The Law Commission

(LAW COM. No. 104)

INSURANCE LAW

NON-DISCLOSURE AND BREACH OF WARRANTY

REPORT ON A REFERENCE UNDER SECTION 3(1)(*e*)
OF THE LAW COMMISSIONS ACT 1965

Presented to Parliament by the Lord High Chancellor,
by Command of Her Majesty
October 1980

LONDON
HER MAJESTY'S STATIONERY OFFICE
£6.20 net

Cmnd. 8064

The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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INSURANCE LAW
NON-DISCLOSURE AND BREACH OF WARRANTY

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THE LAW COMMISSION

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To the Right Honourable the Lord Hailsham of St. Marylebone, C.H., Lord High Chancellor of Great Britain

PART I

INTRODUCTION

1.1 On 17 May 1978 your predecessor referred the topic of insurance law to us under section 3(1)(*e*) of the Law Commissions Act 1965[1] in the following terms:

> "To consider the effect on the liability of an insurer, and on the rights of an insured, of:
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> (*a*) non-disclosure by, or on behalf of, the insured;
>
> (*b*) misrepresentation by, or on behalf of, the insured;
>
> (*c*) breach of "warranty" by the insured;
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> (*d*) special conditions, exceptions and terms;
>
> (*e*) increase and decrease of risk covered;
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> particularly in the light of the Fifth Report of the Law Reform Committee (1957) and the draft E.E.C. Directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts, and to make recommendations."

Scope of this report

1.2 We were asked to consider non-disclosure and breach of warranty as a matter of urgency in the light of the draft E.E.C. Directive on insurance contract law (this is now a "proposed" E.E.C. Directive,[2] having been approved by the Commission of the European Communities in Brussels) and of the Fifth Report of the Law Reform Committee.[3] The proposed E.E.C. Directive (we refer to this subsequently for convenience as "the proposed Directive") has as its object the harmonisation of insurance contract law in the Community. Its implementation would entail far-reaching changes in our law of insurance. Negotiations on the proposed Directive have now reached a critical stage and at the time of writing it is under consideration by the European Parliament, having recently been examined by the Economic and Social Committee. The Fifth Report of the Law Reform Committee was published in 1957, and although the Committee made

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[1]Which provides that it shall be the duty of the Law Commission "to provide advice and information to government departments and other authorities or bodies concerned at the instance of the Government with proposals for the reform or amendment of any branch of the law".

[2]The proposal for a Council Directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts.

[3](*Conditions and Exceptions in Insurance Policies*) (1957) Cmnd. 62.

no formal recommendations for reform of the law they did formulate provisions which in their view could be introduced into the law without legal difficulties arising from their application. We give detailed consideration below both to the proposed Directive and the Fifth Report of the Law Reform Committee.

Working Paper No. 73

1.3 On 12 February 1979 our working paper (Working Paper No. 73: *Insurance Law—Non-disclosure and breach of warranty*) was published. In it we made provisional recommendations for reform of the law as to non-disclosure and breach of warranty. The main provisional recommendation as to non-disclosure was that although the insured should remain subject to a duty of disclosure and the insurer should remain entitled to avoid a contract of insurance on breach of this duty, the extent of the duty should be reduced. As for warranties, our main provisional recommendation was that insurers should only be entitled to rely on a breach of warranty to repudiate the policy if the broken warranty was material to the risk, and should only be entitled to reject a claim under the policy if there was a connection between the breach and the loss. Another important provisional recommendation was to restrict the extent to which insurers should be entitled to rely on the so-called "basis of the contract" clause in order to elevate answers to questions into warranties, thus providing a ground for repudiating the contract and rejecting the claim if any answer were inaccurate. We invited comments on our provisional recommendations.

Results of consultation on Working Paper No. 73

1.4 The response to our working paper came mainly from the insurance industry, consumer interests, the legal profession, government departments and academic lawyers. The views put forward on the question whether or not there was any need to reform the law varied between two extremes. One view was that our law of insurance was by and large clear and in a satisfactory state and that no reform was necessary. Another view was that the law was defective and in urgent need of reform, but that the provisional recommendations in our working paper did not go nearly far enough to provide adequate protection for the private individual seeking insurance as a consumer. The former view was taken by representatives of the insurance industry. They emphasised that insurers do not in practice take advantage of their full legal rights so as unduly to prejudice the interests of an insured, and that this was borne out by the voluntary Statements of Insurance Practice announced in Parliament: these Statements are considered below in paragraphs 3.24–3.30. Those urging the latter view consisted of representatives of consumer interests and some academic lawyers. They contended that there was no necessity for the retention of any duty of disclosure, at any rate in relation to "consumer" insurance. In formulating our recommendations for reform we have of course taken into account both these views and, as in our working paper, we have sought to strike a fair balance between the interests of the industry and those of the insured. There was also a substantial body of moderate opinion which supported the main thrust of our provisional recommendations, although differing as to detailed aspects of our proposals. In particular, our provisional recommendations for reform of the law relating to breach of warranty and "basis of the contract" clauses were substantially approved by all commentators other than some representatives of the insurance industry.

The Fifth Report of the Law Reform Committee

1.5 In July 1954 the then Lord Chancellor, Viscount Kilmuir, invited the Law Reform Committee to consider the effect on the liability of insurance companies of special conditions and exceptions in insurance policies and of non-disclosure of material facts by persons effecting such policies. The Committee included a number of judges and other lawyers with great experience of insurance matters.[4] In January 1957 a report was published (hereafter generally referred to as "the Fifth Committee Report") in which the Committee summarised the practical effects of the matters referred to them[5] and considered whether the situation disclosed was such as to require amending legislation.[6] The Committee reported that the state of the law, combined with the use by insurers of certain types of special conditions and exceptions in policies, was capable of leading to abuse in the sense that a variety of circumstances might entitle insurers to repudiate liability as against an honest and at least reasonably careful insured, and furthermore, that such abuses had in fact sometimes occurred, though not to any substantial extent.[7] The Committee accepted the accuracy of the representations made by the insurance industry to the effect that no reputable insurer would rely on a technical defence to defeat an honest claim but stated that this did not alter the fact that in many cases an insurer was in a position to substitute his own judgment of the claimant's *bona fides* for that of a court.[8] However, they also considered that the mere fact that a branch of the law was theoretically open to criticism and susceptible to abuse did not justify a recommendation that it should be changed, especially where the prejudice to the insured arose from express contractual provisions rather than from rules of law as such. The Committee took the view that legislation to alleviate the position of the insured would involve interference with the liberty of contract of the parties and that the desirability of such legislation was a broad question of social policy outside their competence.[9] Nevertheless, the Committee did consider to what extent it was practicable to introduce new provisions into the existing law and what form such provisions should take. They formulated three provisions which in their view could be introduced into the law without legal difficulties arising from their application. The first two of these provisions alone are relevant to this report and are as follows:

> "(1) that for the purposes of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured.
>
> (2) that, notwithstanding anything contained or incorporated in a contract of insurance, no defence to a claim thereunder should be maintainable by reason of any mis-statement of fact by the insured, where the insured can prove that the statement was true to the best of his knowledge and belief."[10]

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[4]The Committee consisted of Jenkins L.J. (Chairman), Parker L.J., Devlin J., Diplock J., R. J. F. Burrows, Gerald Gardiner, Q.C., Professor A. L. Goodhart, Q.C., J. N. Gray, Q.C., R. E. Megarry, Q.C., R. T. Outen, Professor Sir David Hughes Parry, Q.C., and Pofessor E. C. S. Wade.

[5](1957) Cmnd. 62, paras. 4–10.

[6]*Ibid.*, paras. 11–14.

[7]*Ibid.*, paras. 11–12.

[8]*Ibid.*, para. 11.

[9]*Ibid.*, para. 12.

[10]*Ibid.*, para. 14.

In devising our scheme for reform of the law, we have paid close attention to the report and in particular to the provisions just referred to.

Statements of Insurance Practice

1.6 We now turn to the Statements of Insurance Practice. These are measures of self-regulation by the insurance industry, adopted in response to the exclusion of contracts of insurance from the scope of the Unfair Contract Terms Act 1977.[11] In general terms they provide that insurers will only exercise their right to repudiate liability under a policy for non-disclosure or breach of warranty when it is reasonable for them to do so. On consultation the insurance industry contended that their observance of these Statements rendered reform of the law of non-disclosure and breach of warranty unnecessary. We therefore consider the provisions of these Statements in further detail later in this report[12] as part of our consideration as to whether these areas of our law require reform.

The proposed E.E.C. Directive

1.7 In our working paper we considered the relevant provisions of the fifth draft of a Directive on insurance contract law,[13] which had been prepared by the Commission of the European Communities in Brussels. As we have already mentioned, further work on the Directive has since been done and the Commission have now submitted a final draft in the shape of a proposal for a Council Directive. In this report we are concerned with reform of English law with regard to non-disclosure and breach of warranty, topics to which Articles 3 to 6 of the proposed Directive are relevant. Accordingly, in Parts IV and V[14] of this report we shall deal with the detailed provisions of these Articles which, if implemented, would necessitate far-reaching changes in our law of insurance. Further, in drafting the legislation required to implement the proposed Directive, regard would undoubtedly be had to the terms of its Explanatory Memorandum. We shall therefore consider not only the text of Articles 3 to 6 of the proposed Directive but also the Explanatory Memorandum, so far as it is relevant. Both the Articles and the relevant parts of the Explanatory Memorandum are reproduced at the end of this report as Appendix C.

1.8 As already mentioned, at the time of writing the proposed Directive is under consideration by the European Parliament. Subsequently the Council of Ministers will consider it together with the comments made by the Economic and Social Committee and any made by the European Parliament, as well as any views expressed by the Commission on those modifications and comments. The Council may well itself make further amendments to the document. It follows that if a Directive on harmonisation of insurance contract law is ultimately issued its provisions could well differ from those of the proposed

[11] In the Second Report of the Law Commission and the Scottish Law Commission on Exemption Clauses (Law Com. No. 69, Scot. Law Com. No. 39) (1975) the Law Commission had recommended that the proposals in the report, upon which the 1977 Act was based, should be applied to contracts of all types: see paras. 240–247.

[12] See paras. 3.24–3.30.

[13] Its full title is "The directive on the co-ordination of the legislative, statutory and administrative provisions governing insurance contracts".

[14] See Part IV, paras. 4.2–4.31 and Part V for a critical analysis of Article 3, and Articles 4 to 6, respectively.

Directive. In this report we can of course only consider the text of the proposed Directive as it now stands, although the fate of the present draft (and indeed of the proposed Directive itself) is by no means certain.

1.9 The proposal for harmonisation originally arose from the 1975 version of the draft "services" Directive.[15] This originally called for the harmonisation of "essential provisions" of the insurance contract law of Member States within three years of its notification. However, in the latest draft of the "services" Directive, the reference to "essential provisions" of insurance contract law of Member States has been omitted,[16] as has the time limit of three years. This lends support to the view expressed in the recent Report on the choice of law rules in the "services" Directive, prepared by a Joint Working Group of the Law Commission and the Scottish Law Commission,[17] that the general harmonisation of insurance law seems unlikely to be attained in the foreseeable future.

1.10 There is some uncertainty as to the territorial scope of the proposed Directive. Two earlier Directives adopt differing approaches in this regard. The First Council Directive of 24 July 1973 on the Establishment of Insurance Undertakings in the E.E.C. applies to the establishment of all insurance undertakings in the E.E.C. no matter where the risks are situated. On the other hand, the draft "services" Directive only applies to the provision of services in relation to risks situated within the E.E.C. As we have seen in paragraph 1.9 above, the proposed Directive arose from the negotiations on the draft "services" Directive, and it may be that it is intended to be equally limited in scope, i.e. to risks situated within the E.E.C.[18] However, if the provisions of the proposed Directive come into force in England and Wales in any form, we think that it would be highly undesirable and impracticable to restrict their geographical scope in this way, since different rules would then apply to risks situated within the E.E.C. and those not so situated, with inevitable "demarcation" problems. We shall therefore assume that the provisions of the proposed Directive would, if applied in this country, replace for all purposes the rules of our present law which we are discussing in this report, and that they would therefore have unlimited territorial scope.

1.11 The provisions of Articles 3 to 6 of the proposed Directive seem to be largely modelled on French law. These Articles are intended to enable the insurer to rate the risk in terms of the premium not only when the contract is made but also as the risk increases or decreases during the currency of the policy. This type of continuing assessment seems to have been devised to regulate

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[15]Draft Second Council Directive on the Provision of Insurance Services within the E.E.C. The purpose of this directive is to enable an insurance undertaking established in any Member State of the E.E.C. to provide services elsewhere in the Community without having an establishment in the Member State where the insurance is provided.

[16]Despite this omission the proposed Directive has at present as its main aim the harmonisation only of the "essential provisions" mentioned in the earlier draft of the "services" Directive.

[17]*Report on the choice of law rules in the Draft Non-life Insurance Services Directive* prepared by a Joint Working Group of the Law Commission and the Scottish Law Commission HMSO (1979), para 12.

[18]*Ibid.*, para. 11, and see the opinion of the Economic and Social Committee (1980) para. 2.2.

contracts for long term cover extending over several years rather than contracts of insurance which are renewable annually. With the exception of life insurance, most contracts of insurance in this country are for a period of one year only. Thus life insurance is the only major type of insurance in this country which is long term. However, the continuing adjustment of the premium to the risk is inappropriate for annual contracts and wholly inappropriate for life insurance, to which indeed the proposed Directive itself does not apply. By contrast, as will be seen below,[19] the recommendations in this report are intended also to apply to life insurance. It follows that the ambit of our recommendations is somewhat different from that of the proposed Directive.

1.12 The provisions of Articles 3 to 6 of the proposed Directive have two aims. The first is to enable the insurer to adjust the premium and other terms of cover in the light of changes in the risk. The second is to enable the insured who is in breach of his duty of disclosure nevertheless to recover all or part of his claim unless his conduct was such as to justify its total rejection. The Articles set out to achieve these objectives *inter alia* by the following principles:

(*a*) They impose a duty on the insured to disclose to the insurer all material circumstances known to him when applying for insurance. A circumstance is considered material if it would influence the judgment of the actual insurer in assessing the risk (Article 3).

(*b*) They entitle the insurer to propose a higher premium or different terms of cover if material circumstances which should have been disclosed or which were unknown to both parties at the date of application subsequently come to light (Article 3).

(*c*) They entitle the insurer to propose a higher premium or different terms of cover if the insured either discloses any change in any particular specified circumstances leading to an increase in the risk during the insurance period in pursuance of any duty imposed on him by the contract to do so, or if the insurer discovers such a change in circumstances after a failure by the insured to comply with this duty (Article 4).

(*d*) They entitle the insurer to repudiate all liability under the policy if the insured has acted fraudulently in breaking either of the duties mentioned in (*a*) and (*c*) (Articles 3 and 4).

(*e*) They entitle the insured to make a partial recovery of his claim if he has broken either of the duties mentioned in (*a*) and (*c*) and he "may be considered to have acted improperly" (Articles 3 and 4).

(*f*) They entitle the insured to cancel the contract if the risk has decreased during the insurance period and the insurer has not agreed to a proportionate reduction in the premium (Article 6).

1.13 Later in this report[20] we examine Articles 3 to 6 of the proposed Directive in detail and conclude that several of its features are open to strong objection. In particular, we discuss the "proportionality principle", which is a basic feature of the proposed Directive. This principle enables an insured who

[19]See para. 2.17.

[20]See paras. 4.2–4.31 as regards Article 3 and Part V as regards Articles 4–6.

has failed to comply with either of the duties mentioned in the previous paragraph and who "may be considered to have acted improperly" nevertheless to recover a claim in part (see (*e*) in the previous paragraph). As we explain later, in our view the proportionality principle has inherent limitations and practical drawbacks which would render its introduction into English law undesirable. Although proportionality has also certain advantages, we take the view that these are greatly outweighed by its disadvantages and that our law can be reformed more satisfactorily without recourse to this principle.

The purpose of the proposed Directive

1.14 The proposed Directive is based on Article 100 of the Treaty of Rome. This Article imposes upon the Council of Ministers the duty to issue Directives for the approximation of such laws in Member States as "directly affect the establishment or functioning of the Common Market". The Commission contend that the differences in the insurance law of Member States affect the functioning of the Common Market in that they distort competition between insurance undertakings within the Community. Whether this is so or not may be debatable. In any event, the proposed Directive sets out to harmonise only a relatively small area of insurance law. Furthermore, it leaves untouched substantial differences in the administrative supervision of the insurance industry in the Member States, which in our view are at least as important as insurance *law* as a factor inhibiting competition within the Community. Representatives of the industry have suggested that the proposed Directive would have an imperceptible and insignificant effect on competition within the Common Market.

1.15 Article 189.3 of the Treaty of Rome provides that "a Directive shall be binding, as to the results to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and method". The reason for adopting a Directive, as opposed to a Regulation, as a means of Community legislation is that the former lays down the general principles, leaving it to the legislature in each Member State to give detailed effect to those principles and thereby to promote substantial harmonisation. Regulations, by contrast, contain detailed provisions which are of immediate binding effect in Member States. We think that what we said in our *Report on the proposed E.E.C. Directive on the law relating to Commercial Agents* is equally applicable in the present context:

> "Our view is that the directive, as presently drafted, contains provisions of such a detailed and complex nature as would in effect deprive the national authorities of the choice as to the method by which they should be implemented. We think that the contents of the directive are thus to some extent inconsistent with the status of a directive as an instrument of Community law, and that the directive is an inappropriate vehicle for the creation of this kind of detailed set of rules of private law".[21]

1.16 This point assumes great importance in the light of the pre-emptive effect of the proposed Directive on any possibility of further legislation concerning the matters with which it deals. This is explained in the section of the

[21]See (1977) Law Com. No. 84, Cmnd. 6948 at para. 5.

Explanatory Memorandum which relates to Article 12.[22] The relevant passage, which appears to be declaratory of community law, reads:

> "Some delegations have expressed the desire that this Directive should be considered minimal in all respects—i.e. not only the contracting parties but also the Member States should be able to change the content of the Directive to give increased protection to policy holders . . . The Commission, however, has rejected this view on grounds which appear to it to be decisive. Many provisions have involved a choice between different systems which have nevertheless been justified by the Member States applying them by a desire to afford the best possible protection to the policy holder (e.g. principle of proportionality in Article 3.3*c*. as against the principle of causality). If Member States were free to change the solution adopted in the Directive, the situation would be as before and would therefore negate completely the harmonisation work achieved. Member States would therefore be entitled once again to claim that there was no harmonisation of the fundamental principles of contract law and thus maintain the present obstacles to the effective exercise of the freedom to provide services. It should not be forgotten that the aim of this harmonisation work, as has already been emphasised, is not only to afford essential and adequate protection to the policy holder on the basis of harmonised rules but also to prevent undertakings from being able to use the often considerable differences between various laws to make freedom of choice of applicable law an element of competition which is inadmissible".

Thus, legislatures in the Member States will be unable to enact legislation which would provide either the insurer or the insured with greater rights than are provided under the proposed Directive. We recommend below[23] that to protect the insurer it is necessary to attribute to the insured who answers questions in a proposal form a degree of knowledge based on the enquiries which a reasonable man would make. Such a provision is not to be found in the proposed Directive and clearly our recommendation to this effect could not be enacted by domestic legislation should the proposed Directive be adopted. As we shall see, the proposed Directive does not in our view provide, *inter alia*, adequate protection to the private individual seeking insurance as a consumer. Parliament would be unable to legislate to provide such protection if the proposed Directive were adopted.

1.17 Furthermore, there is the added disadvantage that it might prevent our own legislature from acting not only within the matters directly touched on by the proposed Directive but also within the "domain" covered by the Directive. The issue and implementation of the proposed Directive may preclude, for example, the enactment of provisions requiring that proposal forms and renewal notices should contain a warning to the insured regarding his duty of disclosure which, as will be seen from the relevant sections of this report,[24] we consider to be highly desirable to safeguard the interests of the policy holder.

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[22]This Article reads: "The parties to the contract may agree on more favourable terms for the policy holder, insured person or injured third party than are provided for in this Directive".

[23]See para. 4.61.

[24]See paras. 4.60, 4.64, 4.77 and 4.80.

1.18 Much will therefore depend upon the extent to which the proposed Directive succeeds in achieving one of its avowed objectives: that of protecting the consumer.[25] As has already been mentioned, and as we explain later in this report, the proposed Directive in our view fails, *inter alia*, to provide adequate protection for private individuals seeking insurance as consumers. The result of its adoption would therefore be to freeze our law of insurance in an unsatisfactory state for an indefinite period and to prevent any introduction of domestic consumer protection legislation in the areas covered by it.

1.19 Even on the assumption that the proposed Directive has succeeded in striking a fair balance between the interests of the insurer and the insured, which in our view it has not,[26] it is by no means inconceivable that mischiefs might from time to time arise within the ambit of the proposed Directive as a result of changes in insurance practice. Parliament would be unable to deal with such mischiefs flexibly by legislation because the only way to deal with them would be by the modification of Community law by an amending Directive. This would be not only slow and cumbersome in any event but it might also give rise to substantial disagreements between Member States. Such disagreements would be likely to occur because of the different degrees of administrative supervision of the insurance industry in each Member State. Thus, in England it might only be possible to eradicate a mischief by reforming the law, whereas in France a similar mischief might not arise at all because of administrative control or, if it did arise, it could be dealt with administratively. In effect, therefore, the adoption of the proposed Directive could well rule out any possibility of reforms of important aspects of our insurance law which may be regarded as desirable in the future.

The choice between the proposed Directive and reform of our domestic law

1.20 Some commentators on our working paper expressed the view that it would be undesirable for English law to be altered along the lines suggested in our working paper if thereafter the proposed Directive were adopted, thus necessitating further changes in our law. We agree entirely that confusion, uncertainty and expense would undoubtedly result from two successive measures of law reform. As things stand at present, it looks as though the choice is between, on the one hand, adoption of the proposed Directive in its present or some amended form, as a step towards the harmonisation of insurance law on a Community-wide basis and, on the other hand, the introduction of domestic legislation to reform our own law. We should however point out that if the choice is made to adopt the proposed Directive one of the mischiefs which we identify in this report will be totally unaffected. This mischief consists of the right of an insurer to repudiate liability for *any* breach of a promissory warranty[27] (for example, a warranty to maintain a burglar alarm) irrespective of

[25]The Explanatory Memorandum to the proposed Directive states that its principal object is "to guarantee the policy holder that whatever the choice of applicable law, he will receive identical protection as regards the essential points of the contract".

[26]See paras. 4.2–4.31 and Part V, below.

[27]See para. 6.9, below. Different considerations apply to the mischief with regard to warranties as to past or present fact which is also within our recommendation. These warranties probably fall within the intended ambit of Article 3 of the proposed Directive: see para. 5.2, below.

whether the warranty was material to the risk in question and irrespective of whether the breach in question could in any way have affected the loss which in fact occurred. We think that domestic legislation would still be necessary to reform the law in this respect.

Our views on this choice

1.21 We have already expressed the view that the proposed Directive would be an unsatisfactory instrument of law reform. Our views on this choice and its implications are therefore clear. We believe that they should be stated at the outset, though we shall give detailed reasons for them in the body of this report. They are as follows:

(*a*) The law relating to non-disclosure and breach of warranty is undoubtedly in need of reform, and this reform has been too long delayed.

(*b*) For the reasons given later in this report, the provisions of the proposed Directive do little or nothing to remedy the defects in our present law and are themselves defective.

(*c*) It seems to us that the creation of the complex machinery envisaged by the proposed Directive must lead to much uncertainty in practice and this would in turn enable insurers, if they wished to do so, to use the superior bargaining position which they generally enjoy in a manner adverse to the interests of the insured.

(*d*) Adoption of the proposed Directive would freeze our law indefinitely in an unsatisfactory state. The proposed Directive is therefore an unsatisfactory instrument for the reform of the law of insurance and we cannot support its adoption.

We are in no position to assess the prospects of the adoption of the proposed Directive. The history of the negotiations so far would suggest that its basic features, to which we see grave objection, are likely to be non-negotiable. If this proves correct then in our view Her Majesty's Government should be advised to oppose the adoption of the proposed Directive in the Council of Ministers. In any event, negotiations seem set to continue for a long time, and there may well come a time when the doubtful future of the proposed Directive should not be allowed to impede reform of our law. It is highly desirable, in our view, that an early decision be taken as to whether the proposed Directive is likely to prove satisfactory and whether it is worth holding up much needed law reform here for what may be a remote prospect of agreement on a satisfactory Community instrument. On no view, we suggest, should reform of our law be delayed indefinitely.

1.22 There are two further matters to be borne in mind in the context of the proposed Directive. First, Article 4 of the draft "services" Directive provides that, in relation to contracts concluded by an insurer established in one EEC state in respect of risks situated in another EEC state, in many cases the law applicable to the contract is to be the law of the state where the risk is situated. If this provision of the "services" Directive comes into force it will substantially remove the most important effects of the disparities between the insurance laws of the different EEC states which provided the basis for the harmonisation

intended to be achieved by the proposed Directive. The need for the underlying objective of the proposed Directive would thereby largely disappear, and the objections to it which are at present felt in a number of EEC states apart from the United Kingdom may then in any event prevail over its possible advantages as a desirable instrument of harmonisation. Secondly, if our law is reformed in accordance with the recommendations made in this report, our EEC partners may well consider that our law has been sufficiently improved by the elimination of its most important defects from the point of view of the insured to remove the necessity for any further measure of harmonisation so far as the law of this country is concerned.

Scheme of the report

1.23 Our consideration of the matters within our reference has been divided into eight parts as follows:

PART II — THE SCOPE OF THE RECOMMENDATIONS IN THIS REPORT

This deals with the scope of our recommendations and examines in particular the nature of a contract of insurance and the types of insurance contract to which our recommendations should not apply. It also includes a brief discussion of the topic of insurance intermediaries.

PART III — NON-DISCLOSURE: THE PRESENT LAW AND ITS DEFECTS

This contains a detailed examination of the present law as to non-disclosure and sets out its various defects.

PART IV — NON-DISCLOSURE: REFORM OF THE PRESENT LAW

In this Part we consider a field of choice as to how the present law could be reformed, including consideration of Article 3 of the proposed Directive. We conclude this Part with our recommendations for law reform in this area.

PART V — ARTICLES 4 TO 6 OF THE PROPOSED DIRECTIVE (INCREASE AND DECREASE OF RISK)

This contains a detailed examination of Articles 4 to 6 of the proposed Directive.

PART VI — WARRANTIES

PART VII — "BASIS OF THE CONTRACT" CLAUSES

In Parts VI and VII, we examine the present law as to warranties and "basis of the contract" clauses respectively, analyse the defects in the law and make recommendations for its reform.

PART VIII — MISCELLANEOUS MATTERS

In this Part we consider misrepresentation and fraud and make a minor recommendation for law reform with regard to misrepresentation. We also deal here with contracts of reinsurance, with the possible avoidance of our recommendations and finally with transitional provisions.

PART IX OUR CONCLUSIONS
We end the report with our conclusions on the matters falling within our reference.

PART X SUMMARY OF RECOMMENDATIONS
This summary refers to the relevant paragraphs of the report and of the draft Bill in Appendix A.

APPENDIX A Draft Insurance Law Reform Bill with Explanatory Notes.

APPENDIX B The First and Second Statements of Insurance Practice.

APPENDIX C Articles 3 to 6 of the proposed Directive together with relevant parts of the Explanatory Memorandum.

APPENDIX D List of persons and organisations who sent comments on Working Paper No. 73.

PART II

THE SCOPE OF THE RECOMMENDATIONS IN THIS REPORT

Introduction

2.1 This report is concerned with certain aspects of the law relating to contracts of insurance. It is therefore necessary for us to consider the nature of a contract of insurance in order to see whether any statutory definition is required in reforming legislation.

