid the contract"; these provisions do not even require that there be any connection between wrongful dealing and writing of risk, and cases like *CTI* have thereafter assumed that once the prudent insurer is influenced, it is immaterial that the matter complained of has no effect on the particular insurer's mind.

This, it is submitted, is regrettable and a re-examination of the rationale behind the non-disclosure rule in respect of this issue would be useful here. Since there is a failure on the part of the proposer to furnish the undisclosed information, the insurer is not apprised of the full picture and the remedy to be granted in such a case is rightfully that of avoidance as it cannot be said that there has been true consensus between the two parties at the conclusion of the contract. The obverse of this then provides us with an intriguing counter-perspective. Suppose that for a certain case it can be unambiguously established that the particular insurer does not find the undisclosed material relevant (despite the fact that under the all-inclusive *CTI* umbrella the claim may still be made that a prudent insurer would have deemed it – and in fact practically any other undisclosed fact as well – to be material). Would it not be odd if for this scenario the particular insurer is permitted to avoid the policy since there is patently no absence of consensus that robs it of being a true agreement?

Also, it is interesting to observe that, even for fraudulent misrepresentation under contract law there is a requirement to establish that this fraudulent misrepresentation induced the contract before the promisor can exercise his right of avoidance. It should, *a fortiori*, be all the more necessary to prove a causal link with innocent misrepresentation, especially for cases where the lack of *mala fides* is all too evident. Such was the position in 1906, and the House of Lords in the *Pan Atlantic* case felt that Chalmers, the draftsman of the Marine Insurance Act 1906 had not really intended to alter the law but had instead preserved it by the savings clause in section 91(2).

The consistency between contract law and marine insurance law with regard to the doctrine of misrepresentation should be preserved, and the House of Lords thus implied the requirement of an inducement into section 20(1). Since there is, in insurance law, no perceptible difference between misrepresentation and non-disclosure, the implication for inducement in misrepresentation can well be transposed into non-disclosure (for both

marine and non-marine regimes). This is, after all, a matter of common sense. It is also in the interest of justice, and if, in consequence, there has to be the making of a new law the response of the House of Lords is "... so be it".[54] Even Lord Mustill, who adamantly refused to budge from his stand on the previous issue of materiality, was here prepared to accede on policy grounds to the creation, if found to be necessary, of new law.

(ii) *Meaning of Inducement*

Inducement as a concept may pose some difficulties when transposed from contract law directly to insurance law – especially when juxtaposed with the requirement of materiality. One must therefore, be wary of the possibility of there being certain misunderstandings; Clarke[55] for example, has already drawn attention to the fact that there can be different categories of inducement.

Any meaningful discussion of the scope of an inducement must surely include the infamous recantation of Kerr LJ in *CTI* of the much-publicised view which he previously expressed in *Berger* v *Pollock*.[56] In this earlier case, Kerr J (as he then was) held that, apart from calling for the evidence of the prudent insurer, one needed to examine the response of the particular insurer, for otherwise "...one could in theory reach the absurd position where the court might be satisfied that the insurer in question would in fact not have been so influenced but that other prudent insurers would have been."[57] It would indeed have been a very odd result if, in such a situation, the insurer could still have avoided the policy. However, the *Berger* decision was subsequently resiled from in *CTI* after Kerr LJ (and his fellow judges in the Court of Appeal) chose to rely instead on the Court of Appeal decision in *Zurich General Accident & Liability Insurance Co* v *Rowberry*,[58] in which MacKinnon LJ pointed out that "... what is material is that which would influence the mind of a prudent insurer in deciding whether to accept

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54 *Supra*, note 17, at 712.

55 Clarke has argued in his book *The Law of Insurance Contracts* (2nd ed), at 544-546, that there are probably four scenarios as regards the degree of inducement. Type (a) is a misrepresentation such that if the recipient had known the truth he would not have made the contract at all. Type (b), is a situation where, if the truth had been known, the recipient would still have been willing to make the contract, on different terms. Although for Type (c) the misrepresentation was relevant to the decision to contract, if the recipient had known the truth he would still have made the contract on the same terms; Clarke submits that this is the rule of English law. Type (d), relates to a situation where the degree of inducement is placed between Type (b) and Type (c).

56 [1973] 2 Lloyd's Rep 442.

57 *Ibid*, at 463.

58 [1942] 2 KB 53, CA.

the risk or fix the premium, and if this be true it is not necessary further to prove that the mind of the actual insurer was so affected. In other words, the assured could not rebut the claim to avoid the policy because of a material representation by a plea that the particular insurer concerned was so stupid, ignorant or feckless, that he could not exercise the judgment of a prudent insurer and was in fact unaffected by anything the assured had represented or concealed."[59] By so relying on MacKinnon LJ's dictum, the *CTI* ruling was in essence maintaining that there was no need to examine whether the particular insurer and prudent insurer were of like minds.