The nature of a contract of insurance

2.2 There is at present no statutory definition of a contract of insurance. In *Department of Trade and Industry* v. *St. Christopher Motorists' Association Ltd.*[28] Templeman J. explained the reason for this as follows:

> "This summons having been brought by the Department with a view to exercising certain statutory powers one looks first of all to the statutes to see if they define insurance, and for reasons which are understandable the result is a blank. There are various types of insurance business on which the Act[29] concentrates, and no difficulty has ever arisen in practice, and therefore there has been no all-embracing definition, and the probability is that it is undesirable that there should be, because definitions tend sometimes to obscure and occasionally to exclude that which ought to be included."[30]

2.3 The nature of a contract of insurance was considered in *Prudential Insurance Co.* v. *Inland Revenue Commissioners.*[31]. In that case Channell J. said:

> "A contract of insurance . . . must be a contract for the payment of a sum of money, or for some corresponding benefit such as the rebuilding of a house or the repairing of a ship, to become due on the happening of an

[28][1974] 1 W.L.R. 99.
[29]The Insurance Companies Act 1958.
[30][1974] 1 W.L.R. at 101.
[31][1904] 2 K.B. 658.

event, which event must have some amount of uncertainty about it, and must be of a character more or less adverse to the interest of the person effecting the insurance."[32]

The test laid down by Channell J. has been approved with modifications in two recent cases[33] in which the Department of Trade sought declarations that companies were carrying on insurance business within the meaning of the Insurance Companies Act 1974.[34] In order to succeed the Department had to show that the companies "effected and carried out" contracts of insurance in the course of their business; thus in both cases the nature of a contract of insurance fell to be considered.

2.4 In *Department of Trade and Industry* v. *St. Christopher Motorists' Association Ltd.*[35] the court was asked to make a declaration that a proprietary club was carrying on business as an insurance company. The arrangement between the club and its members was that if an event occurred, such as injury or disqualification, which prevented a member from driving his car the club would provide him with a driver, or a car and driver, for stated periods. Templeman J., in granting the declaration, applied the test for a contract of insurance suggested in *Prudential Insurance Co.* v. *Inland Revenue Commissioners*[36] and held that there was no difference in substance between the company paying for a chauffeur for a member and its agreeing to pay him the cost of providing himself with a chauffeur[37] and that the arrangement accordingly amounted to a contract of insurance.

2.5 In *Medical Defence Union Ltd.* v. *Department of Trade*[38] Megarry V.-C. considered further the nature of a contract of insurance. Although he did not seek to formulate an exhaustive or comprehensive definition,[39] he did attempt to isolate the essential characteristics of a contract of insurance:

(*a*) The contract must provide that the insured will become contractually entitled to money or money's worth or to the provision of services to be paid for by the insurer on the occurrence of some event;

(*b*) The event must be one which involves some element of uncertainty, either as to whether it will ever happen or not, or if the event is one

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[32]At p.664. In *Gould* v. *Curtis* [1913] 3 K.B. 84 it was suggested that the event upon which payment is to be made need not be adverse to the interests of the assured since the insured sum may be payable on the attainment of a certain age.

[33]*Department of Trade and Industry* v. *St. Christopher Motorists' Association Ltd.* [1974] 1 W.L.R. 99; *Medical Defence Union Ltd.* v. *Department of Trade* [1979] 2 All E.R. 421.

[34]Or its statutory predecessors: in the *St. Christopher* case the relevant statute was the Insurance Companies Act 1958.

[35][1974] 1 W.L.R. 99.

[36][1904] 2 K.B. 658.

[37]Thereby not following *Rayner* v. *Preston* (1881) 18 Ch.D.1 which required a contract of insurance to provide for the payment of money to the insured.

[38][1979] 2 All E.R. 421.

[39]Indeed, at [1979] 2 All E.R. 421, 429 he said:—

"I do not know whether a satisfactory definition of a 'contract' of insurance will ever be evolved. Plainly it is a matter of considerable difficulty. It may be that it is a concept which is easier to describe than to attempt to define, and, as I have said, I do not seek to lay down an exhaustive or comprehensive definition". Nonetheless textbooks have made the attempt: see e.g. *Chitty on Contracts* (24th ed., 1977) Vol. 2, p.686, para. 3901. Cf. *Halsbury's Laws* (4th ed.) para. 2.

which must happen at some time, as to the time at which it will happen;

(*c*) The insured must have an "insurable interest"[40] in the subject-matter of the contract.

2.6 In the *St. Christopher* case [41] Templeman J. gave examples of contracts which although possessing the characteristics mentioned in the preceding paragraph would nevertheless not be true contracts of insurance. He instanced contracts of guarantee and of maintenance and repair.[42] We think that there may be other contracts whereby one party undertakes to provide services to the other on the occurrence of stated events which would not constitute contracts of insurance. In many cases the answer to the question whether or not the contract is one of insurance is unclear and we consider that in such cases the court may well take into account whether the party undertaking to provide services is an insurance company authorised to carry on insurance business under the Insurance Companies Act 1974. The object of the 1974 Act is to enable the Department of Trade to take steps to ensure the financial soundness of insurance companies, and to "defeat those who would establish insurance companies, collect the premiums, and then leave the companies with assets which are inadequate to meet valid claims".[43] In order to assist the attainment of this objective those wishing to carry on insurance business are required first to obtain authorisation from the Department. Although "insurance business" is not defined in the Act, section 83 defines various categories of insurance business for which authorisation may be obtained. A common feature of these definitions is that they are expressed in terms of "the business of effecting and carrying out contracts of insurance".

2.7 We are confident that the courts will almost invariably be able to determine whether a contract is a contract of insurance by applying the test formulated by Channell J., as modified by Templeman J. and Megarry V.-C., and, in cases of uncertainty, by having regard to whether one of the parties is an authorised insurance company. This approach is a flexible one which in our view makes a statutory definition of a contract of insurance unnecessary and undesirable.

Marine, Aviation and Transport insurance

2.8 In our Working Paper[44] we provisionally concluded that our recommendations should not extend to marine, aviation and transport insurance ("MAT"). In reaching this conclusion we took account of the fact that the law

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[40]It is the fact that an insured has an insurable interest in the subject-matter of the contract which prevents the contract from being a gaming contract: see *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 1.

[41][1974] 1 W.L.R. 99.

[42]The legal distinction between contracts of guarantee and contracts of insurance is explained in *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 29, paras. 2408–2412. Contracts of maintenance are typically contracts under which a manufacturer undertakes, in return for a periodic fee, to maintain or service machinery in cases of breakdown and at regular intervals.

[43]See *Medical Defence Union Ltd.* v. *Department of Trade* [1979] 2 All E.R. 421, 423 *per* Megarry V.–C.

[44]W.P. No. 73, paras. 15 and 17.

and practice in this area appeared to be working satisfactorily and not to be in need of reform. Thus, as we said, the Marine Insurance Act 1906, together with subsequent case-law, contains comprehensive provisions which provide a context of certainty of law and practice in this country, especially in relation to the conduct of international commerce. In view of London's position as a leading centre for MAT in a very competitive international market it would clearly be undesirable to disturb this basis of legal certainty by making substantial changes to the 1906 Act, as would be made necessary by the application of our recommendations to MAT. In connection with these considerations we referred to the topic under the label of "MAT" as used by the insurance industry, including policies within the Marine Insurance Act 1906 and analagous aviation and transport policies. The contracts falling within MAT are generally effected by "professionals"—that is to say, persons whose everyday business dealings involve the making and carrying out of insurance contracts. Thus, in the vast majority of cases it is merchants, shipowners, aircraft operators, etc. and not private individuals who seek insurance in the field of MAT. They operate in a market governed by long-standing and well-known rules of law and practice and can reasonably be expected to be aware of the niceties of insurance law. We therefore provisionally concluded that, in the context of MAT, reforms for the protection of the insured were unnecessary. It should also be noted that MAT is excluded from the scope of the proposed Directive.

2.9 However, on consultation representations were made to us that MAT insurance includes a number of policy holders who are as much in need of protection as those to whom our provisional recommendations were intended to apply. For example, there are many private individuals who own sailing boats and other pleasure craft and obtain insurance cover for them: such cover will very often fall within section 1 of the Marine Insurance Act 1906. It was also pointed out that a number of private individuals own and insure aircraft.

2.10 Thus it appears that the total exclusion of all MAT insurance from the scope of our provisional recommendations was too wide. We have therefore sought a definition of MAT which, while including "professional" MAT policy holders, would exclude the type of policy holders mentioned in the preceding paragraph. As will be seen below, there is no single definition of MAT insurance of which we are aware which achieves this object. The instances of MAT insurance which consultees suggested should be subject to our recommendations were many and varied. The considerations of policy relevant to the question whether any particular instance should be within our recommendations are likely to differ widely. In our view these considerations could only become apparent after detailed consultation. We therefore consider that while MAT insurance in general should be excluded from our recommendations, the Secretary of State for Trade should be empowered to vary the excluded classes as may appear appropriate after consultation and subject to an affirmative resolution of Parliament.[45] It is however necessary to formulate a defined basis for the general exclusion of MAT insurance which we propose.

[45]See note 51 below.

2.11 Since MAT is a recognised category of insurance in English law, we looked first at the statutory definition of this category contained in Schedule 1 of the Insurance Companies (Classes of General Business) Regulations 1977.[46] MAT insurance business is defined in the Regulations[47] as the "effecting and carrying out of contracts of insurance"

(*a*) Upon vessels used on the sea or on inland water or upon the machinery, tackle, furniture or equipment of such vessels and against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability;

(*b*) Upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft or against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability;

(*c*) Against loss of or damage to railway rolling stock;

(*d*) Against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport;

(*e*) Against death or personal injury sustained as a result of travelling as a passenger on any of the forms of transport mentioned above.[48]

2.12 However, the list in the 1977 Regulations is in our view in some respects too wide and in other respects too narrow for present purposes. For example, the list includes insurance against death or injury in certain cases as the result of travelling as a passenger as well as cover against loss of or damage to passengers' baggage even if carried in a private motor vehicle (neither of which would be regarded as MAT in the industry). On the other hand, it does not include insurance against loss of or damage to installations situated off-shore or on the high seas such as oil rigs, nor does it include insurance against financial loss connected with the use or operation of ships, off-shore installations or aircraft e.g. against loss of freight and salvage[49] (which would clearly be regarded as MAT in the industry). It also includes railway rolling stock which is *sui generis*. These characteristics of this list, and its unsuitability for the purpose of the scope of our recommendations, are to be expected, since the list was drawn up in order to facilitate supervision of the insurance industry and was not directed to considerations such as those with which we are now concerned.

2.13 Another definition of MAT which we considered is that in Article 12A of the E.E.C. Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, as amended by the Convention on the Accession of the New Member States.[50] This has the merit that it avoids some of the shortcomings of the definition of MAT to be found in the 1977 Regulations. How-

[46]S.I. No. 1552: these Regulations were made under s.2(2) of the European Communities Act 1972 and have the effect of amending s.83 of the Insurance Companies Act 1974. This section, and the amending regulations, are concerned with the classification of insurance business for the purpose of its authorisation and regulation.

[47]By para. 3 and Schedules 1 and 2 thereof.

[48]It is worth noting that this list is substantially the same as that used for the exclusion of MAT from the provisions of the proposed Directive.

[49]Both of these are included in the E.E.C. Convention referred to in para. 2.13 below.

[50](1978) Cmnd. 7395.

ever, it was not directed to considerations such as those with which we are at present concerned and it has other characteristics which render it unsuitable for present purposes; for example, it is confined to marine and aviation risks and does not extend to transport risks.

2.14 We have therefore decided to adopt the statutory definition of MAT insurance as set out in the 1977 Regulations, as the basis for the determination of the classes of insurance to which the recommendations in the report should not apply. However, since there can be no doubt that the class of contracts mentioned in (*e*) of paragraph 2.11 (death or injury of passengers) ought not to be excluded from our recommendations, we propose that the adoption of the definition in the 1977 Regulations should omit this class. On the other hand, there are certain other contracts within the statutory definition which in our view should be subject to our recommendations, some of which are mentioned in paragraph 2.12. However, we have not excluded these from the list since, unlike the class mentioned in (*e*) of paragraph 2.11 they are not contained in separate and severable paragraphs and their exclusion at this stage would in our view pre-empt the detailed consultation which ought to take place before any decision on the possible modification of particular classes of excluded contracts. Furthermore, we have borne in mind the desirability of basing the excluded classes of contract so far as possible on the definition of MAT insurance as it currently exists in our law and that detailed amendments to a particular class in a new Act of Parliament would be liable to cause confusion. We therefore *recommend* that the basis for excluding certain classes of contract from our recommendations should be the statutory definition of MAT insurance in the 1977 Regulations, subject to the omission mentioned above, and that the Secretary of State for Trade should be empowered to make orders to add to, subtract from, or otherwise vary these classes of contract.[51]

2.15 We consider that if a contract of insurance covers any risk other than those specified in the excluded classes of MAT insurance then it should be subject to our recommendations. Thus a contract covering a variety of risks, some within and some outside the definition of MAT insurance, would not be excluded. We appreciate that as a result insurers might effect separate policies for MAT risks and non-MAT risks whereas formerly such risks would have been covered in a single policy, but we consider that this development would not pose undue practical difficulties for insurers and might benefit policy holders. The alternative would be to exclude any contract which covered *inter alia* any one or more risks specified as constituting MAT insurance. On that footing, a comprehensive motor vehicle policy which covered loss of or damage

[51]It seems to us that the Secretary of State will almost certainly wish to substitute a revised Schedule after detailed consultations have taken place and the power which we recommend he should have is sufficiently wide to allow him to do so. However, since the power is so wide we think it appropriate that the Secretary of State should not be able to make an order unless a draft has been laid before and approved by both Houses of Parliament. This is the so-called "affirmative resolution" procedure which affords Parliament a greater opportunity to scrutinise and debate such orders than if they could be made under the so-called "negative resolution" procedure. We believe that the "affirmative resolution" procedure is desirable since the rights and duties of the parties to a contract of insurance will vary substantially depending on whether or not the contract is subject to our recommendations.

to baggage carried in the insured vehicle would fall outside our recommendations (since it would in part fall within (*d*) of paragraph 2.11) and this would clearly be undesirable. Furthermore, this approach might afford a means whereby insurers could evade our recommendations by including in an otherwise non-MAT policy a small MAT element.

2.16 The effect of excluding various classes of contract from our recommendations will be that they will continue to be subject either to the Marine Insurance Act 1906 or to the existing common law of insurance, depending on whether or not they are contracts of marine insurance within the meaning of the 1906 Act. If, however, a contract of marine insurance within the meaning of the 1906 Act becomes subject to our recommendations either by reason of its being taken out of the excluded class of contract by the Secretary of State in the exercise of his statutory powers or because it is not initially within the excluded classes of contract (for example, because it relates to risks concerning off-shore oil rigs), then we suggest that in the event of any conflict between our recommendations and the Marine Insurance Act 1906 our recommendations should prevail. It seems to us that such a provision is necessary for the avoidance of doubt, and that it should not give rise to any problems in practice.

Life insurance

2.17 We see no good reason to exclude life insurance from the ambit of our recommendations. The considerations of policy which have influenced us in making our recommendations are in our view equally applicable to life insurance. The proposed Directive, like the other Directives to which it is related, does not apply to life insurance which is the subject of quite separate discussions within the E.E.C. The main reason for the separate treatment of life insurance relates to the nature of the problems involved in the supervision of the insurance industry in different countries. This reason for its exclusion is in no way relevant to this report. Accordingly, the recommendations in this report are intended to apply to life insurance.

Insurance intermediaries

2.18 Our terms of reference are wide enough to cover the effect on the liability of insurers of the negotiation of insurance contracts by agents or brokers. Under the present law such intermediaries are for some purposes regarded as the agents, not of the insurers, but of the insured. The main problem which arises is the fact that an insured is likely to assume that a disclosure of all material facts to such an intermediary is disclosure to the insurer. An insurer may nevertheless repudiate a policy on the ground of a non-disclosure by the insured where an intermediary, whom the insured has allowed to complete his proposal form, has for some reason failed correctly or fully to incorporate the oral information supplied to him, or where a broker has failed to pass on such information to the insurers. This defect in the present law was considered by the Law Reform Committee.[52] In January 1977 the Government published a White

[52]See their Fifth Report (1957) Cmnd. 62, para. 7; indeed in para. 14(3) the Committee formulated a provision which in their view could be introduced into English law without difficulty under which any person who solicits or negotiates a contract of insurance should be deemed, for the purposes of the formation of the contract, to be the agent of the insurers, and that the knowledge of such person should be imputed to the insurers.

Paper[53] on the whole topic of insurance intermediaries in which the introduction of a new framework of control over the entire field of insurance selling was recommended. The White Paper proposed that insurance companies should be fully responsible for the conduct of their agents: this was intended to give effect to the provision formulated by the Law Reform Committee.[54] As regards insurance brokers, the White Paper included recommendations concerning their internal organisation and professional standards.[55] If enacted, these controls would have the effect of substantially eliminating, at least as regards insurance agents, the anomalies mentioned above. Parliament has already implemented some of the White Paper's recommendations,[56] although not those relevant to this problem. In our view this area of the law clearly appears to be in need of reform. In the working paper we expressed the hope that legislation in this regard would soon be forthcoming. We remain of this view. However, in view of the fact that, as the White Paper indicates, the Government was already actively concerned with these problems, we did not deal with them in our working paper and have not consulted on them; and we are therefore not dealing with the question of insurance intermediaries in this report.[57]

Contracts of reinsurance

2.19 For the sake of completeness we should mention that in Part VIII of this report we consider whether our recommendations should be made applicable to contracts of reinsurance and conclude that they should not, but we make some minor recommendations to ensure that anomalies do not arise.

PART III

NON-DISCLOSURE

THE PRESENT LAW AND ITS DEFECTS

The duty of disclosure

General

3.1 In the English law of contract the general rule is that a contracting party is under no duty to disclose material facts known to him but not to the other party: there is no duty of good faith on the parties when they enter into a contract.[58]

3.2 To this general rule there is an exception in respect of contracts *uberrimae fidei*, that is to say contracts of the utmost good faith. The most important contract *uberrimae fidei* is the contract of insurance:

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[53] *Insurance Intermediaries* (1977) Cmnd. 6715.

[54] (1957) Cmnd. 62 at paras. 14–16.

[55] (1977) Cmnd. 6715 at paras. 10–12.

[56] The recommendations regarding brokers were implemented by the Insurance Brokers (Registration) Act 1977 and regulations made thereunder.

[57] Except to a limited extent in relation to renewal notices; see para. 4.75, below.

[58] *Keates* v. *Cadogan* (1851) 10 C.B. 591, 138 E.R. 234; *Fletcher* v. *Krell* (1873) 42 L.J. Q.B. 55.

"It has been for centuries in England the law in connection with insurance of all sorts, marine, fire, life, guarantee and every kind of policy that, as the underwriter knows nothing and the man who comes to him to insure 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."[59]

Extent of the duty

3.3 The Marine Insurance Act 1906 codified the common law in relation to marine insurance, although its provisions probably reflected the common law rules which were at that time applicable to all classes of insurance. Section 18 of the Act provides:

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

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

3.4 In the recent case of *Lambert* v. *Co-operative Insurance Society Ltd,*[60] the Court of Appeal considered the duty of disclosure in non-marine insurance and held that:

(*a*) there was no obvious reason why there should be a rule of disclosure in marine insurance different from the rules in other forms of insurance;

(*b*) the statement by the Law Reform Committee in their Fifth Report[61] that for the purpose of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured, was a recommendation to change the law and not an existing rule;

(*c*) a fact was material if it would influence the mind of a prudent insurer;

(*d*) the law should be reformed: see paragraph 3.19, below.

The extent of the duty of disclosure at common law in non-marine insurance is therefore to disclose every circumstance which is material, that is to say every circumstance which would influence the judgment of a prudent insurer in the relevant type of insurance in fixing the premium or determining whether he will take the risk. It should perhaps be mentioned that in marine insurance it is immaterial that another underwriter has refused the risk, whereas in non-marine insurance this has sometimes been held to be a material fact.[62] It is

[59] *Rozanes* v. *Bowen* (1928) 32 Ll.L.R. 98, 102.

[60] [1975] 2 Lloyd's Rep. 485. See also para. 3.19, below.

[61] (1957) Cmnd. 62, see para 14.

[62] See, for example *Re Yager and Guardian Assurance Co.* (1912) 29 T.L.R. 53 (fire insurance); *Glicksman* v. *Lancashire and General* (1927) A.C. 139 (burglary insurance); *Cornhill Insurance* v. *Assenheim* (1937) 58 Ll.L.R. 27 (motor insurance) and *London Assurance* v. *Mansel* (1879) 11 Ch. D. 363, 371. Examples of material facts in non-marine insurance are to be found in W.P. No. 73 at para. 28.

also relevant to note that the words in Section 18(1) " . . . which, in the ordinary course of business, ought to be known by him" are inappropriate when the insured does not apply for insurance in the course of business.

3.5 Since the decision in *Lambert* in 1975 the test of materiality then laid down by the Court of Appeal has been applied in a number of cases.[63] In a recent case[64] Forbes J. emphasised that the test was whether the insurers could show that the fact which had not been disclosed *would* have affected the judgment of a prudent insurer and not merely that it *might* possibly have done so.

3.6 Before the decision in *Lambert* there was a line of authority,[65] at least in relation to life insurance, that the test was to ask whether a reasonable man in the position of the insured, and with the knowledge of the allegedly material facts, ought to have realised that they were material to the risk. This line of cases was overruled by the Court of Appeal in *Lambert*.

Material facts which need not be disclosed[66]

3.7 The following material facts need not be disclosed:

(*a*) Facts which the insured does not know.
As will be seen,[67] it is unclear to what extent the insured may be taken to have knowledge of facts outside his actual knowledge;

(*b*) Facts which diminish the risk such as, for example, the installation of fire sprinklers;

(*c*) Facts which the insurer knows or may be presumed to know or which are matters of common knowledge;

(*d*) Facts covered or dispensed with by a warranty or condition;

(*e*) Facts as to which the insurer waives disclosure.

3.8 Since a great deal of the type of insurance considered in this report is done on the basis of proposal forms it is particularly relevant to note their legal position in this context. A point of far-reaching importance in practice is that by requiring answers to a long list of questions in a proposal form the insurer does not waive the need to disclose material facts falling outside the scope of the questions asked.[68] Indeed, this was the position in *Lambert*. However, the extent of the residual duty of disclosure may sometimes be reduced in proposal form cases by the application of the doctrine of waiver. Thus the form of particular questions may cut down the extent of the duty so that if, for example, there is a question: "Have you consulted your doctor within the last five years?" the insured would be under no obligation to disclose consultations which had taken

[63]See e.g. *Woolcott* v. *Sun Alliance Insurance Ltd.* [1978] 1 W.L.R. 493 and *Reynolds* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440, 456.

[64]*Reynolds* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440, 456–457.

[65]See *Joel* v. *Law Union and Crown* [1908] 2 K.B. 863, 884–885 and *Rose Lodge* v. *Castle* [1966] 2 Lloyd's Rep. 113.

[66]See generally *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 10, para. 784 *et seq.*

[67]See para. 4.49, below.

[68]*Glicksman* v. *Lancashire & General Assurance Co. Ltd.* [1927] A.C. 139; see also *Schoolman* v. *Hall* [1951] 1 Lloyd's Rep. 139, 142 *per* Cohen, L. J.

place more than five years earlier. Another example of waiver arises when the insurer obtains a clearly incomplete answer to a question but makes no attempt to obtain further information.[69] Waiver may also generally be inferred if in the particular circumstances the insured is justified in assuming that the insurers are waiving disclosure of material matters as to which they appear to be indifferent or uninterested.[70]

Consequences of non-disclosure by the insured

3.9 A breach by the insured of his duty of disclosure entitles the insurer to avoid the contract of insurance *ab initio*. The insurer is then entitled to refuse to pay claims, and to demand repayment of any claims paid, and the insured is entitled to demand the repayment of any premiums which he has paid unless his claim has been met.[71] The contract remains in force unless and until it has been avoided.[72] The insurer must exercise his right of avoidance upon receiving notice of the insured's breach or within a reasonable time thereafter.

3.10 In the working paper[73] we noted the important modern practice mentioned above whereby insurers require the insured to answer detailed questions concerning the risk, usually in a "proposal form". These questions may relate to facts existing at the time of the proposal or which existed at some time in the past. Alternatively, or in addition, they may refer to the future.[74] When the proposer is answering questions as to past or present facts (but not as to the future), the duty of good faith requires that, to the extent that these relate to material facts, his answers must be accurate in the sense that they do not mislead.[75] If an inaccurate answer is given as to a material fact the insurer is entitled to avoid the policy *ab initio* and to reject any claim under it.[76] The meaning of materiality in this context is the same as in the context of non-disclosure generally in the absence of any proposal form.[77] For the sake of completeness, it should also be borne in mind that an inaccurate answer to a question in a proposal form may not only provide the insurer with a defence but may also be actionable by him as a misrepresentation.[78]

Construction of ambiguous questions

3.11 Where a question put to the insured by insurers is ambiguous the overriding principle is that a fair and reasonable construction must be placed upon

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[69]*Roberts* v. *Avon Insurance Co.* [1956] 2 Lloyd's Rep. 240.

[70]*Everett* v. *Desborough* (1829) 5 Bing. 503, 130 E.R. 1155; *Laing* v. *Union Marine Insurance* Co. (1895) 1 Com. Cas. 11, 15.

[71]*Cornhill Ins. Co.* v. *Assenheim* (1937) 58 Ll.L.R. 27, 31.

[72]*MacGillivray & Parkington on Insurance Law* (6th ed, 1975) Chap. 10. paras 744–746.

[73]W.P. No. 73, paras 29–30.

[74]If so the answers may be binding under the contract of insurance if they amount to promises to do or refrain from doing something in the future and if they have been incorporated as terms of that contract: see paras. 6.3 and 6.5, below.

[75]*Everett* v. *Desborough* (1829) 5 Bing. 503, 130 E.R. 1155.

[76]*Graham* v. *Western Australia Insurance Co. Ltd.* (1931) 40 Ll. L.R. 64, 66; *Merchants' and Manufacturers' Insurance Co.* v. *Hunt and Thorne* [1941] 1 K.B. 295.

[77]See para. 3.4, above.

[78]We deal with the relationship between the law of misrepresentation and the recommendations in this report at paras. 8.3–8.9, below.

it.[79] Accordingly, if an ambiguous question is put to an applicant in a proposal form, the insurers cannot rely on the inaccuracy of the answer as a ground for avoiding the contract if that answer is true having regard to the construction which a reasonable man might put upon the question and which the applicant in fact put upon it. However, there is no presumption that the interpretation most favourable to the insured is necessarily that which is fair and reasonable.[80] In particular, the *contra proferentem* rule, that a document is construed against the person who put it forward, is not applicable to the provisions of proposal forms unless such provisions have been incorporated into the insurance contract, for example by a "basis of the contract" clause.

Duration of the duty of disclosure

3.12 The insured is only subject to the duty of disclosure until a binding contract of insurance has been concluded with the insurer.[81] He is not therefore bound to disclose material facts which arise after the contract has been made or of which he only becomes aware after that date.

Renewal

3.13 Since the renewal of an existing policy is regarded in law as the making of a new contract of insurance, the insured is subject to a fresh or repeated duty of disclosure on each successive application for renewal of cover.[82] This has important practical consequences to which we refer below.[83]

Miscellaneous enactments affecting the duty of disclosure

3.14 The insured's duty of disclosure has been affected by recent legislation. The Rehabilitation of Offenders Act 1974 provides that an applicant is entitled to withhold from the insurers information about certain of his or her convictions. The purpose of the Act is, *inter alia,* "to rehabilitate offenders who have not been reconvicted of any serious offence for periods of years".[84] This object is achieved by providing that after the expiry of the "rehabilitation period" a conviction becomes "spent".[85] There are different rehabilitation periods according to the seriousness of the sentence with which the offence is punishable. Under Section 4, a spent conviction is to be treated "for all purposes in law" as though it had never happened, and the person who has a spent conviction is to be treated as though he had not committed or been charged with the offence in question. In the result the insurer will have no remedy if the insured has failed to disclose a spent conviction in an answer in a proposal form. Even if the insured has warranted the truth of all his answers, which thus become terms of the contract, the insurer is not entitled to treat the insured's failure to acknowledge a spent

[79]*Condogianis* v. *Guardian Assurance Co.* [1921] 2 A.C. 125, 130, *per* Lord Shaw of Dunfermline.

[80]*Holt's Motors* v. *S.E. Lancashire Ins.* (1930) 37 Ll.L.R. 1, 4 *per* Scrutton L.J.

[81]*Lishman* v. *Northern Maritime Insurance Co.* (1875) L.R. 10 C.P. 179, 182; *Re Yager and Guardian Assurance Co.* (1913) 108 L.T. 38; the Marine Insurance Act 1906, s. 18 (1); see para. 3.3, above.

[82]*Lambert* v. *Co-operative Insurance Society Ltd.* [1975] 2 Lloyd's Rep. 485.

[83]See paras. 3.20 and 4.69–4.70, below.

[84]See the Long Title to the Act.

[85]The most important exception to the Act is that if a sentence of imprisonment for a term exceeding 30 months is imposed, then the conviction cannot become spent: s. 5(1).

conviction as a breach of warranty entitling him to repudiate the policy or reject a claim made under it. As a result of section 4 (3) (*a*) the proposer for insurance is relieved of any duty to disclose not only a spent conviction but also the events (for example a motor accident) out of which it arose.[86]

3.15 The insured's duty of disclosure is also affected by the Sex Discrimination Act 1975 and the Race Relations Act 1976. Both enactments provide that it is unlawful for persons providing certain services or facilities to the public to discriminate against any person seeking them by failing to provide them on the same terms as those on which they are available to other members of the public.[87] The provision of insurance cover is expressly included within the ambit of both Acts.[88] The effect of these Acts is to make it unlawful for insurers to claim that the insured's sex[89] or racial origins[90] are material to the risk, with the result that they need not be disclosed by an applicant for insurance even if the insurers ask questions about them.

3.16 The implementation of our recommendations regarding non-disclosure would have no bearing on these enactments.

Defects of the present law as to non-disclosure

3.17 The application of the present law as to non-disclosure in modern conditions is open to many criticisms. We set out some of the defects in the following paragraphs.

***The Fifth Report of the Law Reform Committee*[91]**

3.18 In their Fifth Report the Law Reform Committee said:

> "(4) . . . it seems to us to follow from the accepted definition of materiality that a fact may be material to insurers . . . which would not necessarily appear to a proposer for insurance, however honest and careful, to be one which he ought to disclose."

***Lambert v. Co-operative Insurance Society Ltd.*[92]**

3.19 Prior to the *Lambert* case there was some doubt as to which was the correct test for the materiality of a non-disclosed fact. There was a line of

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

[87]Sex Discrimination Act 1975, s.29 and Race Relations Act 1976, s.20.

[88]Sex Discrimination Act 1975, s.29 (2) (*c*): Race Relations Act 1976, s.20 (2) (*c*).

[89]However, a proviso in section 45 of the 1975 Act allows insurers to discriminate against a person as regards acceptance of the risk and assessment of the premium "by reference to actuarial or other data from a source on which it was reasonable to rely and [where such discrimination] was reasonable, having regard to the data and any other relevant factor." The proviso is limited to annuities, life insurance policies, accident insurance policies and other similar matters involving the assessment of risk.

[90]The 1976 Act renders unlawful discrimination on "racial grounds" and "racial grounds" are defined as referring to colour, race, nationality or ethnic or national origins: see ss.1 and 3.

[91](1957) Cmnd. 62.

[92][1975] 2 Lloyd's Rep. 485.

authorities[93] which suggested that at least in certain classes of insurance the law was not as stated by the Law Reform Committee but was that the insured was under a duty to disclose only such facts as a reasonable man would believe to be material. As we have seen[94] this doubt was removed by the decison in *Lambert* which overruled these authorities.

However, all three judges in the Court of Appeal were highly critical of the existing law. MacKenna J., who delivered the leading judgment, said:

> "I would only add to this long judgment the expression of my personal regret that the Committee's recommendation has not been implemented. The present case shows the unsatisfactory state of the law. Mrs. Lambert is unlikely to have thought that it was necessary to disclose the distressing fact of her husband's recent conviction when she was renewing the policy on her little store of jewellery. She is not an underwriter and has presumably no experience in these matters. The defendant company would act decently if, having established the point of principle, they were to pay her. It might be thought a heartless thing if they did not, but that is their business, not mine. I would dismiss the appeal."[95]

Lawton L.J. said:

> "The explanation for this desire to show that the test[96] accepted by the Privy Council in 1925[97] in the clearest possible terms is not the true test may be because some lawyers are of the opinion that it is unfair to many policy holders. It was said by [Counsel], with some force, that when the law first began to develop in the 18th century those who sought to get the benefit of insurance cover were really acting with the same sort of knowledge and understanding as the underwriters from whom they were seeking cover. Nowadays when the ordinary citizen seeks to take out insurance cover for his house and belongings he is not acting on equal terms with the insurance companies. Much as I sympathise with the point of view which was put forward by [Counsel], I cannot accept that it can alter the law."[98]

His Lordship went on to observe:

> "Such injustices as there are must now be dealt with by Parliament, if they are to be got rid of at all."

Cairns L.J. said:

> "I share with respect the view that was expressed in [the Law Reform Committee's] report that the law might well be changed. . . ."[99]

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[93]See *Joel* v. *Law Union and Crown* [1908] 2 K.B. 863, 884–885 and *Roselodge* v. *Castle* [1966] 2 Lloyd's Rep. 113.

[94]See paras. 3.4–3.6, above.

[95][1975] 2 Lloyd's Rep. 485, 491.

[96]Namely that a fact is material if it would influence the judgment of a prudent insurer in fixing the premium or in taking the risk: the "prudent insurer" test.

[97]In *Mutual Life Assurance Co. of New York* v. *Ontario Metal Products Co. Ltd.* [1925] A.C. 344.

[98][1975] 2 Lloyd's Rep. 485, 492.

[99]*Ibid.*, at 493.

We would add that the policyholder may suffer injustice under the present law not only by having his claim rejected and his policy repudiated but also because the repudiation and rejection may create real difficulties for him in obtaining fresh cover from other insurers. The cancellation of cover, or the fact that an insurer has declined a proposal, may in themselves be material facts which have to be disclosed to other insurers thereafter.[100]

Other criticisms

3.20 It has been pointed out[101] that many laymen are not aware that a duty of disclosure exists and that it may be very difficult, if not impossible, for those who are aware of the duty to know what information would be regarded as material by a prudent insurer. This point was put to us forcefully on consultation mainly by those representing consumer interests. One writer has observed[102] that the duty imposes an especially heavy burden on an insured who holds a policy which is renewable year by year since he is most unlikely to realise that the duty arises on each successive renewal. Another has raised[103] the problem of the extent of the duty on an insured when he applies for cover over the telephone. Above all, the general rule of the present law whereby an insured is not relieved of his duty of further disclosure even where the insurer has asked questions of him in a proposal form,[104] is open to the obvious criticism that the insured is thereby likely to be led to believe that no further information is required to be volunteered by him.

3.21 Under the present law, in order to determine disputes as to whether certain facts are material, the courts will hear the evidence of other insurers as expert witnesses. Such evidence will usually be readily available to the insurers who will have no difficulty in selecting appropriate witnesses. However, the insured will often be at a considerable disadvantage in finding expert witnesses prepared to challenge those of the insurer and the position of such witnesses is often invidious. Some judicial doubt has also been cast on the cogency of such evidence.[105]

3.22 Judicial decisions as to the materiality of particular types of fact have also been criticised.[106] It will suffice to mention two such decisions. In *Locker & Woolf Ltd.* v. *Western Australia Insurance Co.*[107] the non-disclosed fact held to be material was a previous rejection of a claim relating to insurance of an entirely different type from that which was being applied for. Another is *Regina Fur* v. *Blossom*[108] in which an insurer was held entitled to repudiate the

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[100]See para. 3.4, above.

[101]R. A. Hasson "The doctrine of *uberrima fides* in insurance law—a critical evaluation" (1969) 32 M.L.R. 615, 633.

[102]R. Merkin *"Uberrimae fidei* strikes again" (1976) 39 M.L.R. 478, 480.

[103]J. Birds "What is a cover-note worth?" (1977) 40 M.L.R. 79.

[104]See para. 3.8, above.

[105]*Roselodge* v. *Castle* [1966] 2 Lloyd's Rep. 113, 131, *per* McNair J. See also *Reynolds* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440, 457–459 *per* Forbes J.

[106]See R. A. Hasson "The doctrine of *uberrima fides* in insurance law—a critical evaluation" (1969) 32 M.L.R. 615, 622–623, 626.

[107][1936] 1 K.B. 408.

[108][1957] 2 Lloyd's Rep. 466; but now see Rehabilitation of Offenders Act 1974, s.4 (3) (*a*) and cf. *Reynolds* v. *Phoenix Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 440, 459–461 *per* Forbes J.

policy because the insured had failed to disclose that 23 years ago he had been convicted of a criminal offence.

Is it necessary to alter the law?

3.23 In our view the foregoing defects in the present law provide a formidable case for reform. However, on consultation it was contended by some representatives of the insurance industry that reform was neither necessary nor desirable. One ground for this contention was the voluntary observance by insurers of the Statements of Insurance Practice. The history of these Statements is as follows. On 4 May 1977, following discussions between representatives of leading insurers and the Government, the Parliamentary Under-Secretary at the Department of Trade announced in the House of Commons[109] that the British Insurance Association and Lloyd's had drawn up a statement of practice (hereafter referred to as the "First Statement of Insurance Practice") which they were recommending to their members. The First Statement of Insurance Practice is restricted to non-life insurance of policyholders resident in the United Kingdom and insured in their "private" capacity only. On 28 July 1977 a further announcement was made by the Parliamentary Under-Secretary at the Department of Trade to the House of Commons[110] that a Statement of Long-Term Insurance Practice (hereafter referred to as the "Second Statement of Insurance Practice") had been drawn up by the Life Offices' Association and Associated Scottish Life Offices. It relates to long-term insurance effected by individuals resident in the United Kingdom in their "private" capacity; in practice this means that the Statement is applicable principally to life assurance since this is the only type of long-term insurance generally available in this country. The Statements arose from concern that in view of the proposed exclusion of insurance contracts from the Unfair Contract Terms Bill[111] (subsequently enacted as the Unfair Contract Terms Act 1977 with insurance contracts still excluded) policyholders might not be afforded sufficient protection from unfair treatment as a result of the terms of insurance contracts. A copy of both Statements is annexed to this report as Appendix B. We deal with each Statement in turn and then make some general comments.

The First Statement of Insurance Practice

3.24 Paragraph 1 (*b*) of the First Statement of Insurance Practice provides that a statement should be prominently displayed on the proposal form informing the proposer of the nature of his duty of disclosure and of the consequences of his failure to comply with it. The proposal form should also contain a warning that if a proposer is in any doubt whether a fact is material he should disclose it.[112] Paragraph 1 (*c*) provides that those matters which insurers have found generally to be material will be the subject of clear questions in the proposal form and paragraph 1 (*f*) requires the insurer to send a copy of the completed proposal form to the insured if the insurer has raised an issue

[109] *Hansard* (H.C.), 4 May 1977, Vol. 931, cols. *218–220.*

[110] *Hansard* (H.C.), 28 July 1977, Vol. 936, cols. *641–644.*

[111] This Bill was based on the recommendations in the Law Commissions' Joint Second Report on Exemption Clauses (1975) (Law Com. No. 69, Scot. Law Com. No. 39) although the Law Commission intended that their recommendations should extend to contracts of all types, including contracts of insurance: see paras. 240–247.

[112] Para. 1(*b*) (ii).

concerning it, unless a copy has already been supplied to him. Paragraph 3 obliges insurers to warn policyholders in renewal notices about the extent of their duty of disclosure on renewal. However, there is no provision requiring the insurers to send the insured a copy of the completed proposal form whether or not an issue has been raised concerning it; this would undoubtedly facilitate compliance with the duty of disclosure on renewal.[113]

3.25 Paragraph 2 (*b*) indicates that, except where fraud, deception or negligence is involved, an insurer will not "unreasonably" repudiate liability to a policyholder where the insured has failed to disclose a material fact (or there has been a misrepresentation of such a fact) and where knowledge of the fact would not materially have influenced the insurer's judgment in the acceptance or assessment of the risk.[114]

The Second Statement of Insurance Practice

31.26 Paragraph 1(*a*) of the Second Statement of Insurance Practice indicates that an insurer will not unreasonably reject a claim, and in particular that a claim will not be rejected for the non-disclosure or misrepresentation of a matter outside the proposer's knowledge. However, there is a proviso that fraud or deception will, and negligence or non-disclosure or misrepresentation may, result in "adjustment" or constitute grounds for rejection. Paragraph 2 of the Statement makes provisions concerning the content of proposal forms similar to those made in the First Statement of Insurance Practice.

Comments on the Statements of Insurance Practice

3.27 The most important provision of both Statements is to the effect that insurers will not "unreasonably" repudiate liability or reject a claim for non-disclosure or misrepresentation. In our working paper we pointed out[115] that this leaves insurers as the sole judges of whether repudiation or rejection is unreasonable in any given situation, and we indicated that in our view this was unsatisfactory. These Statements of Practice do not in themselves change the law but are intended merely to set out existing insurance practice. Thus, insurers are always entitled to invoke their strict legal rights to repudiate policies and reject claims for non-disclosure. However, we have already noted[116] that the law as to non-disclosure is unfair and it seems to us unacceptable that insurers should have what is in effect a discretion to repudiate policies and reject claims on grounds which are in themselves unsatisfactory. On consultation, only very few of the commentators who were unconnected with the insurance industry disagreed with this conclusion. Even amongst the representatives of the insurance industry a number of commentators conceded that some reform was necessary, although most of them would have restricted it to "consumer" insurance.

3.28 We are accordingly not convinced by the objections to reform of the law raised by the industry. In our view the Statements of Insurance Practice are

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[113]For our recommendation in this regard see para. 4.63, below.

[114]For our comments on para. 2(*b*) insofar as it relates to breaches of warranty, see para. 6.10, below.

[115]W.P. No. 73, para. 9.

[116]See paras. 3.17–3.22, above.

themselves evidence that the law is unsatisfactory and needs to be changed. As we have pointed out,[117] the Statements lack the force of law so that an insured would have no legal remedy if an insurer fails to act in accordance with them. Indeed, the liquidator of an insurance company would be bound to disregard them. We consider that the further protection which the insured needs should be provided by legislation. We are fortified in this view by the words of Lawton L.J. in *Lambert* v. *Co-operative Insurance Society*.[118]

> "Such injustices as there are must now be dealt with by Parliament, if they are to be got rid of at all."

We were also impressed by the fact that all those who commented on our working paper, other than those connected with the insurance industry, considered that the law ought to be changed.

3.29 There is one further point. The Statements of Practice are confined to policyholders effecting insurance in their "private" capacity. We assume that this confines the application of the Statements to consumers. It seems to us, however, that the mischiefs in the present law which have just been described apply both to consumers and businessmen. It follows that even if the Statements are an effective means of protecting some insured, they leave others, many of whom are equally vulnerable, without the protection which they need.

3.30 Our conclusion is that the mischiefs which we have noted in the law relating to the duty of disclosure imposed upon applicants for insurance are not cured by the Statements of Insurance Practice. Part IV of this report is accordingly devoted to the examination of various ways in which the law of disclosure can be reformed. However, it will also be noted that many of our recommendations follow lines broadly similar to the provisions of the Statements of Practice, in particular with regard to proposal forms.

PART IV
NON-DISCLOSURE
REFORM OF THE PRESENT LAW

Introduction

4.1 We have now described the present law of non-disclosure and have set out some of its defects. In the immediately preceding paragraphs we have suggested that the removal of these defects requires more than measures of self-regulation by the insurance industry: reform of the law is needed. We shall now consider three different ways in which the law might be reformed.

A. Implementation of Article 3 of the proposed Directive; in particular retention of a duty of disclosure but modification of the "all or nothing" effect of the present law by the adoption of the so-called "proportionality principle".

B. Abolition of any duty of disclosure or abolition or attenuation of the duty with respect to consumers.

C. Reform of the duty of disclosure viz. the retention of a duty of disclosure but the alteration of its ambit.

We accordingly examine each of these proposals.

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[117] See para. 3.27, above.
[118] [1975] 2 Lloyd's Rep. 485, 492.

A. Article 3 of the proposed Directive[119]

General

4.2 Article 3 of the proposed Directive deals with the duty of disclosure resting on an applicant for insurance before the contract is made. The Article attempts to strike a balance between the interests of the insurer and of the insured by retaining a wide duty of disclosure and by providing for partial recovery of the insured's claim in some cases as a sanction for non-compliance. The Article is intended to provide the insurer with all the information he needs for the assessment of the risk at the date of the contract and to enable the insured to make a proportionate recovery where his breach does not justify the rejection of the claim in its entirety. Thus the Article contains detailed provisions with regard to an applicant's duty of disclosure prior to the making of a contract of insurance, the various ways in which the duty may be broken, the consequence of breach in each case and the effect of breach on subsequent claims.

4.3 The provisions of Article 3 differ from our present law in at least three major respects. The first relates to the content of the duty of disclosure itself. Article 3.1 requires an applicant for insurance to disclose to the insurer all facts of which he is aware which may influence the insurer's assessment or acceptance of the risk. By relating the fact or facts to be disclosed to the *actual* insurer's assessment or acceptance of the risk, the Article potentially goes further than our present law which only requires an applicant to dislcose those facts which would influence the judgment of a *prudent* insurer. Secondly, whereas in English law the insurer is entitled to avoid the contract for non-disclosure by an applicant regardless of whether the non-disclosure was fraudulent, negligent or merely innocent, the sanction for breach of the duty of disclosure under Article 3 depends on the nature of the breach, the distinction between different types of breach being based on the concept of "fault" as employed in civil law systems. Thirdly, in English law the insured's entitlement is "all or nothing": in the event of a non-disclosure, the insurer may avoid the contract and may refuse to pay the whole of any claim. By contrast, Article 3 entitles the insured to a proportionate recovery of his claim in some cases. The "proportionality principle" is the lynch-pin of the proposed Directive's approach to non-disclosure[120] and we must now turn to examine it in greater detail.

The proportionality principle[121]

4.4 The proportionality principle is formulated in Article 3.3 (*c*) of the proposed Directive which deals with the common situation where the non-disclosure is discovered only after a claim has been made.[122] It provides:

> "[In the event of a breach of the duty of disclosure by the insured in circumstances where he may be considered to have acted improperly] if a

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[119]For the text, see Appendix C, below.

[120]It is also a feature of Article 4 which is concerned with cases where the contract imposes on the insured a continuing duty to disclose increases in the risk during the period of insurance: see Part V below.

[121]We are indebted to Professor Hellner of the University of Stockholm and Professor Besson of the University of Paris for their considerable assistance in dealing with the problems raised by proportionality.

[122]The less common situation where the non-disclosure is discovered before a claim is made is dealt with by Article 3.3 which provides "If the policyholder has failed to fulfil [his duty of disclosure] and may be considered to have acted improperly, the insurer may terminate the contract or propose an amendment to it".

claim arises before the contract is amended or before termination of the contract has taken effect, the insurer shall be liable to provide only such cover as is in accordance with the ratio between the premium paid and the premium that the policyholder should have paid if he had declared the risk correctly."

This provision, which is closely modelled on French law, is intended to reduce the amount recoverable by the insured in certain cases of failure to comply with his duty of disclosure but without depriving him of the whole of his claim. Proportionality thus has the strong advantage that it eliminates the "all or nothing" result in English law. At first sight, it also seems to provide a basis of arithmetical certainty for the calculation of the amount due to the insured. On further consideration, however, the apparent advantages of the principle are not as they appear to be. In the following paragraphs we examine some of the limitations inherent in the proportionality principle and then consider some of the specific drawbacks to be found in the principle as it is formulated in the proposed Directive, particularly with regard to its application in the context of some of the other provisions of Article 3.

The inherent limitations of the proportionality principle

4.5 The idea underlying proportionality appears to be that the insured's entitlement is to be determined as though the insurer had been aware of the undisclosed facts at the time of the proposal and had fixed the premium on that basis. The proportionality principle provides that if the insurer would have charged a higher premium, the insured's claim is to be reduced in proportion to the ratio between the actual premium and the notional higher premium. However, there are ways in which the insurer might have reacted to the undisclosed facts other than by an increase in premium.

(*a*) He might have declined the risk altogether.

(*b*) He might have imposed additional warranties on the insured.

(*c*) He might have narrowed the scope of the risk through the use of exclusion clauses.

(*d*) He might have imposed or increased an "excess"—that is to say, a sum stated in the policy which the insured must carry himself in the event of a loss.

The proportionality principle gives no guidance as to how the insured's entitlement is to be computed if the insurer would have reacted to the undisclosed facts in any of these ways. Any reduction in the amount due to the insured would in such cases necessarily be a question of guess work. There are additional complications if the insurer, with knowledge of the undisclosed facts, would have re-insured the risk (or a higher proportion of it) or if an insurer who only underwrites part of the risk, such as a Lloyd's underwriter, would have accepted only a smaller proportion of the risk.

An important case to which the proportionality principle provides no adequate solution

4.6 An important case to which the principle provides no solution is that where knowledge of the undisclosed facts would have led the insurer to decline

the risk altogether. In our working paper we pointed out[123] that many insurers, having regard to the quality of the risks usually accepted by them in the course of their business, might not have underwritten the increased risk at any premium. This situation is quite likely to arise where the facts in question relate to the personal characteristics of the applicant—for example, his claims experience or previous convictions. In this connection it is relevant to note that Article 2(6) of the fifth draft of the Directive which entitled insurers to refuse to pay any part of an insured's claim in such circumstances, has been omitted from the proposed Directive.[124] It is not clear whether the insured will be entitled to some part of his claim in such cases; to have to pay anything would be unjust to the insurer if only because he would then be worse off than if he had discovered the non-disclosure before the claim arose. Proportionality can only produce a satisfactory solution in these cases if the fiction is adopted that the insurer would have charged a premium equivalent to the amount of the claim, with the result that the insured would merely recover his premium. Even this fiction would not however do justice to the insurers since they would still be out of pocket to the extent of their expenses incurred in issuing the cover and dealing with the claim. In particular, if the insurer has successfully resisted a claim, he will not be able to recover all his legal costs from the insured. These may well be substantial and could only be established after a trial of the action.

The experience of proportionality in Sweden and France

4.7 In Sweden problems with proportionality have led to a judicial reluctance to apply the proportionality principle in recent years. Indeed, a Government Commission recommended in 1977 abandonment of strict proportionality in consumer insurance in favour of a more flexible rule. This proposal has now been implemented by the Consumer Insurance Act 1980 which comes into force on 1 January 1981. In France, insurance law embodies the principle of proportionality.[125] The application of this principle in practice has raised problems in various types of case[126] but most particularly in the type of case referred to in paragraph 4.6. The French rule seems to be that, although there can be no evidence of the notional premium in cases of this kind, judges at first instance must determine a fair reduction in the insured's entitlement as a matter of fact and discretion.[127] This discretionary reduction has been criticised by the leading French commentator: "elle risque d'être théorique, arbitraire et de non pas correspondre a la réalité des faits".[128] In any event the principle does not and

[123]W.P. No. 73, para. 56.

[124]No such provision is contained in French law, at least not in relation to non-marine insurance: see Code des Assurances, Art. L. 113.9. Cf. the marine insurance rule, Code des Assurances, Art. L. 172. 2. See para. 4.7, below.

[125]Code des Assurances, Art. L. 113.9; Picard & Besson "Les assurances terrestres en droit francais" (4th ed., 1975) Vol. 1, pp. 160–165: this work is the leading French commentary.

[126]E.g., where the policy covers several risks but the loss relates to only one of them. There is authority for the reduction of the claim in proportion to what the total premium should have been rather than in proportion to what the part of the total premium should have been for that particular risk: Paris 1 April 1973, R.G.A.T., 1974. 22.

[127]As is pointed out by Picard & Besson, this rule is based on a decision of the Cour de Cassation, Civ. 9 June 1942, R.G.A.T., 1942. 265, D.C. 1942. 145, J.C.P. 1942. 1982 which has been applied in a number of lower court decisions, e.g. Besançon, 25 May 1950, R.G.A.T., 1950 337; Lyon, 17 May 1965, *ibid.*, 1956. 194; Trib. Seine, 20 December 1961, *ibid.*, 1962. 336; Grenoble, 23 January 1962, R.G.A.T., 1962. 483.

[128]Picard & Besson, at p. 164.

cannot operate with the arithmetical certainty which appears to be its underlying principle and justification. For this reason various French jurisdictions have either refused to apply it[129] or have made only a nominal deduction.[130] Furthermore, it has been strongly criticised as being unjust to insurers.[131]

Difficulties in proving the notional premium

4.8 Even on the assumption that the insurer, with knowledge of the undisclosed facts, would have charged a higher premium, there remain formidable difficulties in establishing the amount of the higher premium. This difficulty is somewhat mitigated when there are fixed tariffs corresponding to the circumstances of the risk as appears to be the case in some continental countries.[132] However, save in exceptional cases even tariffs will not assist the establishment of the notional premium. Tables of tariffs can only correlate specific quantifiable factors, such as age, date of manufacture and so on with the premium to be charged. Thus in the straightforward but unusual case where there has been a mis-statement of age in an application for life assurance or a misrepresentation as to the date of manufacture of a motor vehicle in an application for motor insurance, ascertainment of the notional premium should not be too difficult. Indeed, we understand that it is the practice of life assurance companies to apply a proportional reduction in the amount paid under the policy where there has been a mis-statement of age. However, in the usual case where the undisclosed fact is qualitative rather than quantitative in nature—for example, failure to disclose a gastric complaint in an application for life assurance, or non-disclosure of a previous motoring conviction in an application for motor insurance—tables of tariffs will almost certainly be unable to assist, and disputes would proliferate into litigation with the inevitability of conflicting expert evidence as to what the notional premium should be.

4.9 The preceding paragraphs illustrate some of the difficulties which arise because of an inherent inadequacy of the proportionality principle: that it concentrates on one term of the insurance contract, the premium, to the exclusion of all the other terms subject to which cover is granted, and therefore fails to take account of the fact that insurers might have varied these other terms, rather than the premium, if the risk had been correctly disclosed, and always assuming that they would have accepted it at all. We consider that these difficulties in themselves constitute a compelling case against the introduction of proportionality into our law.

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[129]For refusal to apply the principle, see the following cases referred to in Picard & Besson, at p. 164: Toulouse, 31 May 1943, R.G.A.T., 1943. 239, S. 1945. 2.17; Trib. Seine, 23 December 1946, R.G.A.T., 1947. 253, J.C.P. 1947. II, 3683; Trib. civ. Lille, 9 April 1954, R.G.A.T., 1954. 398.

[130]For an illustration of a nominal deduction, see Paris, 28 April 1964, R.G.A.T., 1965, 87.

[131]Picard & Besson, pp. 164–165.

[132]In England the only comprehensive tables of premiums which can be used virtually automatically are those for life cover which relate the amount of the premium to the age of an applicant in normal health. There are also detailed rates in motor insurance relating to, *inter alia*, the make of the vehicle, the area in which it is used and the age and occupation of the owner; however, the fixing of the actual premium is a much more complicated process because different cover may be obtainable from different insurers for different risks at different premiums.