With the House of Lords having taken the obverse position from those of the *CTI* and *Zurich* cases, it appears that evidence should henceforth be collected from the particular insurer in order to determine whether or not he would have responded in the same manner as that expected of the prudent insurer (*ie*, whether he, too, would consider the undisclosed facts to be something that he wished to be aware of). The degree of inducement required seems by this reckoning to be very slight. Support for this interpretation can additionally be found in the common law contract case of *Edginton* v *Fitzmaurice*[60] which maintains that all that is necessary is that the representation was "...actively present to the mind of the representee".[61]

Another interpretation of inducement which has to be considered is whether in order for the requirement of inducement to be satisfied there must be a strong causative link in that if the recipient had known about it he would not have entered into the contract or would only have entered in on different terms. From the insured's perspective, this alternative meaning of inducement may be preferable: It would then be considerably more difficult to satisfy the non-disclosure rule and some balance could be introduced to the doctrine as a whole. However, one problem to take note of is that, by opting for a much higher degree of inducement, there may be the resultant perception that, in effect, one might be allowing through the back door the element of decisive influence which the majority in the House of Lords rejected. This would, in fact, severely neutralise the lack of decisive influence in the materiality test. However, support for this alternative interpretation may also be inferred from Lord Goff's caution that one should not catalogue materiality and inducement in watertight compartments; as a matter of fact, it is for this reason that critics of *CTI* have "... promoted the idea that the test of materiality should be hardened into the decisive influence test, by introducing into the concept of materiality

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[59] *Ibid*, at 60.

[60] (1884) 29 ChD 459.

[61] *Per* Bowen LJ, *ibid*, at 483. Clarke (*supra*, note 55) favours this interpretation which calls for a minimal degree of inducement.

something in the nature of inducement, though attributing it not to the actual underwriter but to the hypothetical prudent insurer."[62]

Whichever of the interpretations is adopted, it is submitted that there may not be much difference in the final result. If the first interpretation is correct and inducement would be satisfied so long as the facts had a mere effect in that they operated on the insurer's mind, then this test is apparently not much different from the 'want to know' test and provides only very slight reprieve: The insured can escape provided the insurer is willing to be absolutely candid in admitting that he was extremely careless, stupid or ignorant to the extent that he was not even interested in wanting to know these facts. Even if the second interpretation is to be accepted, the reprieve (though slightly greater) may still not prove to be substantial because it appears that there is a presumptive inference of inducement in favour of the insurer once materiality is proved. As Lord Mustill explained, "...there is ample material both in the general law and in the specialist works on insurance to suggest that there is a presumption in favour of a causative effect"[63] and "...as a matter of common sense, even where the underwriter is shown to have been careless in other respects, the assured will have an uphill task in persuading the court that the withholding or misstatement of circumstances satisfying the test of materiality has made no difference."[64] In the final analysis, the inducement requirement may, after all, not have much effect on existing law – making the supposed reprieve not worth very much – given all these additional qualifications that have unfortunately to be appended.

(iii) *Procedural Practicalities*

An important outcome of the House of Lords' judgment in the *Pan Atlantic* case is that it necessitates some procedural changes in the leading of evidence. Henceforth, the insurer can no longer rely solely on expert evidence to prove the prudent insurer's viewpoint. He too has to be called to give evidence of his stance as the particular insurer. In a policy which has been extensively co- or re-insured, the evidence of every insurer involved in covering the risk will have to be provided as each might in principle have been affected differently. This is so notwithstanding that there is a presumptive bias of inducement.

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62 *Supra* note 17, at 683.
63 *Ibid*, at 714.
64 *Ibid.*

VI. Conclusions

The English Law Commission acknowledged nearly fifteen years ago that "... the duty of disclosure imposed on a prospective insured by the present law is inherently unreasonable" and hence "...the standard of disclosure should be modified".[65] In spite of the considerable time which has elapsed since these comments were made, the long-awaited amendments have unfortunately not yet materialised.[66]

Although judges may lament the harshness of the law,[67] they have for a long time been reluctant to initiate any change, waiting – and hoping – instead for parliament to rectify the problems. For the recent *Pan Atlantic* case, this also seems to have been the attitude of the majority in the House of Lords. The decision has come as an anticlimax, a letdown in various respects for the insured. Prior to the House of Lords' decision, the insured could still cherish some hope that the oppressive materiality test might be challenged, but now the 'want to know' test of *CTI* appears to have become ever more entrenched (albeit as a result of the decision of a very narrow majority of judges). Although, in Lord Goff's view, the requirement of inducement has gone in part to neutralise the harshness of the materiality test, the reality, as has been argued in the present article, is that this form of concession is not that significant after all.

In Singapore, however, we can hope that the position may be different. In the light of the recent enactment of the Application of English Law Act,[68] there may, perhaps, be a more conscious shift on the part of the local judiciary to gradually developing a more uniquely Singapore law, retaining the good whilst moderating the more oppressive and negative aspects of the law. This article has pointed out that there are, in fact, other tenable alternatives not seriously considered in the majority judgment in *Pan Atlantic*; and it is urged that, when future opportunities arise, the local judiciary will be prepared to look at other fairer alternatives so as to bring about a more enlightened development of the non-disclosure rule in the insurance law of Singapore.

Yeo Hwee Ying*

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65 *Supra*, note 1, at para 4.43.

66 See North's comments; *supra*, note 15.

67 See comments of judges (who were responsible for adopting the 'prudent insurer' test in general insurance) in *Lambert* itself; *supra*, note 6, at 491-493.

68 No 35 of 1993.

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