4.10 We now turn to consider some of the difficulties which would arise from the application of proportionality under the proposed Directive. The first and most important is that although proportionality seeks to provide a remedy for the breach of the duty of disclosure, the extent of this duty is potentially even more onerous than that in our present law.[133] This is because Article 3.1 requires the insured to disclose those facts which may influence the judgment of the *actual* insurer, the notional premium being that which *he* would have charged if the risk had been described correctly. If anything this goes further than the disadvantage of the English duty of disclosure because it is harder for an applicant for insurance to anticipate the requirements of the actual insurer than it is for him to assess what a prudent insurer would require. To the extent that the requirements of an actual insurer are greater than those of a prudent insurer, the duty in Article 3 will therefore be still more onerous on the insured than the duty in English law.

4.11 From the point of view of the insured, there is also a connected problem as to how the amount of the notional premium is to be determined. Obviously in the exceptional case where one particular material fact has not been disclosed and there is a table which correlates that fact with the premium, a notional premium can easily be ascertained. Usually however, ascertainment of the notional premium will present more difficulty. The insurer would adduce evidence both as to the materiality of the undisclosed fact to him and as to the notional premium which he would have charged if it had been disclosed. Here again it would no doubt be exceedingly difficult for the insured to challenge such evidence successfully. Moreover, even for an insurer it will frequently be difficult to re-rate a risk with hindsight, after a claim has been made, on a basis which will genuinely reflect the rate which he would have required in the first place.

Modification of the duty of disclosure in the proposed Directive

4.12 Could these objections be met by modifying the ambit of the duty of disclosure in the proposed Directive? For example, could proportionality be superimposed on the existing English law of disclosure, with its "prudent insurer" test for materiality, or on a reformed law, under which the duty would be only to disclose those facts which a reasonable insured would consider to be material? It seems to us that this would not work, because the "actual insurer" test for materiality is an integral feature of proportionality, whether under the proposed Directive or otherwise. It would be artificial to apply one test—the "prudent insurer" or "reasonable insured" test—to determine whether knowledge of the undisclosed facts would have influenced the insurer's assesment of the risk at all and another test—the "actual insurer" test—to determine how the insurer's assessment of the premium would have been influenced. If, for instance, an undisclosed fact would have influenced the actual insurer's premium rating of the risk, but not that of the prudent insurer, then under existing English law there would be no breach of duty and proportionality, if it were part of our law, could not be applied; nevertheless the logic of proportionality would in a case of this type require a partial reduction of the insured's claim, because any other result would be unfair to the insurer. A similar result would follow if the "reasonable insured" test for materiality were adopted. Conversely, if the undisclosed

[133]See para. 4.3, above.

fact would have influenced the judgement of a prudent insurer but not that of the actual insurer then, although there would have been a breach of duty, the insured would recover in full.

4.13 These anomalous results could be removed if the duty of disclosure and the determination of the notional premium were both made to depend on either the "prudent insurer" or the "reasonable insured". As regards the "prudent insurer" test this would of course involve expert evidence both as to materiality and as to the notional premium, thus exacerbating the defects of the present law to which we have already referred in paragraphs 3.19 – 3.22, above. As regards the "reasonable insured" test, it is difficult to see how this could also be applied to the determination of the notional premium. Our conclusion is that although the "actual insurer" test for materiality under the proposed Directive is open to objection, proportionality without it would produce results which are either anomalous or undesirable or both. In any event, merely altering the "actual insurer" test would do nothing to remove the inherent inadequacy of the proportionality principle to which we have referred in paragraphs 4.5 – 4.8, above.

4.14 There is the further objection that proportionality is based on the assumption that the insured would have been willing to pay the notional higher premium that would have been charged for the increased risk. As we pointed out in our working paper,[134] the insured might have preferred to carry the risk himself rather than to pay the notional higher premium.

An ambiguity in proportionality under the proposed Directive

4.15 The formulation of the proportionality principle in the proposed Directive also involves a difficulty of ambiguity. The notional premium is that which "the policyholder should have paid if he had declared the risk correctly". It is not clear whether the notional premium is that which would have been charged if the insurer had known the facts which the insured should have disclosed, or whether it is the premium which would have been charged if the insurer had known all the material facts. For example, an applicant for householders' insurance fails to disclose (a) that he keeps flammable materials in the cellar and (b) that the house has defective foundations. At the time of proposing the contract, the applicant is aware of (a) but not of (b). Under Article 3.1 he is therefore only bound to disclose (a).[135] It is unclear whether the notional premium would take into account both (a) and (b) or only (a). The wording of the Article suggests that it should take both into account, but this result would clearly be unjust, since the insured would in effect be penalised for failing to disclose a fact of which he was not aware.[136]

4.16 In view of the foregoing difficulties we consider that proportionality is open to strong objection and ought not to be introduced into English law. We provisionally reached the same conclusion in our working paper. On consultation views were divided as to the desirability of the proportionality

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[134]W.P. No. 73, para. 56.

[135] For the relevant provision of Article 3.1, see para. 4.18, below.

[136]See paras. 4.49 and 4.50, below for a discussion of constructive knowledge and our recommendation.

principle. Although many of those who commented shared our view that proportionality was objectionable, some commentators considered that its introduction would be desirable and that we had exaggerated the practical difficulties which it would involve.[137] They pointed to contributory negligence, the principle of average, and section 84 of the Marine Insurance Act 1906, as analogous principles which the courts have been operating for many years.[138] We consider contributory negligence to be analogous not to proportionality but to a judicial discretion to reduce the insured's entitlement as the court thinks fit, which is dealt with in paragraphs 4.98–4.108, below. As for the other principles just mentioned, the principle of average involves the court in comparing the insured value with the real value and reducing the insured's entitlement accordingly. Such valuations do not present the same or similar evidential problems for the court as does proportionality. By contrast, the computation of the notional premium in the absence of applicable tariffs will seldom be straightforward, since the relevant factors will tend to be qualitative rather than quantitative in character. Lastly, section 84 of the Marine Insurance Act 1906 is concerned with a proportionate refund of the premium where it is apportionable, and the consideration for a part of the premium has totally failed. This provision will usually apply (a) where the policy in question covers two or more distinct risks and one of the risks never becomes applicable, (b) where there is over-insurance and (c) where there is double insurance. In all these cases no more than a relatively simple arithmetical calculation would be needed to show the amount due to be refunded to the insured. We therefore do not consider that section 84 affords a convincing analogy to proportionality.

4.17 Finally there is a general difficulty concerning the introduction of the proportionality principle into our law. As we have already noted in paragraph 4.7, above and as is indeed inherent in the difficulties of applying the principle in individual cases for the reasons explained in the foregoing paragraphs, the experience in Sweden and France shows that the strict arithmetical basis of proportionality becomes diffused in its practical application. What it has led to in practice, in our view inevitably, is the adoption of a system which is not based on arithmetical precision but on discretion. Because there is in practice no way of arriving at the correct notional premium, there is also no way of ensuring that the insured's recoverable claim is arithmetically reduced in the proportion of the actual premium to the notional premium. In the result, as shown by the experience in both these countries, there is a tendency for the court to award to the insured such proportion as they consider to be just in all the circum-

[137]Unfortunately at the time we issued our working paper we were not aware that the practical difficulties involved in its operation had led a Swedish Government Commission to recommend its abandonment in relation to consumer insurance and some French jurisdictions to refuse to apply it in certain circumstances.

[138]Another rule of English law claimed to be analogous to proportionality is that whereby a vendor who has misdescribed land may nonetheless obtain specific performance of the contract of sale subject to an appropriate abatement in the purchase price. In most cases where the misdescription is of, say, the acreage, the amount of the abatement will pose no practical difficulties. Where, however, the misdescription relates to the failure to disclose a restrictive covenant or a lack of planning permission this may involve the courts in a difficult task if the purchaser would not have purchased the land had he been aware of the restrictive covenant or lack of planning permission: see e.g. *Rudd* v. *Lascelles* [1900] 1 Ch. 815; *Flight* v. *Booth* (1834) 1 *Bing.* (N.C.) 370, 131 E.R. 1160.

stances. But under our system we could not escape from the rigidity of the principle in this way. If Article 3.3 (*c*) of the proposed Directive[139] were part of our law, an English court would be bound to make a finding of fact as to what the notional premium would have been, and to explain in the judgment how this amount was arrived at. In many cases it would be impossible to do so in any cogent or convincing manner. It would of course be possible to adopt a regime whereby, in the event of any non-disclosure, the court would be given a discretion to reduce the amount of the insured's claim to such extent as it considers to be reasonable in all the circumstances. We consider this possibility in paragraphs 4.98–4.108, below. But meanwhile it should be noted that a solution on these lines would not give effect to the proportionality principle of the proposed Directive.

Analysis of the remaining provisions of Article 3

General

4.18 Having singled out the proportionality principle for particular attention we must now examine the remaining provisions of Article 3 of the proposed Directive, assuming, as we feel we must for the purposes of this report, that they will have the force of law. Article 3.1 sets out the nature of the duty of disclosure resting upon an applicant for insurance. His duty is to declare "any circumstances of which he is aware which may influence the insurer's assessment or acceptance of the risk". It will be seen that this formulation differs in three respects from the duty of disclosure in English law. The first point has already been explained; the fact or facts which the applicant is required to disclose are related to the *actual* insurer's assessment or acceptance of the risk, whereas in English law an applicant is required to disclose those facts which would influence the judgment of a *prudent* insurer. The second difference is that the applicant is only required to disclose facts "of which he is aware", whereas in English law it is possible that some degree of constructive knowledge is to be attributed to an applicant for the purpose of his duty of disclosure.[140] The third difference is that an applicant must disclose facts "which *may* influence the insurer's assessment . . ." whereas in English law he is only required to disclose facts which *would* influence the judgment of a prudent insurer.[141] Thus in the result the duty of disclosure in Article 3.1 is in two respects more onerous and in one respect less onerous than the corresponding duty in English law. It is more onerous to the extent that the requirements of the actual insurer may be greater than those of a prudent insurer. In any event, it will in practice be very difficult for the insured ever to challenge successfully the insurer's evidence as to what facts he considered to be material to the risk. It is also more onerous because the facts which *may* have had an influence on the judgment of an insurer will usually be much greater in number than the facts which *would* in fact have influenced him. Lastly, it is less onerous because under Article 3.1 the insured can plead ignorance of a material fact of which he had the means of knowledge and which he ought to have known. (In any event, it seems to us that the absence of any element of constructive knowledge is to some extent inconsistent with the policy which may be considered to underlie the proportionality principle—that is, that the facts which

[139]See para. 4.4, above.
[140]See para. 4.49, below.
[141]See para. 3.5, above.

the insured has actually disclosed should be compared with all the available circumstances which are material to the risk and the insured's entitlement reduced accordingly.)

4.19 Article 3.1 then goes on to provide that the duty of disclosure does not arise with regard to facts which are already known to the insurer or which are common knowledge. This provision is the same as in English law.[142] Article 3.1 also raises a rebuttable presumption that circumstances with regard to which the insurer has asked specific questions in writing are material to the risk. This is equally unexceptionable.

4.20 There are no provisions in Article 3 designed to ensure that the insured is warned as to the existence and scope of his duties and of the consequences of any failure to comply with them. It will be seen later in this report[143] that we attach great importance to protecting the insured in this regard, particularly when he is applying for renewed cover. If the proposed Directive were to become law, it is open to doubt whether the United Kingdom would be entitled to enact legislation providing the insured with this protection, since the Commission of the European Communities has stated[144] that legislation of this type would necessarily derogate from the harmonisation of insurance contract law, the principal object of the proposed Directive, and is therefore not permissible.

4.21 Article 3.1 makes no provision as to what the insured's duty is when answering questions put to him by insurers. Article 2.1 of the fifth draft of the Directive provided that the policyholder should provide "precise and complete" answers to questions. This would have imposed upon applicants a duty with which they would often have found it difficult, if not impossible, to comply. In default of any provision the insured's exact duty in this situation must remain uncertain. Since an applicant is only bound to disclose facts "of which he is aware", it would seem that the insured is required to answer questions to the extent of his actual knowledge, but that he can plead ignorance of facts which were relevant and easily ascertainable and contend that he was not bound to disclose them. We consider that a provision which would attribute to an applicant a degree of constructive knowledge of such facts is highly desirable, particularly where his attention has been drawn by the questions to specific topics of interest to the insurer and material to the risk.

4.22 The remaining provisions of Article 3 deal almost exclusively[145] with the remedies which are available to the insurer for breach of the duty of disclosure. The Article lays down three ways in which the duty may be broken by the insured:—

(i) under Article 3.2 he may have broken it innocently;[146]

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[142]See para. 3.7, above.

[143]See paras. 4.60, 4.64, 4.77 and 4.78, below.

[144]See Explanatory Memorandum to the proposed Directive at p. 6: See para. 1.16, above.

[145]Article 3.2 also deals with the case where material facts unknown to both parties at the date of contract subsequently come to light so that no breach of duty has been committed by the insured: see para. 4.26, below.

[146]The term "innocently" is not used in Article 3 but is used here for the sake of convenience to distinguish "innocent" breaches from the other two types of breach considered in the Article.

(ii) under Article 3.3 he may have broken it and "may be considered to have acted improperly";

(iii) under Article 3.4 he may have broken it with the intention of deceiving the insurer.

The consequences of breach will be different in each case. However, the ambit of each type of breach is uncertain. We understand from the consideration of the Directive in the Working Party of the Commission of the European Communities in Brussels that it is intended that a breach of the duty under Article 3.1 will only come within Article 3.2 if it arises as a result of factors outside the control of the insured, as, for example, when the letter disclosing the facts is lost in the post. If this is correct then innocent breaches will obviously be exceptional as, presumably, will be breaches where there is an intention to deceive the insurer. Thus "improper" breaches will be by far the most usual. However, as also pointed out to us on consultation, the formulation of Article 3 is then inapt, because it suggests that innocent breaches under Article 3.2 will be the usual case and that breaches under Article 3.3 and 3.4 will be the exceptional cases.

4.23 However, if innocent breaches of the duty are not intended only to apply to the very narrow category of cases discussed above, then the extent of the category of breaches falling within Article 3.3 becomes crucial. This provision, which deals with cases where the insured who has broken his duty of disclosure "may be considered to have acted improperly" is clearly based on the concept of fault as employed in civil law systems. This concept is a feature of both German and French contract law. Clearly the fact that the concept of fault is alien to the English law of contract is not itself an argument against the concept. However, the term "improperly" holds little or no meaning for the English lawyer. Even if the word "improperly" could be equated with "negligently", it is not clear whether the phrase "may be considered to have acted improperly" has the same meaning as "has acted improperly". The ambit of this concept would therefore be uncertain and an inappropriate basis for the determination of the insured's rights. This is unfortunate because the application of proportionality depends on whether the insured, in committing the breach, "may be considered to have acted improperly".

Consequences of breach of the duty of disclosure

4.24 Since breach of the duty of disclosure in cases where the policy-holder "may be considered to have acted improperly" (under Article 3.3) is likely to be the most important type of breach of the duty under Article 3.1 it will be convenient to deal with its consequences first. These depend on whether the insurer has discovered the breach before or after the claim has been made. In the much more common situation where the insurer only discovers the non-disclosure after a claim has been made the insured's entitlement is to be reduced in accordance with the proportionality principle under Article 3.3(*c*): this has already been fully discussed.[147] In the much less common case where the insurer discovers the non-disclosure before a claim has been made, the insurer is given the option of terminating the contract or of proposing an amendment of its terms. The insurer must elect between these two remedies within two months of dis-

[147]See paras. 4.4–4.17, above.

covering the existence of the undisclosed facts. There is no restriction on the type of amendment which the insurer is entitled to propose. Thus, what is presumably envisaged is that he may propose any one or more of the following:—

(i) that the premium should be increased; or

(ii) that an additional warranty should be given; or

(iii) that the scope of the risk should be narrowed by the use of an exclusion clause; or

(iv) that some other term should be included in the contract; or

(v) that the terms on which cover was granted should be altered or that a term or terms should be deleted.

If such an amendment is proposed by the insurer, the policyholder is given 15 days within which to decide whether to accept or reject it. If he rejects the proposed amendment, or at least if he fails to accept it within the 15 day period, the insurer may terminate the contract within a period of 8 days by giving 15 days notice. If the contract is terminated the insurer is obliged to refund to the policyholder a proportionate amount of the premium corresponding to the period for which cover was not provided.

4.25 It will be seen that Article 3.3 provides for the operation of complicated procedures during the currency of the insurance contract and that strict time limits are imposed within which each step in the procedure must be carried out. However, no provision is made for the situation where the insurer does not exercise his rights after becoming aware of the breach. Presumably, if the time limit has expired without the insurer having exercised his rights he must be taken to have waived the insured's breach of duty and the contract will continue as if there had been a disclosure of all material facts. It is also necessary to consider the situation which arises if the insurer, upon discovering the breach, proposes an amendment to the contract in the erroneous belief that the breach was innocent. As will be seen he has no immediate right to terminate the contract for an innocent breach. Had he known that the insured's breach was "improper" he might have exercised his right to terminate the contract. Is he entitled, upon discovering the true nature of the insured's breach, to terminate the contract, or has he, by proposing an amendment to it, lost his right of termination? Another point is that the policyholder is only given 15 days in which to decide whether to accept or reject the proposed amendment. It seems to us that this is a very short time in which to make what may be an important decision.[148]

Innocent breach of the duty of disclosure

4.26 Again, in the case of innocent breach of the duty of disclosure the consequences of breach differ according to whether the insurer discovers the breach before or after a claim has been made. In the more common case where

[148]In the Report of a sub-committee of the Economic and Social Committee of the European Parliament it is observed: "that there is a measure of imbalance as respects the time-limits for the exercise of certain rights by the policyholder or the insurer. Insurers are granted consistently longer time-limits than policyholders. Although this disparity will not entail disadvantages for policyholders in terms of cover in the event of a claim, the Committee consider that policyholders should be given time (one month for instance) to assess amendments proposed by the insurers."

the breach is discovered after a claim has been made Article 3.2(*b*) (iii) provides that the insurers must pay the policyholder's claim in full. In the less common case where the breach is discovered before a claim has been made, the insurer is given the right to propose an amendment to the contract; he is, however, given no right at this stage to terminate it. The policyholder may accept or reject the amendment and if he rejects it or at least fails to reply within the time allowed the insurer may terminate the contract. The time limits provided for each step in this procedure are the same as those where there has been an "improper" breach of duty. The consequences with regard to the refund of premium where the contract has been terminated are also identical. It should be pointed out that the above consequences also ensue in cases where there has been no breach of duty by the insured but where material circumstances subsequently come to light which were unknown to both parties when the contract was concluded.

4.27 The procedures in cases of innocent breach and where material circumstances subsequently come to light are open to criticisms similar to those which we made in relation to "improper" breaches. There are, however, additional criticisms. If the insurer proposes an amendment which is unacceptable to the policyholder and the contract is terminated in consequence the policyholder will be deprived of cover in circumstances in which he has not been at fault and may not even have been in breach of his duty. He will then be faced with the problem of obtaining fresh cover; not only will this be most inconvenient but also, and more importantly, there may be considerable practical difficulties involved because of the importance which insurers attach to the circumstances in which an insured's previous cover was terminated. Since the insured will only receive 15 days' notice of termination, he will almost inevitably be without cover for some time after the expiry of the notice.

Breach of the duty with the intention of deceiving the insurer

4.28 If the policyholder has committed a breach of the duty of disclosure with the intention of deceiving the insurer, Article 3.4 provides that the insurer may within two months of discovering the breach terminate the contract, retain all premiums paid, collect any premiums still outstanding and will not be bound to meet any claims made. The phrase "with the intention of deceiving the insurer" seems to be narrower than fraud since it contains no element of recklessness. The procedure provided by Article 3.4 is unexceptionable save for the difficulty mentioned already in connection with "improper" breaches: the insurer, upon discovering the breach, may have proposed an amendment to the contract in the erroneous belief that the breach was either innocent or "improper"; had he been aware of the insured's intention to deceive him he would no doubt have terminated it. It is unclear whether the insurer's conduct will then preclude him from exercising the right to terminate the contract if he subsequently discovers the true nature of the breach.

Miscellaneous

4.29 Article 3.5 provides that the burden of proving that a breach was committed improperly or with the intention of deceiving the insurer rests on the insurer. No provision is made as to what standard of proof is required. Since this is a procedural matter, our view is that it will be a matter for the laws of the different Member States.

4.30 The Explanatory Memorandum states[149] that Articles 3 and 4 are not to apply to "the existence or emergence of circumstances excluded from the insurance cover, or the causes of withdrawal of cover, or where the risk has changed fundamentally."[150] The scope of this exclusion is not at all clear to us. Indeed, we are unable to understand why this provision, which relates to matters which are obviously of some importance, is dealt with in the Explanatory Memorandum and not in the text of the proposed Directive itself.

General comments on Article 3[151]

4.31 In addition to the fundamental objections to the adoption of the principle of proportionality (which we have mentioned already), our conclusion is that Article 3 is open to the following major criticisms:

(i) the formulation of the Article as regards the various ways in which the duty of disclosure may be broken is inapt and the ambit of each type of breach is not defined with sufficient precision;

(ii) the Article provides for complicated and uncertain procedures to be put into motion during the currency of the contract;

(iii) as a whole Article 3 seems likely to bring about undue and unnecessary increases in administrative expenses;

(iv) the Article is bound to lead to a great deal of litigation.

For these reasons we think that Article 3 cannot form a satisfactory basis for the reform of our law.

B. Abolition of any duty of disclosure or abolition or attenuation of the duty with respect to consumers.

Total abolition of any duty of disclosure

4.32 The second way in which the law might be reformed is by the abolition or attenuation of the duty of disclosure. In our working paper we rejected the suggestion that the duty should be abolished altogether. We pointed out that despite the radical changes since Lord Mansfield's judgment in *Carter* v. *Boehm*,[152] and in particular the widespread use today of the proposal form as a means of eliciting from the insured information relevant to the risk, insurers still often rely, at least in part, on the insured's duty of disclosure as well as on their own means of information and enquiry. No one on consultation took the view that the duty to disclose should be abolished in all cases, but many commentators considered that the duty should be abolished or, at least, attenuated, with respect to consumers. In our working paper we stated[153] that it was significant that some duty of disclosure was imposed on the insured not only by the draft Directive but also by the laws of all the common law and civil law jurisdictions which we had been able to study. As we have seen, the proposed Directive continues to subject the insured to a wide duty of disclosure, and no one on consultation drew our attention to a system of law which dispenses with any

[149]For our comments on this statement as it relates to Article 4, see para. 5.14, below.
[150]See p. 4 of the Memorandum.
[151]Articles 4–6 of the proposed Directive are dealt with in Part V, below.
[152](1766) 3 Burr. 1905, 97 E.R. 1162.
[153]See W.P. No. 73, para. 51.

such duty. We remain firmly convinced that the total abolition of any duty of disclosure would be undesirable and impractical.[154] Two examples should help to make this clear. Suppose that a prospective insured's life has been threatened. If there were no duty of disclosure he could then apply for life insurance, knowing this fact and knowing it to be material, and could say nothing about it unless he was asked, which would be unlikely to be the case. Again, a threat may have been made to burn down his premises. In the absence of any duty of disclosure the insured could apply for a fire policy on his premises without revealing the threat unless he was asked. In both cases it is clear that insurers must be told about the threats, and in both cases it would be unreasonable to expect them to ask the appropriate questions. Such undesirable results could only be avoided by compelling the use of long questionnaires in relation to all types of cover.[155] It was made clear to us on consultation, and seems self-evident, that such a requirement would add substantially to administrative expenses and that it would interfere with normal and reasonable underwriting practice.

4.33 It was represented to us forcefully on consultation by representatives of the insurance industry that abolition of the duty of disclosure would mean that insurers would be unable to assess risks accurately and would accordingly be unable to differentiate in their premiums between good and bad quality risks. As we suggested in our working paper,[156] the general body of honest and reasonable policyholders would then have to pay higher premiums to compensate for "sharp practice" on the part of the few. It was also pointed out to us that the British insurance industry would then be unable to quote premiums that were competitive in the international market. We accept the force of those contentions. Whether they have the same force in relation to proposals to *attenuate* the duty of disclosure is another matter to which consideration is given below.[157] We therefore *recommend* against total abolition of the duty of disclosure.

Abolition of the duty with respect to consumers

4.34 Having rejected the suggestion that the duty of disclosure should be totally abolished we must now consider the proposal, which was advanced by some of those who commented on our working paper, that it should be abolished with respect to consumers. These commentators urged that consumers as a group should be treated differently from commercial undertakings. In particular, it was suggested that consumers should be under no duty to volunteer material information to insurers and that if insurers wanted such information they should ask for it. In the paragraphs which follow we shall adapt the definition of "consumer" used in section 12 of the Unfair Contract Terms Act 1977 in the case of contracts other than contracts for sale or hire-purchase: we intend "consumer" to mean a person who neither makes the contract in the course of a business nor holds himself out as doing so. Thus, a shopkeeper living in a

[154]For a more detailed account of the reasons for our rejection of a complete abolition, see W.P. No. 73, paras. 44–49.

[155]In our working paper we pointed out that underwriters do not use proposal forms in respect of many types of commercial risks: see W.P. No. 73, paras. 44–49.

[156]See W.P. No. 73, para. 49.

[157]See paras. 4.43–4.45, below.

flat above his shop would insure his shop and its contents as a businessman but his flat and its contents as a consumer.

4.35 In our working paper we rejected any distinction between consumers and non-consumers on the ground that the arguments in regard to "sharp practice" against the total abolition of the duty of disclosure apply equally to the proposal that it be abolished with regard to consumers only.[158] For example, in the absence of any duty of disclosure the insured could apply for cover on his premises without revealing that a threat had been made to burn them down. This result would be unacceptable even if the prospective insured were a consumer applying for insurance on his house.

4.36 The basis for any differentiation between consumers and non-consumers must be that the more lenient treatment of a particular category is justified because that category is in need of special protection. As explained in our working paper,[159] there are certain mischiefs in the law of non-disclosure which apply equally whether the insured is a consumer or a businessman who is not constantly concerned in his business activities with the insurance market.[160] Neither consumers nor ordinary businessmen who are not in the insurance market have the knowledge or experience to identify all facts which may be material to insurers. Both are therefore to this extent in need of protection and both may properly be regarded as consumers vis-à-vis insurers.

4.37 It may also be contended that it is unfair to consumers to subject them to a duty of disclosure since they may be totally unaware of the duty or of the consequences of breach of the duty. However, many small businesses are equally unlikely to be aware of the niceties of insurance law when applying for insurance. Similarly, consumers are on the whole considered less likely than businessmen to take advice—for example, from insurance brokers—which might reveal the existence and extent of the duty. But the well-off or cautious consumer may as a matter of course seek the advice of an insurance broker when in need of cover, while the small businessman may not. It is however impracticable to draw a line between those who consult brokers and those who do not. This is not to say that a person's need for protection may not depend on his situation and the circumstances in which he enters into the contract. For example, if a large business corporation enters into a contract for the supply of goods or services it will usually appreciate the nature and consequences of the transaction far better than a small business or a private individual. Thus there may well be a sensible dividing-line between those insured who are in need of special protection and those who are not, but in

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[158] W.P. No. 73, para. 50.

[159] W.P. No. 73, paras. 38–41.

[160] It is relevant to note that many of the cases cited in Part III under the heading "Defects in the present law as to non-disclosure" are cases where the insured was acting in the course of a business. It is also worth pointing out that though the Unfair Contract Terms Act 1977 is generally thought to be an Act for the protection of consumers, s. 2 of that Act (exclusion or restriction of liability for negligence) does not distinguish between consumers and others, and s. 3 (exclusion or restriction of liability for breach of contract) treats alike consumers and businessmen dealing on other businessmen's written standard terms of business. These sections reflected the Law Commission's view that businesses are in need of protection against exemption clauses in the same way as consumers: See *Second Report on Exemption Clauses* (Law Com. No. 69; Scot. Law Com. No. 39) (1975).

our view this dividing line should be between "professionals" and "non-professionals". The exclusion of MAT insurance from the scope of our recommendations[161] reflects this distinction.

4.38 Furthermore, if a special regime were devised for consumers, there would be three categories of insured to each of which different rules would apply. Those insured against MAT risks would be excluded from the scope of our recommendations and would be regulated by the present law; non-consumers would be subjected to a modified duty of disclosure, and consumers would be exempted from any duty. This multiplication of legal categories would clearly be complex and undesirable.

4.39 A further reason against differentiating between consumers and non-consumers is connected with the fact that the vast majority of consumer insurance is written on the basis of proposal forms. As we point out below,[162] the present law in relation to proposal forms is defective in certain respects. In particular, we think it likely that many applicants, regardless of whether they are consumers or businessmen, who have completed a proposal form may erroneously believe that they are under no duty to disclose further information, and in our view such a belief will usually be perfectly reasonable. For this reason we have made detailed recommendations in this report in order to protect applicants for insurance who complete such forms.[163] These recommendations are in effect measures of consumer protection. But the use of proposal forms and the mischiefs associated with them are not confined to consumer insurance; to this extent our recommendations also protect businessmen, and in our view it is right that they should do so.[164]

4.40 Finally, if the duty of disclosure were to be wholly abolished for consumers, the granting of provisional insurance cover prior to the completion of a proposal form would give rise to difficulties. This type of cover is often granted to consumers.[165] For example, insurance cover for motor vehicles is often granted over the telephone by a broker and a cover note is then issued. Similarly, house insurance cover is often granted over the telephone where the insured has just exchanged contracts for the purchase of a property. In the absence of any duty it would be open to a prospective insured to conceal any information which he knew to be material but which was unusual in its nature, so that the insurer or broker could not reasonably be expected to ask about it over the telephone. As we pointed out in our working paper,[166] while insurers might not withdraw facilities for such cover they might well increase premiums, and might also insert a greater number of conditions and exceptions into their policies to narrow the scope of the risk covered.

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[161]See paras. 2.8–2.16, above.

[162]See paras. 4.56 and 4.61–4.63, below.

[163]See paras. 4.54–4.68, below.

[164]Proposal forms are used in regard to many commercial risks where the insurer wishes to obtain detailed information by asking searching questions.

[165]Some consumer insurance is granted without a proposal form ever being issued: there seem to be few types of such insurance and the only examples we have been able to discover are "householders" policies entered into through Building Societies and package holiday cancellation insurance. As regards the former there is a defect in the present law which is dealt with in para. 4.68, below.

[166]W.P. No. 73, para. 49.

Attenuation of the duty of disclosure with respect to consumers

4.41 It was suggested to us that in relation to cover obtained by consumers, insurers should not be entitled to repudiate a policy unless the non-disclosure was fraudulent. We think that it would only be in exceptional cases that an insurer would be able to discharge the onus of proving that an applicant for insurance omitted to volunteer a material fact with the intention of deceiving him.[167] Even where there has been a misstatement in the proposal form the onus of proving fraud is difficult to discharge. We think that such an attenuation would be unacceptable. Like the proposal to abolish any duty of disclosure with respect to consumers, it would create three categories of policy holders to each of which different rules would apply, with resultant multiplicity of legal categories and undesirable complexity. In any event, as a matter of underwriting practice insurers must be able to rely upon a prospective insured to disclose those material facts which a reasonable man would in all the circumstances disclose to them: the duty merely not to act fraudulently would be virtually useless to them as a means of assessing the risk.

4.42 In the result it seems to us that any separate regime for consumers and non-consumers would lead to anomalous results in practice. This can again be illustrated by a shopkeeper who lives above his shop. He applies for fire and burglary cover in respect of both his shop and his flat at the same time: the former application would be made in the course of a business, but the latter would not. It would be odd, to say the least, if the resulting contracts were subject to different vitiating factors. We are persuaded by all these cumulative considerations that there should be no special category of consumer insurance to which more lenient rules should apply, and we are reinforced in this conclusion by the attenuation of the general duty of disclosure which we recommend in the following paragraphs in relation to all insurance (other than MAT).

C. Reform of the duty of disclosure

Introduction

4.43 Earlier in this report[168] we pointed out that the duty of disclosure imposed on a prospective insured by the present law is inherently unreasonable, because it requires him to identify all the facts which would influence a prudent insurer in accepting the risk and fixing the premium. Most insured, whether consumers or businessmen, do not have the knowledge or experience required to identify such facts. A consequence of the present law is therefore that an applicant for insurance may still be in breach of his duty of disclosure despite having disclosed all those facts which an honest and reasonable man would have disclosed, with the result that the insurer is entitled to repudiate his policy. It seems to us that insurers should only be entitled to invoke this drastic remedy if the insured has conducted himself dishonestly or unreasonably. We therefore recommend that, although the duty to disclose material facts should remain, the standard of disclosure should be modified.

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[166]W.P. No. 73, para. 49.

[167]The rule seems to be that silence amounts to fraud only if a man who is *under a legal duty to speak* deliberately holds his tongue with the intention of inducing the other party to believe that he did not speak because he had nothing to say: see *Winfield & Jolowicz on Tort* (11th ed., 1979), p. 248.

[168]See paras. 3.18–3.19, above.

4.44 In 1957 the Law Reform Committee reported[169] that if it were decided, as a matter of policy, that the law of disclosure should be reformed, then the following provision could be introduced into the law[170] without giving rise to legal difficulties:

> "that for the purpose of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured".

In *Lambert* v. *Co-operative Insurance Society Ltd.*[171]—a case in which the "prudent insurer" test for materiality was re-affirmed—the Court of Appeal expressed regret that a provision along these lines had not been enacted.[172]

4.45. Virtually none of the commentators on our working paper who were unconnected with the insurance industry considered that the duty of disclosure under the present law was acceptable. Indeed, some modification of the duty was considered necessary even within the industry itself, although some of these commentators would have confined such modification to consumers only. As we have pointed out above[173] the contention of some of those representing the industry that no reform is necessary because of adherence by insurers to the Statements of Insurance Practice is in our view untenable. We have accordingly concluded that the duty of disclosure should be modified along the lines suggested by the Law Reform Committee.

Our proposals in outline

4.46 In the following paragraphs we set out our recommendations for reform of the law of disclosure. First, we recommend modifications to the duty of disclosure with a view to removing its inherent unreasonableness to which we have already referred and in order to clarify certain aspects of the present law. Secondly, we deal with the case where the insured fulfils his duty of disclosure by answering the questions in a proposal form. The proposal form is in widespread use in relation to many types of consumer insurance and its use raises problems which require specific treatment. Thirdly, we deal with the duty of disclosure on applications for renewal of an existing insurance policy which again raises problems requiring specific treatment. In all three cases our concern has been to extend to the insured the protection which he needs, but at the same time to strike a fair balance between the interests of insurers and insured and in particular not unduly to interfere with underwriting practice.

The duty of disclosure

4.47 We recommend that the duty of disclosure imposed on an applicant for insurance should be modified as follows. A fact should be disclosed to the insurers by an applicant if:—

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[169](1957) Cmnd. 62, para. 14.

[170]Other than the law relating to marine insurance which the Committee excluded from their consideration: See (1957) Cmnd. 62, para. 3.

[171][1975] 2 Lloyd's Rep. 485.

[172]*Ibid.*, at pp. 491–493.

[173]See paras. 3.27–3.30, above.

(i) it is material to the risk;

(ii) it is either known to the applicant or is one which he can be assumed to know;

(iii) it is one which a reasonable man in the position of the applicant would disclose to his insurers, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought.

It will be seen that this formulation departs somewhat from that put forward in our working paper.[174] In the following paragraphs we will elaborate the elements of the modified duty of disclosure.

A fact which is material to the risk

4.48 A fact must be material to the risk before there can be any question of a duty to disclose it to the insurers. We propose that the definition of a material fact should remain substantially the same as in the present law.[175] Thus a fact should be considered as material if it would influence a prudent insurer in deciding whether to offer cover against the proposed risk and, if so, at what premium and on what terms.[176] This definition amplifies the present one, which only refers to the prudent insurer's decision to accept the risk and to his premium-rating of the risk. Insurers may however react to the disclosure of material facts otherwise than by refusing the risk or altering the premium: they might, for example, insert additional warranties, increase the "excess", or narrow the scope of the risk by exclusion clauses. The revised definition takes these additional factors into account by referring to terms other than the premium upon which the insurers would be prepared to offer cover.[177]

A fact which is known to the proposer or which he can be assumed to know

4.49 No duty to disclose a material fact will arise unless that fact is known to the proposer or can be assumed to be known by him. The present law is uncertain as to whether the duty of disclosure extends beyond facts actually known by the insured, and in our view is in need of clarification. In marine insurance the rule is that, for the purpose of his duty of disclosure, the insured is to be treated as knowing facts if he ought to have known them in the ordinary course of business.[178] It has not been clearly settled whether or to what extent this rule applies to non-marine insurance, but in life insurance cases there are *dicta*[179] which suggest that the insured is only bound to disclose facts within his actual knowledge. Moreover, the words "in the ordinary course of business"

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[174]W.P. No. 73, paras. 60–61.

[175]Which is reflected in the Marine Insurance Act 1906, s. 18 (2): see para. 3.3, above.

[176]See the Road Traffic Act 1972, s. 149 (5) (6) for a definition of materiality which is along the same lines.

[177]It is clear from the language used by the courts that when considering whether facts are material they have regard to whether they would have influenced a prudent insurer in fixing the terms of cover since these terms are ultimately reflected in the premium charged.

[178]The Marine Insurance Act 1906, s. 18 (1).

[179]e.g. in *Joel* v. *Law Union and Crown* [1908] 2 K.B. 863, 884 *per* Fletcher Moulton L.J.

are inappropriate to cover private individuals who obtain insurance otherwise than in the course of business. In one fairly recent case,[180] the extent of the duty in non-marine insurances was left open. We do not consider that it would be acceptable for the insured to be required to disclose all material facts without regard to whether such facts were known or ought to have been known by him, since an insurer would then be entitled to repudiate the contract for the non-disclosure of a fact outside the insured's knowledge or means of knowledge. Equally it seemed to us in the working paper[181] that it would not be acceptable for the insured to be able to say that he has complied with his duty of disclosure if he did not actually know a fact even when that fact was obviously relevant and easily ascertainable by him. On consultation few commentators referred specifically to the question of constructive knowledge and opinion was divided amongst those who did.

4.50 In our view an insured should not be entitled to say that he did not know facts which were obviously relevant and easily ascertainable by him.[182] However, the insured should clearly not be obliged to mount elaborate investigations within the whole spectrum of material facts. What we recommend is that he should be assumed to know a material fact if it would have been ascertainable by reasonable enquiry and if a reasonable man applying for the insurance in question would have ascertained it.[183]

A fact which a reasonable man in the position of the proposer would disclose to the insurer, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought.

4.51 Even if a fact is material to the risk and is known to the proposer or can be assumed to be known by him he will only be obliged to disclose it to the insurers if a reasonable man in his position would disclose it. The words "in the position of the proposer" would allow the courts to have regard to the knowledge and experience to be expected of a reasonable person in the position of the applicant. Thus, more would be expected of the large company with an insurance division than of the small shopkeeper. On the other hand, we would not wish the court to take account of the individual applicant's idiosyncrasies, ignorance, stupidity or illiteracy in determining whether a reasonable man in his position would disclose a known material fact. Our formulation would only direct the court's attention to the nature and extent of the insurance cover which is sought and to the circumstances in which it is sought. Thus, a reasonable man applying for life insurance would not disclose facts relevant to his house or his car.

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[180] *Australia and New Zealand Bank* v. *Colonial and Eagle Wharves Ltd., Boag (Third Party)* [1960] 2 Lloyd's Rep. 241, 252 *per* McNair J.

[181] See W.P. No. 73, para. 64.

[182] We deal with the constructive knowledge of material facts to be attributed to an insured who is answering questions in a proposal form below at para. 4.61.

[183] In our working paper (at paras. 63–64) we provisionally recommended that there should be a requirement of constructive knowledge and our formulation of this requirement included the phrase "reasonable man in his circumstances". The use of this phrase was widely criticised on consultation, on the ground that it would be undesirable if the court were to have regard to the individual applicant's idiosyncrasies. We also used this phrase in the working paper in relation to the extent of the duty of disclosure where there was no proposal form. We agree with the criticisms of the phrase and have used instead a phrase which we consider will be sufficiently flexible without allowing the court to have regard to the individual applicant's idiosyncrasies.

Equally, a reasonable man applying for householder's cover would not disclose facts relevant to his health. The court would also have regard to whether the cover applied for was only provisional or temporary, since a reasonable man would not necessarily disclose the full spectrum of known material facts when applying for merely temporary cover. In addition, the extent or magnitude of the proposed risk would be relevant. Thus more would be expected of a businessman applying for insurance on a factory full of machinery than would be expected from a householder insuring his house and its contents.

4.52 Our formulation would also concentrate the court's attention on the circumstances in which insurance cover was sought. Thus a reasonable man applying for insurance over the telephone might well address his mind to the disclosure of material facts to a different extent than if he were making a written proposal for insurance. Equally, in negotiating the cover the insurers may have given the insured the impression that on certain aspects material facts need not be disclosed in full or at all; in such cases the insured may assume that they are waiving disclosure of matters concerning which they appear to be indifferent or uninterested. For example, if insurers ask "Have you had any illnesses in the past five years?" it would be reasonable for the insured to assume that his insurers are not interested in an illness suffered six years ago. Another example of a case where waiver could be inferred is provided by "coupon" insurance. This type of insurance can be obtained either by inserting the required amount of money into a machine, as happens mainly at airports, or by completing a very simple application form which asks only for the name, address and occupation of the applicant. The "coupon" itself is a document which may either itself be a contract of insurance or an undertaking to issue a policy. In such cases there would seem to be no duty of disclosure, since the applicant is unlikely to have any occasion to disclose anything. By making an offer to the public which is capable of being accepted by anyone, the insurers in such cases in effect indicate that they are willing to insure anyone regardless of his antecedents or characteristics. Another example is provided by the issue of immediate or interim cover, usually in connection with motor vehicles. It is usual in such cases for insurers to require an applicant to complete a proposal form at a later stage, and a reasonable applicant might therefore assume that the insurers were at this stage not interested in the disclosure of material facts which would be relevant only to the premium-rating and not to the question whether the risk should be accepted. In all such cases the position is that the insurers have adopted a procedure whereby cover is applied for and granted in such a way that a waiver as to the disclosure of material facts may be inferred. Under our recommendations all such matters could be taken into account by the courts in determining whether or not there had been a material non-disclosure.

4.53 Since we are not recommending that the remedy for non-disclosure should be altered, it follows from the formulation in paragraph 4.47 above that an insured would only be deprived of cover if he had acted unreasonably. We therefore feel confident that if facts such as those in *Lambert's* case[184] were to come before the courts on the basis of the modified duty of disclosure recom-

[184][1975] 2 Lloyd's Rep. 485. See para. 3.19, above.

mended in this report the decision would be in the insured's favour. This formulation would therefore remove one of the major mischiefs in the present law, and in our view it is both in accordance with commonsense and fair to both parties.

Proposal forms

Introduction

4.54 We now turn to consider the problems concerning the duty of disclosure which arise in contracts of insurance which are initiated by the completion by the insured of a proposal form, i.e. a document containing questions which the proposer is required to answer in writing. We discussed these problems in the working paper and made a number of provisional recommendations.[185] One of the matters suggested to us on consultation by some commentators from the insurance industry was that it would be undesirable to make any specific recommendations for cases in which proposal forms are used because it might be difficult to identify such cases. Thus, it was suggested that many documents might be exchanged between the insurer and the insured during the negotiations leading up to the contract and that it might be difficult to determine whether any of them (or some of them cumulatively) constituted a proposal form. However, in our view such fears are unfounded. Proposal forms are used by insurers in large numbers of cases, particularly in relation to the vast majority of consumer insurances, and also in relation to many other risks. In our view there is no real difficulty in identifying proposal forms or contracts of insurance which have been initiated by the completion of a proposal form.[186] We also consider that special provisions concerning proposal forms are required for the protection of the insured and we deal with these in the following paragraphs.[187] Before leaving this topic there is one further matter with which we must deal. In our working paper[188] we attempted to provide an exhaustive definition of a proposal form. On consultation this attempted definition was criticised on the ground that many documents might come into existence during the negotiations for insurance and that any definitions might cause difficulty in such circumstances. On reconsideration, we have concluded that it is neither necessary nor desirable to provide an exhaustive statutory definition of a proposal form.

4.55 There is one minor matter concerning proposal forms to be noted in passing before dealing with them in detail. While the insured is usually required to complete a proposal form by supplying answers to questions, he may also be required to supply information by indicating his assent to a list of prepared answers by means of a tick or other symbol, or simply by deleting a question or

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[185]See W.P. No. 73, paras. 65–77.

[186]We make a special recommendation in para. 4.68 below, whereby applications for insurance in connection with applications for mortgages, such as to Building Societies and banks, are also to be treated as proposal forms and are to be subject to the same recommendations.

[187]Problems concerning the duty of disclosure also arise when cover is renewed. whether or not proposal forms were initially completed; we deal with these separately in paras. 4.69–4.81, below.

[188]W.P. No. 73, para. 71.

otherwise indicating that it is not applicable. We shall for convenience refer to all such provisions in a proposal form as questions, since this is their real effect.[189]

The duty of disclosure in relation to proposal forms

4.56 A major criticism of the present law, as we have already noted in paragraph 3.20, above, is that an insured may well be unaware that he is under a residual duty to disclose material facts to the insurer when he has answered a series of specific questions in a proposal form, because these could naturally lead him to believe that the questions cover all matters about which the insurer is concerned to be informed. Indeed, the very fact that specific questions are invariably asked in proposal forms, which is their essential purpose, may have the effect of creating a trap for the insured under the present law. We have no doubt that this is a mischief which requires reform for the protection of the insured.

4.57 In the working paper we made the provisional recommendation[190] that this protection should be provided by confining insurers to the answers to specific questions asked in proposal forms and that they should be treated as having waived the disclosure of any information to which no specific question had been directed. Consequentially to this, we also provisionally recommended[191] that no general questions in addition to specific questions should be permitted, such as a question whether there were any other facts which might influence the judgment of a prudent insurer in accepting the risk and fixing the premium. The effect of these recommendations would be to confine insurers to specific questions in all cases in which proposal forms are used and to abolish any residual duty on the insured beyond answering the questions. We have given careful further thought to the desirability of resolving the problem by a recommendation which would have this effect, which at first sight is clearly one which appears attractive. However, in the light of the comments received on consultation from the insurance industry, and for other reasons explained in the following paragraphs, we have concluded that despite its attractions this solution would not be the right one and that the necessary protection for the insured can and should be provided by other means.

4.58 In the comments received on consultation our provisional recommendations were criticised on the ground that the purpose of proposal forms was to elicit information of a standard nature and not to circumscribe the nature of the risk in all respects. It was pointed out that the effect of our provisional recommendations would be that proposal forms would inevitably have to become far more lengthy, detailed and complex than at present and, further, that proposers might well be aware of facts which any reasonable person would realise should be disclosed but about which insurers could not reasonably be expected to ask specific questions. We accept these criticisms. For instance a person might take out product liability insurance when it appears to him that his quality control is inadequate but he does not know the reason, or a businessman might effect some special fire cover on his premises when he has reason to

[189]An applicant for insurance is also frequently required to declare that his statements are to form the "basis of the contract" and to warrant their truth. We DISCUSS "basis of the contract" clauses in Part VII of this report.

[190]W.P. No. 73, para. 66.

[191]*Ibid.*, paras. 72 and 74.

believe that they might be burned down. Such cases could not possibly be expected to be covered by specific questions in proposal forms. They would of course be covered by a general question, such as we have instanced above, which is indeed commonly included as normal underwriting practice in many kinds of proposal forms at present. The effect of a general question of this kind is that the insured is placed under a residual duty to volunteer further information, though with the advantage of having had his attention drawn specifically to this duty. On further consideration we see no reason to outlaw such general questions; indeed, it seems to us that they can be said to fulfil a useful purpose, and that they may indeed be essential in many cases. This is the first reason why we consider that it would be impracticable to confine the duty of the insured in relation to proposal forms simply to supplying answers to specific questions and thus to eliminate any residual duty of disclosure.

4.59 The second crucial matter to bear in mind on the question whether it would be right to abolish any residual duty of disclosure in cases where proposal forms are completed is that the effect of the recommendations which we have already made[192] is to reduce the level of the duty of disclosure to that of the reasonable insured in all cases (other than MAT insurances),[193] whether proposal forms are used or not. It follows that under our recommendations no insured will have been in breach of his duty of disclosure in any event unless *ex hypothesi* he has fallen below this standard.[194] The effect of this recommendation is therefore that it also greatly reduces the remaining problems concerning non-disclosure in cases of proposal forms. Nevertheless, there still remains the problem that in cases of proposal forms, particularly where no general question is asked in addition to specific questions, a proposer is likely to be unaware that he may be under a further residual duty to volunteer additional material information. It may well be, of course, that in the absence of a general question the courts might hold in the particular circumstances of some cases that a proposer could reasonably assume that he was under no further duty beyond answering the specific questions; on this basis the effect of our recommendations will be that in such cases he will have discharged his duty of disclosure by answering the questions. However, we do not think that this is sufficient; in our view the interests of both parties require that various matters concerning the insured's obligations when he completes a proposal form should be drawn specifically and explicitly to his attention.

4.60 In our view the solution to the foregoing problem lies in the requirement that all proposal forms should contain certain clear and explicit warnings to the insured, presented in a prominent manner, together with appropriate sanctions wherever such warnings have not been given.[195] In many cases

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[192]See paras. 4.47 to 4.53, above.

[193]See paras. 2.8 to 2.16, above.

[194]Or of course if he has acted fraudulently: see paras. 8.8 and 8.9, below.

[195]We have considered as an alternative that the insured should be under a duty to do no more than answer the questions in a proposal form, including a general question. Thus if a general question is not asked there will be no residual duty of disclosure and if a general question is asked the answer to it will "trigger off" the new duty of disclosure. This alternative gives rise to great complexity especially with regard to the legal consequences of a general question and to the duty of disclosure on renewal in cases where a general question was not asked in the proposal form. We have therefore rejected this alternative.

proposal forms already contain some warnings of the kind which we have in mind, and we see no administrative or other difficulties in requiring them to be included as a matter of law and providing for appropriate legal consequences if they are omitted. However, before dealing with these matters at greater length we must deal with two further topics; the standard which should be required from an insured in answering questions in proposal forms, and the necessity to supply to the insured a copy of his completed proposal form for future reference, particularly in relation to renewals of the cover.

Standard of answers to questions in proposal forms

4.61 We turn first to the standard which should be required from an insured in answering specific questions in a proposal form. In our working paper[196] we pointed out that it followed from the principle of utmost good faith on the part of the insured that he should *prima facie* only be considered to have discharged his duty of disclosure if he had answered the questions in the proposal forms completely and accurately. However, we added the qualification that it would not be reasonable to expect an applicant always to give an objectively accurate answer to a question. We accordingly added that if he could prove that he had answered a material question to the best of his knowledge and belief, having carried out all those enquiries which a reasonable man in his circumstances would have carried out, he should be considered to have discharged his duty of disclosure notwithstanding that the answer was in fact inaccurate. On consultation this proposal attracted some criticism because the words "in his circumstances" were considered to import a subjective element into the nature of the enquiries which an individual applicant could be expected to make. As already mentioned[197] we consider this criticism to be well-founded. We therefore *recommend* that an applicant for insurance should be considered to have discharged his duty of disclosure in relation to the answers to specific questions if, after making such enquiries as are reasonable having regard both to the subject-matter of the question and to the nature and extent of the cover which is sought, he answers the questions to the best of his knowledge and belief. This formulation would allow the court to take account of the particular topic raised by a specific question when assessing what enquiries ought to have been made into that topic. Further, the nature of the topic itself would be relevant. Thus, enquiries as to the materials of which a factory roof is constructed would obviously need to be more extensive than those concerning the cubic capacity of the engine of a motor vehicle. Equally, it would clearly be reasonable to expect enquiries to be substantially more thorough if the cover applied for was on a factory worth several million pounds than if the subject-matter of the insurance was a house. If it can be established by reference to this standard that the insured has discharged his duty of disclosure, then it would not matter if his answer turns out in fact to have been inaccurate. This recommendation is along lines similar to those suggested by the Law Reform Committee in their Fifth Report, in which the Committee formulated the following rule which in their view could be introduced into the law without difficulty: "that, notwithstanding anything contained or incorporated in a contract of insurance, no defence to a claim thereunder should be maintainable by reason of any

[196]W.P. No. 73, paras. 67–70.
[197]See note 183, above.

mis-statement of fact by the insured, where the insured can prove that the statement was true to the best of his knowledge and belief".[198]

4.62 In the foregoing paragraph we dealt with the standard required from an insured when answering specific questions in a proposal form. To complete this aspect it remains to mention the standard which is to be required from him when he answers a general question at the end, such as whether there are any other facts which might influence the judgment of a prudent insurer in accepting the risk and fixing the premium.[199] We think that the standard required from the insured in answering such questions in proposal forms should be assimilated in all respects with our basic recommendation concerning the reduced standard required from proposers in relation to their general duty of disclosure: viz. they are under no higher duty than to disclose material facts which they know or are to be assumed to know and which would be disclosed by a reasonable person in the position of the proposer, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought.[200] Thus, for the avoidance of doubt we propose that the legislation which we recommend should also expressly provide that all general questions in proposal forms shall be construed as seeking no further information from the proposer than such information as he would be bound to disclose by virtue of the reduced duty of disclosure referred to above.[201] We *recommend* accordingly.

Copies of proposal forms to be supplied to insured

4.63 Next we turn to a problem which is of particular significance when an insured is attempting to fulfil his duty of disclosure on renewal of his insurance.[202] It was forcefully represented to us on consultation that the insured will often no longer remember the information which he supplied to the insurers on his initial application and on subsequent renewals (if any), unless he is at least able to refer to a copy of his proposal form. In our view, insurers should be required to supply the insured with a copy of his completed proposal form. Insurers should be able to comply with this requirement by providing a carbon copy with the original proposal form which can be torn off and retained by the insured after completion. If a tear-off carbon copy is not supplied, then insurers should be obliged to send a copy of the proposal form to the insured as soon after he has submitted the original form as is practicable in the circumstances.[203] In addition, the proposal form should warn the proposer of the importance of keeping a copy of the proposal form as supplied to him. Further, in some cases there may be further communications between the insurer and the insured after the proposal form has been filled in, in the course of which the insured may supply further written information to the insurer, either in

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[198]See (1957) Cmnd. 62, para. 14.

[199]We have already given our reasons why we consider that it would be wrong to preclude insurers from asking such questions: see para. 4.58, above.

[200]See paras. 4.47–4.53, below.

[201]We make the same recommendations in relation to general questions in renewal notices and in relation to further written questions concerning matters arising out of proposal forms and renewal notices: see paras. 4.73 and 4.82, below.

[202]See para. 4.69–4.72, below.

[203]Indeed we understand that it is the present practice of some insurers to supply tear-off carbon copies to the insured and of other insurers to supply photocopies.

amplification of an answer given or in regard to a matter not canvassed specifically in the proposal form. The insured should clearly also be able to refer to these matters on renewal, and we again consider that he should be warned of the importance of keeping copies for future reference of the information which he has supplied.

Warnings to be included in proposal forms

4.64 We have already explained[204] that in our view all proposal forms should contain certain warnings to the insured and that these should be presented in a prominent manner. We can now summarise the warnings which we *recommend* should be required to be included in all proposal forms in this manner. These should warn the insured:—

(i) that he must answer all questions to the best of his knowledge and belief, after making such enquiries as are reasonable in the circumstances;

(ii) that in relation to any matter which is not the subject of a question in the proposal form, he must disclose any matter which he knows or could ascertain by reasonable enquiry and which might reasonably be considered to influence the judgment of a prudent insurer in deciding whether or on what terms to provide the cover which is sought;

(iii) of the consequences to the insured of a failure to fulfil the obligations referred to in (i) and (ii) above, i.e. of the insurer's right to repudiate the policy and to reject any claim which may have arisen; [205] and

(iv) of the importance to the insured of keeping the copy of the completed proposal form which will have been supplied to him under our recommendations and of any additional information which he may give to the insurers.

Sanctions if any of the requirements concerning proposal forms are not complied with

4.65 We have already mentioned[206] that it is clearly necessary to provide sanctions against insurers in cases in which any of the prescribed warnings are omitted or are not presented in a prominent manner.[207] Similarly, sanctions will clearly also be necessary if an insurer fails to comply with the obligations which we have recommended[208] to supply to the insured a copy of the completed proposal form. We therefore turn to this aspect.

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[204]See para. 4.60, above.

[205]See para. 3.9, above.

[206]See para. 4.60, above.

[207]Later on in this report we make certain recommendations to the effect that, if necessary, the Secretary of State may make orders regulating the matters to be included in proposal forms as well as renewal notices, either generally or in relation to certain types of insurances: see paras. 4.85–4.87, below. For the present, however, we are proceeding on the basis that insurers will comply with our recommendations without any need for administrative regulations.

[208]See para. 4.63, above.

4.66 Since we foresee no real difficulties for insurers in complying with the foregoing recommendations, which are in any event already widely adopted so far as concerns warnings about the duty of disclosure and the standard for answering questions in proposal forms, we consider that there should be a clear and substantial sanction for cases in which there is a failure to comply with these requirements. They are all directed to seeking to assist the proposer to discharge his obligation to disclose material facts to the insurer, whether by answering questions in proposal forms or by complying with any residual duty of disclosure which might still subsist. In these circumstances we consider that the appropriate sanction is that if there is a failure to comply with any of these requirements the insurer shall not be entitled to rely on any failure by the insured to disclose any material fact, and we so *recommend.*

4.67 However, there may be cases in which the stringency of this sanction would be inappropriate because it may be quite clear that some trivial failure on the part of the insurer will not have caused any prejudice to the insured in relation to any failure of disclosure on his part. For instance, the insurer may have failed to provide the insured with a copy of the proposal form, but the insured may have kept his own copy. Alternatively, although the absence of the warnings concerning the duty of disclosure and of answering questions in the manner required, as well as of the consequences of non-compliance by the insured with his duty of disclosure,[209] is in virtually all cases likely to lead to the conclusion that the insured was thereby prejudiced, there might also be rare cases, particularly in commercial insurance, where this would not be so. For instance, a particular proposal form covering an important particular risk may have been settled in negotiations between the insurer and the proposer, perhaps with the assistance of a broker or even with lawyers, and one or more of the required warnings may have been accidentally omitted from the final form, even though the original form may have contained them or there may have been specific discussions about the insured's duty in relation to the completion of the form so as to make him fully aware of his obligations and of the consequences of any breach on his part. In such cases it may be quite clear that the non-disclosure of some material fact has had no connection with some particular failure on the part of the insurer to comply with the requirements. We think that some additional provision should be made for exceptional cases of this kind. We accordingly *recommend* that where there has been a failure by the insured to disclose a material fact in circumstances in which the court is satisfied that a failure on the part of the insurer to comply with the requirements did not cause any prejudice to the insured with regard to his obligation to disclose such fact, then the court may give leave to the insurer to rely on the non-disclosure in question.

Applications for insurance in connection with mortgages

4.68 On consultation our attention was drawn to a problem which arises when a prospective insured applies for cover on a house through a Building Society. Often a prospective purchaser applies to a Building Society for an advance on the basis of a form which states that the house will be insured by the Society but, apart from a request to state the amount for which the house is to be insured, the applicant is not asked to give any information for the purpose of

[209] See (i), (ii) and (iii) in para. 4.64, above.

the insurance. In a recent case[210] an applicant for this type of cover failed to volunteer the fact that he had certain previous convictions by way of disclosure to the Building Society when he completed the form of application for the advance. The insured had not been asked any questions relating to his moral character and insisted that if he had been so asked he would have given a truthful answer. Nonetheless it was held that the insurance company could repudiate the policy for non-disclosure. This is an undoubted mischief in the present law, and it is aggravated by the fact that an applicant for a Building Society mortgage will often not be aware that one of the forms he completes when applying for his mortgage is an application for insurance as well. We consider that this mischief would be removed if forms of application for advances on the security of freehold or leasehold property which state that cover will be arranged on behalf of the applicant, whether by the prospective lender or some other person, should be treated as proposal forms for the purpose of the recommendations made in the foregoing paragraphs. Thus, the warnings and other requirements under our recommendations in paragraph 4.64 above, and the sanctions in case of non-compliance mentioned in paragraphs 4.65 to 4.67 above, would equally apply to applications for insurance in such cases.

Renewals

Introduction

4.69 Having dealt with the topic of disclosure in the context of proposal forms we now turn to deal with it in relation to renewals. In this context the topic is of great importance because the vast majority of insurance contracts made in England are by way of renewal of existing policies, with the result that the duty of disclosure will most often arise on applications for renewed cover. The reason is that most insurance policies in England, other than policies of life insurance, are contracts for a term of one year and are renewable annually. In relation to such contracts the parties usually envisage that the contract will be renewed each year. In law such renewal, even if it is taken for granted at the outset, is a new contract, with the result that the insured is under a fresh duty to disclose all facts which are material at the date of renewal.[211] The extent of the duty is the same as on the original application. However, since the insured need not disclose facts which are known to the insurer,[212] and on the assumption that the insured has complied with his duty of disclosure on the original application (and on any subsequent renewals), he will only be under a duty to disclose any material changes in circumstances that have occurred since the date of the initial application or the date of the previous renewal, as the case may be.

4.70 This situation gives rise to two major difficulties. First, it is most unlikely that the ordinary insured is aware of this somewhat technical rule of law, with the consequence that he will be unlikely to be aware of the existence of any duty of disclosure on renewal; further, even if he is aware of it he is unlikely to be aware of its extent. Secondly, even if the insured is aware of both the existence of his duty and of its extent, he is likely in many cases to find great difficulty

[210] *Woolcott* v. *Sun Alliance and London Insurance Limited* [1978] 1 W.L.R. 493.

[211] See e.g. *Lambert* v. *Co-operative Insurance Society Ltd.* [1975] 2 Lloyd's Rep. 485.

[212] See *Carter* v. *Boehm* (1766) 3 Burr. 1905, 1911, 97 E.R. 1162, 1165 *per* Lord Mansfield C.J.

in complying with the duty unless he is able to refer to the documents which record the information previously supplied by him to the insurer. This difficulty will increase on each successive renewal.

4.71 One possible solution would be to abolish the duty of disclosure on renewal. However, this would mean that the insurer could not rely on the volunteering of information relevant to the circumstances on which his assessment of the renewal of the risk depends. He would then either have to make fresh investigations each year, perhaps even by means of a fresh proposal form, thus increasing administrative costs, or to increase premiums generally to take account of the new material facts which would not have come to his notice. Clearly either alternative would be undesirable. Our conclusion is that the reasons which led us to recommend that the duty of disclosure should not be abolished as regards original applications for insurance apply with equal force to renewals. However, the implications of this conclusion require further consideration.

Reform of the duty of disclosure on renewal

4.72 Earlier in this report[213] we concluded that, to put it shortly, an insured should on an original application for insurance, be under a duty to disclose only those material facts which, having regard to the particular circumstances, a reasonable man would disclose. On this basis we consider that it would be clearly unsatisfactory if an insured were under a more onerous duty of disclosure on renewal than when he made his original application, and in our view the same standard of duty should clearly apply. On the other hand, since an insured is under no obligation to disclose matters which are already known to the insurer,[214] on renewal the insured will only be obliged to update the matters disclosed when the contract was concluded or on the occasion of the last renewal, as the case may be. The effect of this, and of our recommendation about the general duty of disclosure, will therefore be that on renewal the insured will have to disclose material facts which he knows or is assumed to know, which have not been disclosed by him and which would be disclosed by a reasonable insured in his position, having regard to the nature and extent of the cover which is renewed and the circumstances in which it is renewed. We *recommend* accordingly.

Standard of answers to questions on renewal

4.73 Apart from the duty of disclosure on renewal (discussed in the previous paragraph) whereby the insured must update the material facts previously disclosed, the insurer may also seek further information on renewal. In rare cases he might require the completion of a proposal form, whether the insured had originally completed one or not. Such cases should not be regarded as renewals at all but as the granting of fresh cover to which our recommendations[215] concerning proposal forms would apply. However, it is not unusual for insurers to ask for further information before deciding whether or not to renew, and any further questions put to the insured on renewal might either relate to specific

[213]See paras. 4.46–4.53, above.
[214]See note 212, above.
[215]See paras. 4.54–4.68, above.

matters or might include a general question such as whether there are any new material facts which might influence the judgement of the insurers in deciding whether or not to renew the risk. Such information might be sought from the insured on any renewal of cover which might have been in existence for several years, whether on the basis of an original proposal form or without one having ever been completed. Here again we consider that the standard should be the same as we have already recommended[216] in relation to answers to questions in proposal forms: where the question is specific the insured will have discharged his duty if, after making such enquiries as are reasonable having regard to the subject matter of the question and the nature and extent of the cover to be renewed, he answers the questions to the best of his knowledge and belief. Where there is a general question it is to be construed as seeking no further information from the proposer than such information as he would be bound to disclose by virtue of the reduced duty of disclosure referred to above.[217] We *recommend* accordingly.

4.74 It follows from the foregoing paragraphs that the standard of the duty of disclosure imposed on the insured at the time of each renewal is in principle the same as when the cover was granted originally, subject only to the difference that the insured is not required on renewal to disclose facts which have already previously been disclosed by him.[218] It also follows that if the insured is asked any questions on the occasion of any renewal, he must discharge his duty of disclosure in relation to the answers on the same basis as his answers to questions in a proposal form. Under our recommendations the extent of the duty imposed on the insured in relation to both these matters will be no higher than that he must act reasonably. However, for the same reasons as those which led us to recommend that in relation to proposal forms the insured must be given clear warnings of his obligation concerning the disclosure of material facts,[219] we also consider that he must be given similar warnings of his obligations concerning disclosure at the time of each renewal, and we further consider that in some cases he should be supplied with a copy of any updated information which he may have given on renewal, in order to assist him in discharging this duty. We discuss these recommendations in detail hereafter.[220] Before doing so, however, we must deal with the topic of renewal notices.

Renewal notices

4.75 When cover is due for renewal insurers generally send a renewal notice to the insured; usually this consists of a written invitation to the insured to renew his policy, normally for a further year. However, there are also documents which the insured may receive from his broker which merely inform him that his insurance is due for renewal without expressly inviting renewal, though the insured is likely to treat them as invitations to renew the policy. In our view it is

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[216]See paras. 4.61 and 4.62, above.
[217]See para. 4.62, above.
[218]See note 212, above.
[219]See para. 4.64, above.
[220]See paras. 4.77–4.81, below.

highly desirable that such documents should constitute renewal notices for the purposes of our recommendations.[221] Similarly, where a mortgagee has effected insurance on behalf of the insured over freehold or leasehold property he may send a document to the mortgagor informing him that his insurance is due for renewal. In our view such documents should also be regarded as renewal notices, since this is how the mortgagee would in effect regard them. We have already made a similar recommendation[222] in relation to original applications for insurance made at the same time as applications for a mortgage by recommending that such applications for insurance should be treated as proposal forms, and the present recommendation logically follows from the previous one.

4.76 However, we should add, for the sake of completeness, that we appreciate that in some cases an insurance policy may be renewed without any prior notice having been sent to the insured. Thus, in cases of mortgaged property this may be done on the basis of standing instructions from the mortgagee, a Building Society or bank. In these and other cases of more or less automatic renewal there may be no prior communication with the insured but merely a notice from the broker or mortgagee that the cover has been renewed. Such communications after the event could clearly not constitute renewal notices for present purposes. We recognise that in such cases issues might in theory arise concerning non-disclosure by the insured of any material change of circumstances in the interim, before the cover was renewed in this way. However, we are not aware that such problems have in fact arisen, and in the great majority of such cases any non-disclosure by the insured would no doubt be held to have been waived by the insurers on the ground that the cover had been renewed by them without prior communication with the insured.

Warnings in renewal notices and supply of copies to the insured

4.77 As we have already pointed out, [223] an insured may well be quite unaware that he is under any fresh duty of disclosure when his cover is renewed. Under our recommendations[224] this duty of disclosure will be reduced, to put it shortly, to the updating of the previously disclosed matters to the extent which a reasonable man in the position of the insured would disclose in all the circumstances after making reasonable enquiries. However, as in relation to proposal forms, we consider that some clear and explicit warning of the existence and extent of the insured's duty of disclosure should be given to him on the occasion of each renewal. Many forms of renewal notices already contain such warnings, and we see no difficulty in making it a requirement that such warnings should always be given. Further, on the occasion of each renewal the insured should also be warned of the consequences of any breach by him of his duty of disclosure.

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[221]We realise that this matter falls within the area of insurance intermediaries which we did not canvass in our working paper because it was the subject of the Government White Paper on Insurance Intermediaries (1977) Cmnd. 6715: see Working Paper No. 73, para. 19. Accordingly we have put the relevant clause in the Bill attached to this Report in square brackets, particularly since our recommendations on this point may overlap with matters concerning insurance intermediaries which are at present being considered by the Department of Trade.

[222]See para. 4.68, above.

[223]See para. 4.70, above.

[224]See para. 4.72, above.

We summarise later on[225] the full warnings which we recommend. However, we see no need to make any specific recommendation in this respect concerning the insured's duties in relation to the answers to any questions which he may be asked on renewal. This is not a standard procedure as it is in relation to questions in proposal forms. Moreover, under our recommendations[226] the legislation will provide that the insured need answer any specific questions only to the best of his knowledge and belief after making such enquiries as are reasonable in the circumstances, and that no general question can be construed so as to seek from the insured any information beyond that which he would be bound to disclose by virtue of the reduced duty of disclosure which we have already recommended. We therefore consider that no further recommendation is necessary in this connection.

4.78 The warnings which we have recommended in the foregoing paragraph concerning the insured's duty of disclosure on renewal will apply to all renewals. However, we consider that special considerations apply to renewals of insurances which have been initiated by the completion of a proposal form by the insured. In relation to proposal forms we have already recommended[227] that the insured should be supplied with a copy of the proposal form and that he should be warned of the importance of keeping both it and a copy of any further information which he may supply to the insurer thereafter, because he will need these for reference on the occasion of each renewal. In our view the same considerations apply in proposal form cases to any information which the insured may supply on any renewal. The reason is that in such cases the matters disclosed by the insured on each renewal will have to be updated on the occasion of each subsequent renewal if there is any material change.

We accordingly *recommend* that in relation to insurances initiated by proposal forms the insured should be supplied, on the occasion of each renewal, with a copy of any information supplied by him on that renewal. If the renewal notice invites the insured to give information by writing it on the renewal notice and returning the notice to the insurer then, as in relation to proposal forms, the insurer may comply with this requirement by supplying a carbon copy with the renewal notice which can be torn off and retained by the insured. Alternatively, the insurer must send the insured a copy of the information supplied by the insured as soon as is practicable. Further, as in relation to proposal forms,[228] we *recommend* that the renewal notice should contain a warning to the insured about the importance of keeping the copy supplied to him for future reference.

4.79 However, we do not consider it necessary to make the same recommendations in relation to renewals of insurance which have not been initiated by the completion of a proposal form. Such cases will normally only concern commercial insurances where the original cover and the renewals may often result from more elaborate negotiations. We consider that in such cases the insured can be relied upon to keep any copies of any information supplied by him in the ordinary course of his business, and the need to refer to the answers

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[225]See para. 4.80, below.
[226]See para. 4.73, above and para. 4.82, below.
[227]See para. 4.63, above.
[228]*Ibid.*

in a proposal form will in any event not arise. We therefore see no need to recommend the introduction of any similar procedures in relation to such insurances.

4.80 We can now recapitulate the recommendations made in the foregoing paragraphs concerning the requirements as to warnings to the insured on renewal and the supply to the insured of copies of any information furnished by him on renewal. Before doing so, however we should point out that under the recommendations made hereafter,[229] compliance with these requirements by insurers will only be necessary if they wish to be able to rely on the updating by the insured on renewal of any information previously supplied by him. The requirements on the part of insurers which we recommend on this basis on the occasion of each renewal are the following:—

A *If the insurance has not been initiated by the completion of a proposal form*

The insured will have to be warned in the renewal notice in a prominent manner:

(i) that he is under an obligation to disclose to the insurer all material facts not previously disclosed, which he knows or could ascertain by reasonable enquiry and which might reasonably be considered to influence the judgment of a prudent insurer as to whether and on what terms to renew the cover; and

(ii) of the consequences to the insured of a failure to fulfil the obligations in (i) above, i.e. of the insurer's right to repudiate the policy and to reject any claim which may arise.[230]

B *If the insurance has been initiated by the completion of a proposal form*

The requirements on the part of insurers which we recommend are the following, if they wish to be able to rely on the updating by the insured of any information previously supplied to them:

(i) to supply to the insured a copy of any information supplied to the insurer on each renewal, either at the time of the renewal or as soon thereafter as is practicable in the circumstances;[231]

(ii) a warning as under A (i) and (ii) above; and

(iii) a further warning, also prominently displayed in the renewal notice, of the importance to the insured of keeping the copy supplied to him under (i) above for future reference.

In addition to the foregoing requirements it follows from our earlier recommendations[232] concerning proposal forms that the insurer will also have to have complied with the requirements concerning proposal forms if he wishes to rely on any non-disclosure by the insured on the occasion of any renewal. However,

[229]See para. 4.81, below.
[230]See para. 3.9, above.
[231]See para. 4.78, above.
[232]See paras. 4.63–4.65, above.

as in relation to proposal forms,[233] the sanctions for non-compliance, to which we now turn, will not apply if the non-compliance has not caused any prejudice to the insured.[234]

Sanctions for non-compliance with any of the requirements on renewal

4.81 We have already made recommendations as to the sanctions which should in our view become applicable if an insurer fails to comply with the requirements which we have recommended concerning proposal forms and explained our reasons for these recommendations.[235] We make the same recommendations in relation to renewal notices, and we do so for the same reasons, which we do not need to repeat. We accordingly *recommend* that in the event of any failure by an insurer to comply with any of the foregoing requirements as to renewals,[236] the insurer shall not be entitled to rely on any failure by the insured to disclose any material change of circumstances on the occasion of any renewal. However, where there has been a failure by the insured to comply with his duty of disclosure in circumstances in which the court is satisfied that any failure by the insurer to comply with any such requirement has not caused any prejudice to the insured in connection with such non-disclosure, we *recommend* that the court may give leave to the insurer to rely on the non-disclosure in question.

Further matters concerning questions in and relating to proposal forms and renewal notices

4.82 There are certain further general matters concerning questions in proposal forms and questions which may be put to the insured in renewal notices or other written questions connected with the grant or renewal of cover with which we must deal. In this connection we have already made certain recommendations. First, that the insured is to be under no higher duty in answering any specific question in proposal forms or on renewal than to answer it to the best of his knowledge and belief after making such enquiries as are reasonable having regard to the subject-matter of the question and to the nature and extent of the cover which is sought.[237] Secondly, that no question put to the insured should be construed as seeking from him any further information than such as he would be bound to disclose by virtue of the reduced duty of disclosure which we have recommended generally.[238] We *recommend* that these recommendations should apply to all written questions as mentioned above. However, there are two further matters concerning such questions with which we must briefly deal.

4.83 The first concerns the materiality of the subject-matter of any question as referred to in the foregoing paragraph. Unless the subject-matter of a question is material to the risk[239] the question is irrelevant so far as concerns the in-

[233]See paras. 4.65–4.67, above.
[234]See para. 4.81, below.
[235]See paras. 4.65–4.67, above.
[236]See paras. 4.77, 4.78 and 4.80, above.
[237]See paras. 4.61 and 4.73, above.
[238]See paras. 4.46–4.53, above.
[239]As to materiality, see para. 4.48, above.

sured's duty of disclosure, as well as any answer which the insured might give to it. There should therefore be no obligation on the insured to answer any immaterial question, and we so *recommend.* On the other hand, since insurers are unlikely to ask any question which is not material, there should be a presumption that the subject-matter of any question asked by the insurer is material, though it should be open to the insured to rebut this presumption by proving that the subject-matter of the question did not relate to any fact or facts which would have influenced the judgment of a prudent insurer in accepting the risk or fixing the premium. In our working paper we made a provisional recommendation to this effect[240] and the vast majority of commentators agreed with this proposal. Our final recommendation is therefore to the same effect.

4.84 The second matter concerns the construction of questions put to the insured. In the context of questions in proposal forms we pointed out in our working paper[241] that injustice might arise if an insured, misunderstanding a question in the proposal form, answered it correctly according to his understanding of it but incorrectly according to its ordinary and natural meaning. We provisionally recommended that where a question might reasonably be understood in two senses, one favourable to the insured and the other favourable to the insurers, the courts should always construe it in the former sense, because it seemed to us desirable to apply a rule of construction to the wording of questions asked by an insurer which in effect gives the benefit of the doubt to the insured. Few comments were received in relation to this provisional recommendation. On further consideration we conclude that it would be right to make a final recommendation on these lines in relation to written questions in general, but to modify it in the following manner to avoid the possibility of an insured seizing upon a question which can be interpreted in more than one sense and then answering it in a way which would be unreasonable in the circumstances. We accordingly *recommend* that if a written question asked by an insurer might reasonably be understood in more than one sense, and the insured adopts a construction of it which is not unreasonable in the circumstances, then (but only then) shall the question be construed in the sense adopted by the insured.

Powers of the Secretary of State

4.85 We have made a number of recommendations as to the warnings to the insured to be included in proposal forms[242] and in renewal notices.[243] For the reasons already explained we do not anticipate that insurers will experience any difficulty in complying with these recommendations. They already include similar warnings in many cases, no doubt because it is as much in the interests of an insurer as of the insured that the insured should comply with his duty of disclosure and that future disputes should be avoided to the greatest possible extent. However, we also consider it desirable to provide a residual power in the legislation which we recommend for the Secretary of State to prescribe specific forms of warning for proposal forms and renewal notices, as well as warnings concerning any further aspects of the insured's duty of disclosure as may appear

[240]W.P. No. 73, para. 68.
[241]W.P. No. 73, para. 76.
[242]See para. 4.64, above.
[243]See para. 4.80, above.

to him to be appropriate. In this context we have in mind in particular standard types of insurance such as householders' cover and motor insurance. In such cases the Secretary of State should in our view also be empowered to prescribe how the warnings are to be presented in relation to type, size, colour or other wise.[244] We hope that it will not become necessary for the Secretary of State to exercise these powers, and indeed we think that this will be unlikely in relation to those areas of commercial insurance to which our recommendations apply. We cannot anticipate, however, what problems may arise in relation to the duty of disclosure in the various different classes of insurance. If there proved to be real uncertainty as to the adequacy of warnings provided by some insurers under our recommendations, it seems to us desirable for these difficulties to be resolved, not by litigation, but by the Secretary of State making it clear by order precisely what must be included in the various warnings. Before exercising this residual power, we would expect that the Secretary of State would consult with the various interested bodies, such as representatives of the insurance industry, consumer bodies and the Office of Fair Trading.

4.86 To provide for the event that it might become necessary for the Secretary of State to exercise the powers referred to in the foregoing paragraph, it is also necessary to make provision in the legislation for what is to happen if orders made by the Secretary of State are not complied with. We do not think that the imposition of a criminal sanction would be the most appropriate way of providing a sanction in this context. In our view it is sufficient for this purpose to provide that if any such order is not complied with, then the insurer in question will face even greater difficulty in relying upon any non-disclosure on the part of the insured than is already the position under the recommendations which we have made earlier in this report.[245] We consider that in such cases of non-compliance the insurer should not be entitled to rely on any non-disclosure on the part of the insured unless the insurer satisfies the court that he took all reasonable steps to comply with the order concerning warnings, and also that in the circumstances of the case it is just and equitable that he should have leave to rely on the non-disclosure in question, and we *recommend* accordingly.

4.87 Finally, there is still one further matter which should be mentioned in this context although it may be self-evident. This is that if the Secretary of State should, in relation to any particular class of insurance, prescribe the content and form or other matters concerning warnings to the insured for inclusion in proposal forms or renewal notices, then any proposal form or renewal notice which complies with the order shall also be treated conclusively as complying with the recommendations which we have made earlier[246] in relation to such warnings, and we so *recommend.*

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[244]Similar powers are already in force in relation to hire purchase and credit sale transactions: see Consumer Credit Act 1974 s. 60.

[245]This is analogous to the position under the Consumer Credit Act 1974 with regard to hire purchase transactions; see s. 127 of that Act.

[246]See paras. 4.64, 4.78 and 4.80, above.

Should the insurer's rights in respect of non-disclosure be further restricted?

Introduction

4.88 In the following paragraphs we will consider whether the balancing of the interests of the insurer and the insured requires that the insurer's rights in respect of non-disclosure by the insured should be still further restricted than on the basis of the recommendations which we have already made. We consider two possible further restrictions. The first would preclude the insurer from rejecting a claim if the insured could prove that there could have been no connection between his non-disclosure and the loss. The second would leave the remedy for non-disclosure to the discretion of the court and would thus allow the insured who is in breach to make partial or total recovery of his claim in some cases. We deal with these proposals in turn.

Connection between the non-disclosure and the loss

4.89 In our working paper[247] we dealt with the question whether our provisional recommendations should go further to protect the insured on the basis that insurers should only be entitled to reject a claim on the ground of non-disclosure of a material fact if the undisclosed fact is in some way connected with the loss. We refer to this hereafter for convenience as a "nexus test".[248] Our provisional conclusion was that our recommendations had already struck a fair balance between the interests of the insured and of the insurer, and that it was neither necessary nor desirable to introduce any further restriction on the insurer's rights in the event of non-disclosure. On consultation a number of commentators took the view that a duty of disclosure coupled with a nexus test would provide a second best to abolition of the duty. Those who took this view appear to have made their comments mainly in the context of protecting consumers. We have already stated our reasons for rejecting the outright abolition of the duty of disclosure as well as any regime based on a "consumer—non-consumer" dichotomy.[249] However, in view of the support that was expressed for the adoption of a nexus test in non-disclosure we have reconsidered the possibility of introducing such a test in this context.

4.90 In our working paper we provisionally recommended[250] that the law of warranties should be reformed so that rejection of a claim for breach should only be allowed if there is a connection of some kind between the insured's breach and the loss. We adhere to this recommendation in this report.[251] In the context of non-disclosure the precise formulation of a nexus test would require separate consideration, but for the purpose of the present discussion it is sufficient to put the issue in broad terms. Suppose that an insured has failed to disclose a material fact, that is, one which would have affected a prudent insurer's decision whether or not to accept the risk at all or, if so, at what premium and on what terms. Suppose also that a loss subsequently occurs which could not have had any connection with the undisclosed fact. Although the

[247] See W.P. No. 73, at paras. 92–96.

[248] This test is of particular significance when we come to discuss the law of warranties. See paras. 6.15–6.22, below.

[249] See paras. 4.32–4.42, above.

[250] W.P. No. 73, paras. 120–124.

[251] See paras. 6.15–6.22, below.

insurer would be entitled to repudiate the policy, should the insured nevertheless be entitled to recover his claim?[252]

4.91 At first sight this result may appear to be just, as some of our commentators felt. However, on examination it is clear that the insurer would thereby be held to a contract which he would either not have accepted at all, or only at a higher premium or subject to different terms, or both. This would appear to be unfair. For this reason and for the reasons set out in the paragraphs below we have concluded that whatever superficial attraction the nexus test may have in the context of non-disclosure it is misconceived and should not be adopted in this context.

4.92 One must begin by putting the issue into the perspective of our other recommendations in this report in order to see the extent of the problem which would remain if these are adopted. Our present law of non-disclosure has caused hardship and led to widespread criticism, as we have already pointed out.[253] In particular, we have identified the following mischiefs with which we have already dealt, viz. (a) that the standard to be applied to the duty of disclosure is that of a prudent insurer and not of a reasonable insured, and (b) that in proposal form cases it may well not occur to the proposer that in addition to answering a large number of questions he is required to volunteer material information without his attention having been drawn to this obligation in any way. However, under our recommendations[254] these mischiefs will disappear. By applying the test of a reasonable insured many of the "moral hazard" cases,[255] which have been subject to particularly strong criticism, may in any event be decided differently. Further, in proposal form cases, which in the present context in our view present the greatest mischief in practice, the insured will have had his attention drawn expressly to his duty to volunteer material information. If the insurer has failed to give the necessary warning, he will not be entitled to rely on the non-disclosure of such information.

4.93 For present purposes one therefore starts with cases concerning proposers who will *ex hypothesi* not have acted in the way in which a reasonable person in the position of the insured would have acted. On this basis the considerations of justice concerning the consequences of a non-disclosure at once assume a different aspect. But then one comes to a further consideration. Suppose that a proposer unreasonably fails to disclose some material fact under the rubric of "moral hazard": how could the application of a nexus test work in practice? Suppose that an applicant fails to disclose a bad claims record or (unspent) convictions for dishonesty: such facts could in practice hardly ever be shown to have had any connection with a particular loss. The result would be that an insured who is unreasonably in breach of his duty of disclosure would

[252]In the unlikely event that the insurer discovers the non-disclosure before a loss has occurred he would of course be entitled to repudiate the policy.

[253]See paras. 3.17–3.22, above.

[254]See paras. 4.47 and 4.60, above.

[255]That is to say, cases in which the insured has failed to disclose some personal aspect bearing on the risk (for example previous convictions for dishonesty or a bad insurance record) such as *Lambert* v. *Co-operative Insurance Society Ltd.* [1975] 2 Lloyd's Rep. 485 and *Woolcott* v. *Sun Alliance and London Insurance Ltd.* [1978] 1 W.L.R. 493.

in such cases virtually always recover. We do not think that this would be acceptable or that it strikes a fair balance between insured and insurer against the background of the reforms of the law of non-disclosure which we are recommending.

4.94 There is a further and perhaps even more fundamental objection to the introduction of a nexus test into the law of disclosure which applies whether or nor the undisclosed material fact concerns "moral hazard". This objection stems from comments which we received from the insurance industry on consultation which have greatly impressed us. Unlike cases of breach of warranty, in relation to which we are recommending that there must be a connection between the breach and the loss, all considerations relating to non-disclosure must focus on the moment when a proposal for insurance is put forward and either accepted on certain terms or rejected, in either event by reference to what the insurer judges to be the quality of the risk. The technique—one might almost say the art—of good underwriting is to judge all the factors affecting an offered risk at this moment, when the underwriter must then and there assess its quality on the basis of his experience, as though he were considering the overall impression given by a "still photograph" of the risk at this point. In these respects the implications of non-disclosure are quite different from those of breaches of warranties during the currency of the cover. As a result of the non-disclosure the insurer will have accepted a risk which, had he known all the material facts, he would either not have acceptedd at all or would have accepted at a different premium or on different terms. In these circumstances we see great force in the contention made on behalf of the industry that it would be wrong in principle to hold the insurer to the contract in such cases. Furthermore, under our recommendations made later[256] in this report we severely curtail the rights of insurers to rely on "basis of the contract" clauses as a means of avoiding liability, with the result that their rights in cases of non-disclosure would assume even greater importance than at present.

4.95 In addition, many underwriters are anxious to confine their portfolios to "good risks", particularly in the context of large commercial insurances to which our recommendations would of course apply in the same way as to "consumer" insurance. In such cases the world-wide insurance market in this country strongly relies for its competitiveness on the duty of a proposer to disclose material facts (which under our recommendations a reasonable insured would realise required disclosure) of which the insurer knows nothing and about which he could not in practice be expected to ask exhaustive questions. We have in mind matters such as the tests carried out in a manufacturing process in connection with liability insurance for defective products, or security aspects in businesses which are insured against a variety of risks (for example, the routes taken by vehicles carrying a firm's payroll in connection with insurance against theft and allied risks). We are satisfied that in relation to cover of these types, which provides premium income which is of great financial importance to this country, the introduction of a nexus test into the law of disclosure would prevent the insurer from quoting rates for "good risks" which are competitive in comparison with those quoted by insurers operating under

[256]See paras. 7.5–7.11, below.

the present system, because he would be less able to identify which risks are good and which are bad and to adjust premium rates accordingly. Since it would clearly be unacceptable to erect protective walls around the market in which a nexus test prevailed, the British insurance industry might therefore suffer a substantial loss of competitiveness. For an international market such as London the consequences of this might be extremely serious.

4.96 Finally, let us take one extreme type of case in order to illustrate the difference between the superficial attraction of a nexus test in relation to non-disclosure and its deeper implications. Suppose that a person insures his life without disclosing that he is suffering from constant stomach ache. Some months later he is killed in a railway accident. It is then discovered during the post-mortem that he had been suffering from terminal cancer, and the insurers repudiate on the grounds of non-disclosure. Supporters of a nexus test might well say that this would be unjust, since the death clearly had no connection with the non-disclosure. At first sight this may seem attractive, but only because one is reasoning with hindsight from the knowledge of a clearly unconnected loss. But suppose that the problem is put differently: suppose that one month after the conclusion of the contract the insurers learn that the insured is suffering from cancer and claim to cancel the policy because they would never have accepted the risk if the insured had disclosed its existence. Clearly, we think, they should be entitled to do so and not be held to a cover which they would never have accepted if the full facts had been disclosed. In our view, the death of the insured in the meantime should make no difference in principle and the insurer should be entitled to refuse to pay the sum assured.

4.97 For these reasons we *recommend* against the introduction of a nexus test in relation to non-disclosure.

A judicial discretion to reduce the insured's entitlement

Introduction

4.98 Finally, we consider whether an approach leaving the remedy for the breach of a duty of disclosure to the discretion of the court might not be preferable to any of the proposals so far canvassed in this report. In our working paper we did not consider this approach as one of the field of choice for reform because we thought that it would inevitably give rise to unacceptable uncertainty. However, recent proposals in other countries for the reform of insurance law have envisaged the introduction of a judicial discretion. We will briefly examine the position in Australia, Sweden and France and then consider whether such a discretion should be introduced in this country.

Australia

4.99 The Australian Law Reform Commission has proposed in a discussion paper[257] that an insurer should be able to avoid a claim in cases where the insured was guilty of concealment of deliberate misrepresentation; however, the Commission proposed that the court should be given a general discretion to adjust the rights of the parties where rejection of a claim would otherwise be

[257]Discussion Paper on Insurance Contracts (October 1978).

permitted but would result in a clear injustice to the insured. Australian commentators have expressed reservations on this proposal,[258] about the granting of a general discretion of this kind to the courts. They considered that it would only add to uncertainty and possibly encourage excessive litigation.

Sweden

4.100 In 1977 a Swedish Government Commission recommended[259] the abandonment of proportionality—an integral feature of Swedish insurance Law[260]—as regards consumer insurance in favour of a more flexible provision which conferred a discretion on the court. The summary of the Commission's Report on the draft Consumer Insurance Act states in the official translation:

> " . . . The consequence of a relevant breach of a duty is, under the proposed Act, the reduction of the indemnity so far as is reasonable in the circumstances, having regard chiefly to the influence of the breach on the occurrence and extent of the loss, the degree of fault, and the need for indemnity. The draft thus dispenses both with the "proportional-to-premium" rule and the "causation" rule . . . . . It introduces instead a general principle of reasonableness under which, however, causation is to be the most important circumstance. Where the breach does not influence the loss, it should be irrelevant."

The Commission continued:

> "However, it is realised that both courts and insurers will find it hard to apply immediately such broad principles of reasonableness, and it is suggested in the report that the principle laid down in the draft Act should be regarded as a general guide for the formation of insurance conditions, in which more precise norms may be laid down, not as a rule which must be reproduced in the insurance conditions."

The Commission's proposals have recently been embodied in the Consumer Insurance Act 1980, which comes into force on 1 January 1981.

4.101 The difficulty just referred to would be much greater in England than in Sweden if such a discretion were to be introduced. In Sweden there is extensive administrative supervision of the contents of insurance policies. The Swedish Report suggests that the standard terms in insurance contracts should provide the basis for the calculation of the sum due to the insured in the majority of cases. Judicial discretion would only come into play in a small number of unusual cases. By contrast, in England there is no such administrative control of the contents of policies and the exercise of discretion would be relevant in virtually all cases.

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[258]Australian Treasury Submission to the Law Reform Commission on their Discussion Paper on Insurance Contracts – August 1979.

[259]Konsumerforsakingslag deliverankade av forsakingstrattskomitten (Stockholm 1977:84).

[260]See the Swedish Insurance Contracts Act 1927.

France

4.102 In France, where the proportionality principle applies, the Cour de Cassation has held[261] that, where the insurers would not have accepted the risk, the judges at first instance must evaluate the reduction in the insurer's entitlement as a matter of fact and discretion. Although this is regarded as an application of the proportionality principle, in practice it seems to have much more in common with the proposal under discussion. As we have noted, the leading French commentary[262] regards this as unsatisfactory.

Should a discretion be introduced here?

4.103 Our brief examination of judicial discretion in the context of three other countries suggests that such a discretion is only practicable if the very real danger of commercial uncertainty can be overcome. It can be overcome in Sweden by administrative control. It might be argued that it could be overcome here by the formulation of statutory guidelines as to how the discretion should be exercised. Presumably, the court could have regard at least to the following:

(*a*) whether the undisclosed facts are connected with the loss;

(*b*) the degree of the insured's blameworthiness in failing to make full disclosure; and

(*c*) the way in which the insurers would have assessed the risk had they been aware of the undisclosed facts at the date of the contract.

4.104 As regards (*a*), we have just discussed in some detail[263] whether there should be a requirement of a "nexus" in relation to non-disclosure and concluded that to use it as a factor to determine the insured's rights would give rise to many difficulties. As regards (*b*), this would involve the danger that the assessment by the court of the blameworthiness to be attributed to the insured would entail an investigation into the subjective circumstances and attributes of the individual insured, factors excluded from consideration in deciding whether there had been a breach of the duty of disclosure. It also seems to us that the only way in which the court would be able to correlate the insured's entitlement with his blameworthiness would be by having regard to his degree of negligence—that is to say, whether he had been grossly negligent, merely negligent or slightly negligent. However, as one judge said "epithets applied to negligence, so far as the common law is concerned, are really meaningless."[264] As regards (*c*), this must in our view be a crucial factor to which the court would have to pay regard. Indeed, to the extent that the court has regard to any factors other than (*c*) the result is bound to be artificial and unfair to insurers. For example, if with knowledge of the undisclosed facts the insurer would have refused the risk, then it seems to us wrong that the insured should be entitled to recover anything—yet, by having regard to (*a*) or (*b*) the court would presumably be able to achieve just this result.

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[261]Civ. 9 June 1942, R.G.A.T., 1942. 265, D.C. 1942. 145, J.C.P. 1942. 1982. For other cases in which the lower courts have made rulings to the like effect, see n. 127, above.

[262]Picard & Besson *Les assurances terrestres en droit francais* (4th ed., 1975) Vol. 1, p. 164, see para. 4.7, above.

[263]See paras. 4.89–4.97, above.

[264]See *Pentecost* v. *London District Auditor* [1951] 2 K.B. 759, 764 *per* Lynskey J.

4.105 The advantage of a judicial discretion lies in the flexibility which it would give to the courts to do justice in individual cases. However, this flexibility also constitutes its major disadvantage. As has been pointed out in Australia, because of the uncertainty inherent in the exercise of a judicial discretion such a proposal is likely to provoke excessive litigation, and it would only be after the accumulation of considerable case-law that there would be any indication as to how the courts were exercising the discretion. Even if case-law did develop, it is doubtful whether it would assist a litigant to predict the likely outcome of a claim and thus to decide, for example, whether to accept a given sum paid into court by the insurers. This is because the case-law would not provide him with a body of general principles, like the well-defined system of rules developed by the courts in relation to the apportionment of damages under the Law Reform (Contributory Negligence) Act 1945.[265] For example, how would the court deal with a case in which the insured had been negligent in failing to make full disclosure but where there was no possible connection between the undisclosed facts and the loss? Again, what would happen if the insured had only barely transgressed the bounds of reasonableness in failing to disclose the material fact, but the insurers would have declined the risk altogether had they been aware of it?

4.106 Before leaving this topic, we should perhaps consider for the sake of completeness whether the law of contributory negligence could provide a useful analogy in the present context. It was suggested to us on consultation that an important advantage of the proportionality principle is that it avoids an "all or nothing" result, and that the difficulties which we saw in the way of proportionality could be avoided by the adoption of a test modelled on the present law of contributory negligence. We have come to the conclusion earlier that, for a variety of reasons, the principle of proportionality with its illusory promise of arithmetical precision is not acceptable. It might nevertheless be argued that some form of judicial discretion to apportion a claim between the insurer and the insured, modelled on the Law Reform (Contributory Negligence) Act 1945, could provide an acceptable method of striking a different, and arguably better, balance between the interests of the parties.

4.107 We do not agree with this argument since the unacceptable uncertainty inherent in a judicial discretion in this context would not be mitigated by any attempt to draw a direct analogy with contributory negligence. In contributory negligence, apportionment between plaintiff and defendant is based on two principles—the extent to which the plaintiff's negligence may be said to have caused his loss and the extent of the plaintiff's blameworthiness. However, neither causation nor comparative fault are appropriate factors on which to base a judicial discretion in the context of insurance. If the insured has broken his duty of disclosure to the insurer, there is no fault on the part of the latter to be compared with the former. Equally, no question can arise of the insured's breach of the duty of disclosure having caused or contributed to his own loss. We therefore do not regard the law relating to contributory negligence as any analogy or argument for introducing a judicial discretion into the law of non-disclosure.

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[265] We discuss the suggested analogy between the judicial discretion and contributory negligence in more detail below, see paras. 4.106 and 4.107.

4.108 Our conclusion is that a general judicial discretion would do more harm than good. It would introduce an unacceptable element of uncertainty into the law and we do not believe that this could be overcome by the introduction of guidelines.

PART V

ARTICLES 4-6 OF THE PROPOSED DIRECTIVE[266] (INCREASE AND DECREASE OF RISK)

Introduction

5.1 It will be recalled that in our terms of reference[267] we were asked to consider the effect on the liability of an insurer, and on the rights of an insured, of an increase or decrease of the risk covered, having particular regard to *inter alia* the proposed Directive (then a draft Directive) on insurance contract law. Articles 4 and 6 of the proposed Directive deal with the mutual rights and obligations of the insurer and the insured in the event that the risk changes during the currency of the insurance contract. Article 4 regulates the rights and obligations of the parties where the contract imposes on the policyholder a continuing duty to notify insurers of the occurrence of certain matters stipulated in the contract which have the effect of increasing the risk. By and large Article 4 adopts the elaborate machinery of Article 3.[268] Article 6 deals with cases where the risk has diminished during the insurance period and entitles the insured in certain circumstances to cancel the contract if the insurer does not agree to an appropriate reduction of the premium.[269]

5.2 In our working paper we analysed the corresponding provisions in the fifth draft Directive (Articles 3 and 4).[270] We had understood that these provisions were not intended to co-exist with a system of warranties such as that in English law. Accordingly, we treated the introduction of a continuing duty to notify increases of the risk to the insurers as an alternative to a system of warranties.[271] However, the Commission of the European Communities has indicated [272] that it is not their intention that the provisions of Articles 4 and 6 of the proposed Directive should be implemented in substitution for the creation and enforcement of promissory warranties. It seems to be intended that it should not be possible to create warranties as to past or present facts[273] since these would circumvent the provisions of Article 3, but it appears to be the Commission's view that if a continuing duty to notify increases in the risk is imposed by the contract this can and should co-exist with a system of promis-

[266]For the text of the Articles, see Appendix C.

[267]See para. 1.1, above.

[268]For a discussion of this, see paras. 4.18–4.31, above.

[269]Article 5 deals with unjustified payments made by virtue of Articles 3 and 4. We describe the effect of this Article in para. 5.17, below.

[270]W.P. No. 73, paras. 147–159.

[271]W.P. No. 73, paras. 109–114.

[272]By *inter alia* informing the C.E.A. These initials stand for the Comité Européen des Assurances, which is a body recognised by the Commission as representing the European Insurance industry.

[273]As to which see para. 6.4, below.

sory warranties,[274] i.e. undertakings by the insured that he will do or refrain from doing certain things during the currency of the contract with a view to decreasing the risk or preventing it from increasing.[275] It seems unfortunate that this position was not explained in the fifth draft Directive or in its Explanatory Memorandum, and that it has not been made clear by the proposed Directive or its Explanatory Memorandum. It should certainly be made explicit in any final version of the Directive.

5.3 For the reasons given above, we are dealing in this report with Articles 4 and 6 independently of the reform of our law of warranties. The purpose of Articles 4 and 6, taken together, appears to be:

(*a*) to provide the insurer with all the information he needs on the matters stipulated in the contract for the continuous assessment of the risk throughout the term of the contract and to allow him to propose corresponding adjustments of the premium or other terms of cover as the risk changes from time to time during that period;

(*b*) to enable the insured to make a proportionate recovery of his claim where his breach of the continuing duty to notify increases in the risk does not justify the rejection of the whole of his claim;

(*c*) to prevent the insured from being obliged to continue to pay a premium which has become excessive because of a decrease in the risk.

5.4 The main feature of Article 4 is that it does not of itself impose any obligation on the policyholder but rather that it triggers off the elaborate machinery regulating the mutual rights and duties of the parties where the contract of insurance itself has obliged the policyholder to "declare to the insurer any new circumstances or changes in circumstances *of which the insurer has requested notification in the contract*". The result is that whenever an insurer stipulates for the continuing notification of changes in any specified circumstances all the provisions of Article 4 will automatically apply. As will be seen,[276] these provisions are similar to those contained in Article 3. Thus they provide for three different ways in which the obligation may be broken and stipulate the remedies available to the insurer for each type of breach together with a detailed procedure in connection with each such remedy. These detailed provisions are subject to the same criticisms as those in relation to Article 3.[277]

5.5 As we pointed out in our working paper[278] the provisions of Article 4 (Article 3 of the fifth draft Directive) seem to envisage long-term cover extending over a period of several years, in respect of which the adjustment of the premium from time to time in the light of the changing risk may not be unusual. Such long-term cover is a feature of Continental insurance practice; but in this country insurance contracts are, with the exception of life policies, almost

[274]This information was contained in a letter dated 6 August 1979 from the Commission of the European Communities to the Secretary-General of the C.E.A.

[275]As to which see para. 6.5, below.

[276]See paras. 5.6–5.13, below.

[277]See paras. 4.22–4.31, above.

[278]W.P. No. 73, para. 148.

invariably for a period of a year or less. We were told on consultation that life and allied policies do not provide for continuing disclosure on specified topics after the making of the contract and therefore the provisions of Article 4 would be irrelevant to such cover. As for annual contracts of insurance, fire insurance is the only case which we have been able to discover in which insurers in practice impose such an obligation on the insured. In some fire policies the policyholder is obliged to notify the insurers of any increase of risk or of a specified change in circumstances; such as any addition or alteration to the insured premises, or any change in the nature of the adjoining premises, in default of which the insurers are released from all liability under the policy. If the proposed Directive were implemented, such clauses would presumably be invalid to the extent that they were more favourable to the insurer than the provisions of Article 4, since under Article 12 contracting out of the provisions of the proposed Directive is prohibited except to the extent that the terms agreed upon by the parties are more favourable for the policyholder.[279] The Explanatory Memorandum points out that legislation by Member States other than in the terms of the proposed Directive, even if more favourable to the insured, cannot be permitted since the purpose of harmonisation would otherwise be defeated.[280] The provisions of Article 4, and in particular the remedies which are thereby afforded to the insurer, may therefore be of considerable concern to fire insurers. Accordingly, although Article 4 would have a very limited application to insurance contracts in this country, we must nevertheless consider its detailed provisions.

The detailed provisions of Article 4

5.6 Under Article 4.1 a policyholder must declare to the insurer any new circumstances or changes in circumstances "of which the insurer has requested notification in the contract". However, in England the request for information is likely to be contained in the policy which in practice may not be issued for some considerable time after cover has been granted. In these circumstances the insured will be bound by the continuing duty of disclosure during a period—after the acceptance of his application for insurance but before the policy has been issued—in which he will find it very difficult if not impossible to comply with it, because in practice he is likely to be unaware of the matters required to be notified. We assume that the reference to "in the contract" means that the request must be made in a written document. If not, then requests made orally are obviously likely to lead to litigation. It may therefore be necessary for insurers to alter their existing practices and send written requests for information on specified topics when cover is granted.

5.7 Where the policyholder has intentionally brought about new circumstances or a change of circumstances which increase the risk, he must declare the increase as soon as it happens. Where the increase in the risk is not attributable to an intentional act of the insured, the declaration must be made "immediately the policyholder becomes aware of the increase". It therefore seems that the new circumstances or changed circumstances of which notification has been requested often need only be declared when the insured is aware that

[279]The Article provides that "The parties to the contract may agree on more favourable terms for the policyholder, insured person or injured third party than are provided for in this Directive".

[280]See para. 1.16, above.

they have increased the risk. It is questionable whether an insured will always appreciate that the new or changed circumstances have in fact increased the risk.

5.8 Where the new or changed circumstances are not "liable" to increase the risk "appreciably and permanently" *and* to lead to an increase in the premium, Article 4.3 provides that a failure by the policyholder to comply with his duty will not give rise to any sanction. Three comments may be made on this provision. The first is that upon analysis the fact situations which can give rise to a sanction under Article 4.3 differ from those which constitute a breach of the duty under Article 4.1. This appears to us anomalous.

5.9 Secondly, the availability of a sanction depends on the changed or new circumstances being liable "appreciably" and "permanently" to increase the risk. The first term is vague and uncertain and the second would exclude temporary but nevertheless serious increases in the risk. The aim of this provision seems to be to prevent the insured from being penalised if he has only failed to notify the insurer of a trivial increase in the risk. However, the present formulation of the provision does not achieve this aim.

5.10 Thirdly, not only must the change of circumstances be "liable to appreciably and permanently increase the risk", but they must also be liable to lead to an increase in the premium. Thus, apparently, if the insurer would have granted cover at the same premium but *on different terms* no sanction is incurred by the insured if he fails to comply with his continuing duty of disclosure. The provision thus shares one of the inherent limitations of the proportionality principle[281] in that it concentrates exclusively on assessment of the risk in terms of the premium, while disregarding the possibility that the insurer might have adjusted the other terms of the contract and left the premium unchanged.

5.11 The sanctions for breach of the obligation under Article 4.1 depend on the nature of the breach. The classification of breaches for this purpose is similar to that in Article 3, as are the sanctions themselves. The procedure and time-limits within which they must be carried out are also similar. In all these respects, therefore, Article 4 is open to the same criticisms as those made in relation to Article 3.[282] With respect to the application of the proportionality principle, where the policyholder has committed a breach and "may be considered to have acted improperly", there is the further difficulty that whereas under Article 3 the notional premium will automatically be calculated with effect from the date of the contract, under Article 4 the increase of risk will take place during the currency of the contract, and the increase of the premium should only be calculated with effect from the time when the risk has increased. However, no provision is made for the notional premium under Article 4.5 to be pro-rated according to the unexpired length of the contract.[283]

5.12 There is an additional difficulty when the policyholder has committed a breach of the obligation "with the intention of deceiving the insurer".[284] Since

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[281]See para. 4.5, above.

[282]See paras. 4.4–4.17 and 4.31, above.

[283]Article 4.5 merely provides that "if the policyholder has failed to fulfil [the obligation under Article 4.1] and may be considered to have acted improperly, Article 3.3 shall apply."

[284]This is dealt with in Article 4.6.

Article 4.3[285] applies equally to each type of breach, the insurer would presumably be left without a remedy if the new or changed circumstances which were withheld from him dishonestly were not "liable to appreciably and permanently increase the risk and lead to an increase in the premium". In our view this result is most unsatisfactory, since insurers should be entitled to a remedy where the insured has acted dishonestly, regardless of the nature of the increase in the risk.[286]

5.13 As with Article 3, the burden of proving improper or fraudulent conduct on the part of the policyholder lies on the insurer.[287]

5.14 The Explanatory Memorandum states that in certain cases Article 4 is not to apply. We have seen that this statement also applies in relation to Article 3 and excludes certain matters from its scope.[288] We noted that the ambit of the matters to be excluded from Article 3 was unclear and that we were unable to understand why a provision relating to matters which are obviously of some importance was dealt with in the Explanatory Memorandum and not in the text of the proposed Directive itself. These comments apply equally to the restriction imposed by the Explanatory Memorandum on Article 4.

The detailed provisions of Article 6

5.15 Under Article 6 of the proposed Directive, if the risk has diminished "appreciably and permanently" as a result of circumstances other than those contemplated by the contract, and a reduction in the premium is justified as a result, then the insured is entitled to terminate the contract if the insurer does not consent to a proportionate reduction in the premium. We have already criticised the vagueness of the word "appreciably" and the limitations of the word "permanently" in relation to Article 4[289] and the same criticisms apply in relation to Article 6. Moreover, it is difficult to see how the insured could assess whether a proposed reduction was correct in the circumstances.

5.16 A further minor point arises if the contract is terminated by the insured. The insurer must then refund a proportion of the premium corresponding to the period for which cover is not provided "less the administrative costs involved". It is not clear what these administrative costs include. Are they confined to the expenses involved in terminating the contract or do they extend to other costs, expenses or overheads involved in granting the cover? In any event, it is not clear why the insured should be obliged to reimburse the insurer for expenses which the insurer has incurred in circumstances where the insurer has *ex hypothesi* acted unreasonably in failing to agree to a proportionate reduction in the premium. It must also be borne in mind that the insured will be caused inconvenience and expense through having to find alternative cover.

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[285]See para. 5.8, above.
[286]See para. 8.8, below.
[287]Article 4.7.
[288]See para. 4.30, above.
[289]See para. 5.9, above.

Article 5

5.17 For the sake of completeness we should finally refer to Article 5 of the proposed Directive which provides that any unjustified payment made pursuant to Articles 3 and 4 shall be refunded. For example, if the insurer has paid a claim under the mistaken impression that a failure by the insured to comply with his duty of disclosure was innocent whereas in fact he "may be considered to have acted improperly", then the insurer will be entitled to recover the amounts mistakenly paid to the extent that they exceed those payable under the proportionality principle.

General comments on Articles 4 to 6

5.18 In addition to the foregoing detailed observations on Articles 4 to 6 we have the following general comments:

(i) The possibility of frequent adjustment of the premium and the complicated procedures envisaged in these Articles may be appropriate for the Continental type of long-term insurance extending over several years. However, they are wholly inappropriate for the only case in English insurance practice, i.e. fire insurance, where insurers require compliance with a continuing duty to disclose particular matters during an annual contract of insurance.

(ii) These complicated procedures, and the uncertainties attendant upon them, would cause unnecessary expense and would undoubtedly lead to increased litigation.

We therefore conclude that the provisions of Articles 4 to 6 of the proposed Directive are inappropriate to English law and practice.

PART VI

WARRANTIES

A. The present law

Introduction

6.1 Today it is common insurance practice for a contract of insurance to contain a number of stipulations both as to the existence or continuation of a certain state of affairs and as to the performance or non-performance of some act by the insured. Many of these stipulations amount to what are generally known in insurance law as "warranties". We must examine the present law as to warranties in order to ascertain the manner in which they are created and their precise legal effect.

What is a warranty?

6.2 The word "warranty" is used in insurance law in a special sense to denote a term of the contract of insurance which must be strictly complied with and upon any breach of which, however trivial, the insurer is entitled to repudiate the policy.[290] It follows that upon breach of a warranty the insurer has the right

[290] *Pawson* v. *Watson* [1778] 2 Cowp. 785, 787, 98 E.R. 1361, 1362 *per* Lord Mansfield; *De Hahn* v. *Hartley* [1786] 1 T.R. 343, 99 E.R. 1130. See also the Marine Insurance Act 1906, 5. 33 (3).

to repudiate the whole contract from the date of the breach regardless of the materiality of the term, the state of mind of the insured, or of any connection between the breach and the loss.[291] The meaning of warranty in insurance law is thus similar to the meaning of "condition" in the law of sale of goods.[292] The promise which forms the subject-matter of a warranty consists of an undertaking by the insured that some particular thing shall or shall not be done or whereby he affirms or negatives the existence of a particular state of facts.[293]

Creation of warranties

6.3 A warranty may be created in one of the following ways:

(*a*) by the use of the word "warranty"; for example, "the insured warrants . . .";

(*b*) by an express provision for strict compliance and the right to repudiate for breach;[294]

(*c*) by the use of a phrase such as "condition precedent" from which the court can infer that the parties intended strict compliance and the right to repudiate for breach;[295]

(*d*) by the use of any other words such that the court concludes that, on the true construction of the whole document containing the term, the parties intended the term to possess the attributes of a warranty;

(*e*) by the use of a "basis of the contract" clause.[296]

Warranties as to past or present fact

6.4 A warranty may relate to a state of affairs existing in the past or in the present and such warranties are referred to hereafter as "warranties as to past or present fact": this type of warranty will generally arise from the application of a "basis of the contract" clause to the contents of a completed proposal form. We deal with the creation of warranties as to past and present fact by "basis of the contract" clauses in Part VII and so need say little further about them here save to point out that such warranties may sometimes appear on the face of the policy independently of a "basis of the contract" clause.

Promissory warranties

6.5 A warranty may on the other hand relate to the future; it is often then referred to as a "promissory warranty"[297] or a warranty of a continuing nature.

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[291]See generally *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 10, esp. paras. 635–638 and 814–912. For the effect of repudiation for breach, see para. 6.6, below.

[292]See the Sale of Goods Act 1979, s. 11 (3).

[293]This is taken from the Marine Insurance Act 1906, s. 33 (1) but is also apt in the context of non-marine insurance.

[294]For example, the standard clause in fire policies requiring notification of any increase in the risk.

[295]In insurance law it is clearer and more convenient to restrict the word "condition" to terms upon breach of which the insurer may be able to reject a claim in respect of a particular loss but not to avoid the policy: see *MacGillivray & Parkington, op. cit.*, paras 639–645. Conditions will generally concern collateral promises by the insured, e.g. concerning the time within which notice of loss must be given, or terms which confer particular rights on the insurer.

[296]See Part VII for the present law relating to "basis of the contract" clauses.

[297]Cf. the meaning of "promissory warranty" in the Marine Insurance Act 1906, s. 33 (1).

Whether the answers in a proposal form or the terms of a policy constitute promissory warranties turns on their precise wording.[298] As regards proposal forms, a clear reference to the future in a particular question or statement will always suffice.[299] Without such a reference, a provision will not normally be a promissory warranty,[300] but it may still be treated as a promissory warranty if that is the only real purpose which it could serve. This is particularly likely to be the case in property insurance in respect of warranties as to the use of the premises and the precautions to be taken against loss;[301] for example, a warranty in a fire policy as to the presence on premises of fire sprinklers, or the absence of inflammable goods.[302] A term may also, on its proper construction, constitute both a warranty as to past or present fact and a promissory warranty.

The effect of a breach of warranty

6.6 A breach of a warranty as to past or present fact occurs at the commencement of the insurance period. Since the insurer may repudiate the policy with effect from the date of breach[303] he will be entitled to reject all claims under the policy. By the same token, it seems that the insured will be entitled to a refund of any premium he has paid. A breach of promissory warranty, by contrast, will take place during the currency of the policy with the result that the insurer remains liable for claims made in respect of losses (if any) prior to the breach, but is entitled to reject claims in respect of losses occurring subsequently. There is authority[304] for the proposition that an insurer may not reject a particular claim in reliance upon a breach of warranty unless he also repudiates the whole policy. However, undue reliance ought not to be placed upon this authority because the distinction between the legal effect of a material non-disclosure or mis-statement by the insured in the proposal form and of a breach of warranty does not appear to have been argued before the court or considered fully in the judgments. The law is also uncertain as regards the insured's entitlement to a proportionate refund of premium where the insurer has repudiated the policy during its currency for breach of a promissory warranty, but in most cases his rights in this regard will be determined by an express contractual provision.

Warranties of opinion

6.7 If a particular question, or the general declaration in a "basis of the contract" clause in a proposal form, requires the insured to warrant only his

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[298]Cf. *Grant* v.*Aetna Fire Insurance Co.* (1862) 15 Moo. P.C.C. 516, 15 E.R. 589 and *Grant* v. *Equitable* (1864) 14 Low. Can. R. 493. See *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 10, para. 857.

[299]A question in a proposal form may refer to the future as well as to present facts: see *Dawsons Ltd.* v. *Bonnin* [1922] 2 A.C. 413. If the provision can only be read as to the future it will be a promissory warranty: see *Beauchamp* v. *National Mutual Indemnity* [1937] 3 All E.R. 19.

[300]*Woolfall & Rimmer* v. *Moyle* [1942] 1 K.B. 66; *Kennedy* v. *Smith and Adsvar Ins. Co. Ltd.* 1976 S.L.T. 110.

[301]*Sillem* v. *Thornton* (1854) 3 E. & B. 868, 118 E.R. 1367; *Hales* v. *Reliance Fire & Accident Ins. Co.* [1960] 2 Lloyd's Rep. 391.

[302]As in *Hales v. Reliance Fire & Accident Ins. Co.* [1960] 2 Lloyd's Rep. 391.

[303]See para. 6.2, above.

[304]*West* v. *National Motor Insurance Union Ltd.* [1955] 1 All E.R. 800 (C.A.) See also *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 10, para. 887.,

opinion as to the truth of his answers, there will be a breach of warranty only if the insured dishonestly supplies an incorrect answer.[305]

Interpreting warranties contra proferentem

6.8 If there is any doubt as to the scope of a warranty, whether it is as to present or past fact or promissory or both, it will be construed *contra proferentem,* that is, against the insurer who formulated its wording.[306]

B. Defects in the present law

6.9 Later[307] we set out our view on the defects in the rules of law which give insurers the right to create warranties as to past or present fact by means of "basis of the contract" clauses. There are however in our view four major defects in the present law of warranties which derive from the characteristics of warranties and the ways in which they are created.

(*a*) It seems quite wrong that an insurer should be entitled to demand strict compliance with a warranty which is not material to the risk and to repudiate the policy for a breach of it.

(*b*) Similarly, it seems unjust that an insurer should be entitled to reject a claim for *any* breach of even a material warranty, no matter how irrelevant the breach may be to the loss.

(*c*) Material warranties are of such importance to the insured that in our view[308] he ought to be able to refer to a written document in which they are contained.[309]

(*d*) As we have already mentioned, we deal below [310] with the mischiefs which arise from the creation of warranties by the use of a "basis of the contract" clause in a proposal form.[311]

C. Is reform of the law necessary?

6.10 In our view the defects in the present law just described show a formidable case for reform. On consultation there was general agreement that the law of warranties was in need of reform. Nevertheless, as with non-disclosure, it was contended by some representatives of the insurance industry that reform was neither necessary nor desirable, especially in view of the Statements of Insurance Practice. We have already examined a similar contention when dealing with non-disclosure and have concluded that the mischiefs in the present law of disclosure are not cured by the Statements.[312] The only provision in the Statements which is relevant exclusively to the law of warranties is to be found in paragraph

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[305]*Huddleston* v. *R.A.C.V. Insurance Pty. Ltd.* [1975] V.R. 683.

[306]*Provincial Ins. Co.* v. *Morgan* [1933] A.C. 240 (promissory warranty arising from proposal form); *Shaw* v. *Robberds* (1837) 6 Ad. & E. 75, 112 E.R. 29 (promissory warranty arising from policy document).

[307]See paras. 7.2–7.4, below.

[308]For our recommendation to this effect, see para. 6.14, below.

[309]See also *MacGillivray & Parkinson on Insurance Law* (6th ed., 1975) Chap. 10, para. 815 and E. R. H. Ivamy "Insurance Law Revision" (1955) 8 C.L.P. 147, 158.

[310]See paras. 7.5–7.11, below.

[311]For the general effect of our recommendation, see paras. 7.10 and 7.11, below.

[312]See paras. 3.28–3.30, above.

2(*b*) of the First Statement of Insurance Practice which indicates that except where fraud, deception or negligence is involved an insurer will not unreasonably repudiate liability to indemnify a policy holder where there has been a breach of warranty or condition but the circumstances of the loss are unconnected with the breach. We would again[313] draw attention to the fact that this provision in effect confers a discretion on insurers to repudiate a policy on technical grounds if they suspect fraud but are unable to prove it. For the same reasons as those stated in Part III[314] we have concluded that the protection of the insured requires more than measures of self-regulation by the insurance industry and that reform of the law of warranties is necessary. In the remainder of this Part we accordingly consider how the law should be changed. It will however be seen that the approach to reform which we recommend is broadly along the lines suggested in paragraph 2(*b*) of the First Statement of Insurance Practice and in the main follows the provisional recommendations in the working paper.

D. Reform of the law of warranties

Introduction

6.11 As we have seen, warranties are of two types: warranties as to past or present fact, and promissory warranties. In view of the recommendations which we make as regards "basis of the contract" clauses[315] insurers wishing to introduce warranties of the first type will no longer be able to do so either by the use of appropriate words in a proposal form or by a provision which refers to a proposal form. Insurers will have to introduce them individually in compliance with the formal requirements set out in paragraphs 6.14 and 7.10, below. However, we anticipate that as a matter of underwriting practice insurers will find it necessary to introduce such warranties in relatively few cases, usually in relation to large commercial risks and normally as a result of negotiations with the insured. Thus, although the recommendations in this Part are intended to apply both to warranties as to past or present fact and to promissory warranties, they will be applicable in the main to promissory warranties.

A modified system of warranties

6.12 In our view the system of warranties in English insurance law should be modified to the extent necessary to eradicate the defects we have described. The first defect in the present law noted above was that a breach of any warranty entitles the insurer to repudiate the policy whether or not the warranty was material to the risk. We consider that insurers should not be entitled to repudiate the policy for the breach of an undertaking which is immaterial to the risk, even if the word "warranty" is used or if the true construction of the contract provides the insurer with the right to repudiate for any breach of warranty even if immaterial. Accordingly, we recommend that a term of the contract should only be capable of constituting a warranty if it is material to the risk, in the sense that it is an undertaking relating to a matter which would influence a prudent insurer in deciding whether to accept the risk and, if he decides to accept it, at what premium and on what terms.

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[313]See para. 3.27, above.
[314]See paras. 3.23–3.30, above.
[315]See Part VII, below.

6.13 In our working paper we took the provisional view that since the materiality or otherwise of a particular warranty depends on its influence on the judgment of a prudent insurer it would be inappropriate and unduly harsh on the insured if the onus of disproving materiality were placed on him, and that the onus should accordingly be on the insurer to prove that the warranty broken was material to the risk.[316] However, we have reconsidered this. We now consider that if the insurer has complied with the formal requirements recommended in the next paragraph, so that the insured is made aware of his obligations, but the insured nonetheless acts in breach of any such obligation, it is inappropriate that the insurer should also have to prove the materiality of the obligation to the risk as a condition of being entitled to avoid the policy. We accordingly *recommend* that there should be a presumption that a provision in a contract of insurance, which possesses the attributes of a warranty at common law, is material to the risk. The insured can rebut this presumption by showing that the provision in question relates to a matter which would not have influenced the judgment of a prudent insurer in assessing the risk. It is to be noted that this recommendation is along the same lines as that made in relation to the materiality of questions in proposal forms.[317]

6.14 It will be convenient to discuss next the third of the defects relating to warranties which we noted in paragraph 6.9. This concerns the desirability of the insured being able to refer to a written document containing the warranties by which he is bound. In our view the insurer should be obliged, as a condition precedent to the legal effectiveness of the warranty, to furnish the insured with such a document at least as soon as practicable after the insured gave the warranty in question. If the insured has completed a proposal form and has given answers to certain questions relating to the future, these answers will often have the force of promissory warranties because of the inclusion of a "basis of the contract" clause.[318] The insurer would accordingly be able to comply with this obligation by furnishing the insured with a copy of the completed proposal form.[319] Where no proposal form has been completed, and the insured has given a promissory warranty, we consider that it should be incorporated as an individual term on the face of the policy or in an endorsement thereon. However, we are aware that in some cases, for example where short term cover is granted, no policy is ever issued and that in others, for example where provisional cover is granted, a policy may not be issued within a reasonable time of the warranty having been given. In the case of provisional cover, a warranty may often be given over the telephone. In all such cases the insurer should be required to confirm in writing the warranty given by the insured as soon as is practicable in the circumstances. This may be done in a cover note, in a certificate of insurance or even by letter. If the insurer fails to comply with these formal requirements

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[316]W.P. No. 73, para. 116.

[317]See para. 4.83, above.

[318]For our recommendations concerning "basis of the contract" clauses see Part VII. Here it suffices to point out that our recommendations would prevent the creation of warranties as to past or present fact by means of such clauses but would not prevent the creation of promissory warranties in this way.

[319]It will be recalled that in Part IV of this report we recommend that the insurer should be obliged to furnish the insured with a copy of the completed proposal form. Thus if the insurer has complied with this obligation he will have satisfied the formal requirements relating to promissory warranties created in the proposal form.

he should in our view be precluded from relying on a breach of the warranty in question in order to repudiate the policy or reject a claim. Nevertheless, if a loss should occur in the interim, before it has become practicable for the insurer to provide such written confirmation, then the insurer should be entitled to rely on an oral warranty as this will then still be fresh in the mind of the insured.

The legal effect of a breach of warranty

6.15 We must now deal with the second, and perhaps the most important, of the defects in the law of warranties which we have described. The effect of our recommendations so far is that if the insured is in breach of a term of the contract which possesses the attributes of a warranty at common law[320] and has failed to rebut the presumption that it relates to a matter which is material to the risk, and the insurer has complied with the formal requirements set out in the preceding paragraph, then the insurer will be able to repudiate the policy for breach of warranty. Under the present law the insurer's repudiation relates back to the date of the breach with the result that he can also reject all claims for losses occurring thereafter. One of the mischiefs in the present law of warranties to which we have drawn attention is that insurers are thus able to base their refusal to pay a claim on a breach of warranty which may be totally unconnected with the loss. We are told that insurers usually only make use of this type of "technical repudiation" if they suspect but are unable to prove some other ground for repudiation.[321] In our working paper our provisional view was that an insurer should not be entitled to reject the claim unless he is able to prove a valid ground for rejection.[322] Our provisional recommendation was that the insurer's right to reject a claim for a loss occurring after the date of the breach should be restricted.

6.16 On consultation it was put to us that such a restriction would result in the erosion of safety standards by removing or reducing the incentive for compliance with warranties many of which are in the nature of undertakings on the part of the insured to observe precautions. We think it unlikely that a restriction of the insurer's rights of rejection would remove or reduce the incentive to comply with warranties: it may well be that many insureds observe prescribed precautions not out of any considerations relevant to their rights against the insurers but simply because they wish to preserve their persons or property from loss or damage.

6.17 On consultation the majority of those who commented agreed that the insurers' rights to reject claims should be restricted, but some of them raised minor points as to how the restriction proposed in the working paper would work in practice. In order to meet these points we have attempted, in the following paragraphs, to improve our formulation. We also recommend some changes in the present law relating to the effect of repudiation which would necessarily follow from introduction of our proposed restrictions.

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[320]See para. 6.2, above.
[321]Cf. the First Statement of Insurance Practice, para. 2 (*b*), reproduced in Appendix B.
[322]W.P. No. 73, para. 84.

6.18 In our working paper[323] we considered a number of possible alternative solutions to the problem considered in the preceding paragraphs. These were as follows:

(*a*) that the court should determine the insurer's entitlement to reject a claim for breach of warranty by reference to whether this would be reasonable in all the circumstances;

(*b*) that the insurer's entitlement in this regard should depend on the presence of causal connection between the breach and the loss;

(*c*) that the entitlement should depend on whether the loss was reasonably foreseeable as resulting from the breach.

We remain of the view that none of these alternative solutions is to be preferred to the recommendation which we provisionally made and which we now set out below.

The nature of the restriction

6.19 As mentioned earlier, the purpose of a promissory warranty is to compel the insured to do or refrain from doing something in order to prevent the risk from increasing or in order to reduce the risk. However, policies nowadays commonly cover more than one risk. An obvious example is a motor policy. Statute[324] requires that such a policy must provide cover in respect of liability for death of or personal injury to passengers and third parties. However, the policy will almost always also provide cover against fire or theft of the vehicle and comprehensive policies cover loss of or damage to the vehicle however caused, and often the contents as well. Similarly, householders' or houseowners' policies cover the risk of fire, burglary, storm and subsidence, and there are usually separate sections of the policy for the building and its contents. But if the insured commits a breach of a warranty which is relevant to only one risk and a loss is connected with another risk, then the breach would be irrelevant to the loss and it would clearly be unjust to permit the insurer to reject the claim. To illustrate what type of repudiation can be considered to be a "technical repudiation" we set out a number of examples. When considering these examples it must be borne in mind that all the warranties mentioned are clearly material in the context of the particular type of insurance, and that under the present law the insurer can reject *every* claim in *all* these cases.

(*a*) A warranty in a motor policy that the vehicle is to be kept in a roadworthy condition. The warranty is clearly intended to prevent an increase in the risk of accidents whilst the car is being driven. The warranty is broken because the headlights do not function. The vehicle is then stolen. The insured has committed a breach of warranty which increased the risk of one type of loss occurring, but the subsequent loss has been of a different type. The insured should be able to recover.

(*b*) A broken warranty as in (*a*) but the vehicle is run into while it is parked without anyone in it. It seems to us that in this case it should be open to the insured, if he establishes these facts, to resist rejection of the claim on the same ground as in (*a*).

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[323]W.P. No. 73, para. 123.

[324]The Road Traffic Act 1972, s. 145.

(*c*) A warranty in a motor policy that the insured has had a driving licence for ten years. He has in fact only held it for nine years. The vehicle is stolen. It seems to us that in this case, as in (*b*), rejection of the claim should not be permitted.

(*d*) A warranty in a householder's policy that the front door should be fitted with a particular make of lock. Another type of lock is fitted in breach of warranty. The house is damaged by fire. Again it seems to us that the insured should be entitled to resist rejection of the claim for the reasons given in the above examples.

(*e*) A warranty in a fidelity policy that the insured employer will engage no one without first having taken up satisfactory references. The employer fails to do so in relation to employee A who steals his employer's money. It seems to us that the insurer should be entitled to reject the claim, because the warranty was intended to prevent an increase in the risk of a particular type of loss and the subsequent loss has been of that type.

6.20 The test suggested by these examples is that the insurer should not be permitted to reject a claim if the breach of warranty was irrelevant to the loss in the sense that the broken warranty was intended to reduce the likelihood of a particular *type* of loss occurring and the actual loss which occurred was of a different *type*.

6.21 Although the insurer should generally be entitled to reject a claim for the breach of a warranty if the warranty broken was intended to reduce the likelihood of a loss of the type which actually occurred, it is still necessary to examine whether *any* breach of such a warranty should entitle the insurer to reject a claim in respect of *any* loss of such type. In the simple case where the actual loss is of the type which the broken warranty was intended to make less likely—as where the breach is directly connected with, or even causative of, the loss—it seems self-evident that the insurer must be entitled to reject the claim. Two examples should make this clear:

(*f*) The extent of a loss by fire has been increased by the breach of a warranty to maintain a sprinkler system.

(*g*) There has been a loss by burglary and the entry by the thieves has been facilitated by the breach of a warranty to maintain a burglar alarm.

However, in our view there will still remain some cases in which it would be unjust to permit the insurer to rely on the breach in order to reject a claim, even where the type of loss envisaged by the warranty and the actual loss are of the same type, because there may still be no possible connection between the breach and the actual loss. In such cases rejection of the claim would also not be justified. In order to illustrate the different situations which can arise we set out a number of further examples. Again it must be remembered when considering these examples that all the warranties are clearly material in the context of the particular type of insurance and that under the present law the insurer can reject *every* claim in *all* these cases.

(*h*) The facts as in (*e*) in paragraph 6.19, but the theft is committed by employee B who has supplied satisfactory references. It seems to us

that, although the likelihood that this type of loss (breach of fidelity) would occur was intended to be reduced by the warranty broken in relation to employee A, the breach could have had no possible connection with the way in which the actual loss occurred and the insured should be entitled to succeed in his claim.

(*i*) The facts as in (*e*) in paragraph 6.19, but the insured contends that if employee A had been asked for references, they would have been either satisfactory or forged. The insurer should still be entitled to reject the claim because the insured would be unable to prove that his breach, although not causative of the actual loss, could not have increased the *risk* that employee A would steal.

(*j*) A warranty in a fire policy on a factory that an efficient sprinkler system will be maintained throughout. A fire occurs in a workshop at one end of the factory where the system is properly maintained, but there is no such system in a workshop at the other end to which the fire does not spread. It seems to us that on proof of these facts the insured should be entitled to recover for the same reasons as in (*h*) above.

(*k*) A warranty in a burglary policy that a burglar alarm will be maintained on all doors and windows to the premises. The insured fails to maintain the burglar alarm in working condition. Thieves gain entry by tunnelling or by making a hole in the ceiling, and a loss occurs. It seems to us that the insured should only be entitled to recover if he can establish that in all the circumstances his failure to maintain the burglar alarm could not have increased the risk that a loss would occur through the thieves having obtained access to the property by tunnelling or making a hole in the ceiling.

(*l*) The owner of a motor vehicle fails to ensure that its headlights are functioning in breach of a warranty as to roadworthiness. The vehicle is involved in a collision in broad daylight. The insured should be entitled to recover because the malfunction of the headlamps could not have increased the *risk* that a collision in broad daylight would occur.

(*m*) A warranty in a fire policy on a factory that an efficient sprinkler system will be maintained. The sprinkler system does not function for two months. It is then repaired and subsequently there is a fire. Again the breach could not have increased the risk of fire because it had been remedied at the date of the loss.

Although the above examples represent unusual situations in comparison with the general run of insurance claims and the answer which justice requires may well be clear in most of them, there may be others in which the answer may not be obvious. It is therefore necessary to devise a test for dealing with all such cases. The test which is suggested by the examples which we have just analysed is that the insurer should not be entitled to reject a claim if the insured's breach of warranty could not have increased the risk of a loss occurring in the way in which it did in fact occur, even though the loss was of a type which the warranty was intended to make less likely. This forms the basis of the solution which we propose (and for convenience we refer to it as "the nexus test").

Our recommendation

6.22 Our recommendation is that in cases of breach of warranty the insurer should *prima facie* be entitled to reject claims in all cases which occur after the breach provided that the formal requirements enumerated in paragraph 6.14 have been complied with. However, if the insured can show either

(*a*) that the broken warranty was intended to reduce (or prevent from increasing) the risk that a particular type of loss would occur and the loss which in fact occurs is of a different type, or

(*b*) that even though the loss was of a type which the broken warranty was intended to make less likely, the insured's breach could not have increased the risk that the loss would occur in the way in which it did in fact occur

then the insured should be entitled to recover; but in such cases the insurer should remain entitled to repudiate *the policy* for the future on account of the breach of warranty which has occurred. The reason for the latter qualification is that in our view insurers should not be compelled to continue to cover insureds who have committed breaches of warranty; they should remain liable for prior claims on the basis of the nexus test referred to above, but subject to this they should be entitled to discontinue the cover. These recommendations necessitate some minor changes in the law relating to the effect of repudiation for breaches of warranty; we discuss these in the next paragraph.

The effect of repudiation for breach of warranty

6.23 The recommendations made above to restrict the insurer's right to reject claims for breach of warranty could not work if the present law as to the retrospective effect of repudiation[325] remains unchanged. If the insurer's repudiation operated retrospectively to the date of breach, then the contract of insurance would cease to exist from that date, with the result that the insurer would be entitled to reject all claims for subsequent losses. As pointed out in paragraph 6.6, under the present law it is unclear whether insurers have a right to reject claims without at the same time repudiating the policy.[326] However under the above mentioned recommendations an insured who has committed a breach of warranty will nevertheless be entitled to recover claims if he can satisfy the nexus test. This right, and the consequent liability of the insurer, can co-exist if the contract of insurance remains in existence. We accordingly *recommend* that if insurers exercise their right to repudiate a policy for breach of warranty, that repudiation should take effect for the future only and should no longer be retrospective to the date of the breach. The effective date of repudiation should be the date on which the insurer serves a written notice of repudiation on the insured. In the result the insurer would remain on risk between the date of the breach and the effective date of repudiation, but would be entitled to reject all claims which occur during that period unless the insured could satisfy the nexus test. We *recommend* accordingly. Further, for the avoidance of doubt, and

[325]See para. 6.2, above.

[326]The uncertainty arises because *West* v. *National Motor Insurance Ltd.* [1955] 1 All E.R. 800 (C.A.) seems to have been decided without argument about the distinction between the legal effect of a material non-disclosure or mis-statement by the insured and of a breach of warranty.

as a consequence of the foregoing proposals, we *recommend* that rejection of claims on account of breaches of warranty should not necessarily also involve repudiation of the policy: insurers should be free to reject a particular claim without also repudiating the policy. It should in our view be open to insurers to make independent decisions as to whether or not to reject individual claims and as to whether or not to continue on risk for the remainder of the policy period, without having to make these decisions in tandem. We believe that this reflects the present practice of the industry, but since the present law is uncertain we make an express recommendation to cover this point.

PART VII

"BASIS OF THE CONTRACT" CLAUSES

The present law

7.1 We have seen that an insurer may avoid a contract of insurance for the non-disclosure of a material fact.[327] However, insurers often pre-empt the issue whether a particular fact is material by including in the proposal form a declaration for signature by the proposer whereby he warrants the accuracy of all the answers to the questions asked: the usual formula is to provide that the proposer's answers are to form the "basis of the contract" between the insurer and the insured. Sometimes the policy itself contains a provision to the like effect.[328] Such declarations and provisions are known as "basis of the contract" clauses. Their effect in law is that all answers in the proposal form are incorporated into the contract as warranties and that, in the event of any inaccuracy in any one of them, the insurer may repudiate the contract for breach of warranty regardless of the materiality of the particular answer to the risk.[329] Since in cases where the answer relates to past or present facts the breach of warranty is committed at the moment when the contract is made, the effect is that the insurer may refuse to pay any claims under the policy. The fact that the insured may have answered the questions in good faith and to the best of his knowledge and belief does not help him if his answers are in fact inaccurate.[330]

Criticisms of the present law

7.2 The conversion of answers in a proposal form from mere representations to warranties by "basis of the contract" clauses has attracted a great deal of judicial criticism. In *Joel* v. *Law Union and Crown Insurance Co.*[331] Fletcher Moulton L. J. said:

> "Insurers are thus in the highly favourable position that they are entitled not only to bona fides on the part of the applicant, but also to full disclosure of all knowledge possessed by the applicant that is material to the

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[327]See para. 3.9, above.

[328]See *Everett* v. *Desborough* (1829) 5 Bing. 503, 130 E.R. 1155 and *Anderson* v. *Fitzgerald* (1853) 4 H.L. Cas. 484, 10 E.R. 551, for example.

[329]See *Thomson* v. *Weems* (1884) 9 App. Cas. 671, 689 *per* Lord Watson.

[330]See the Fifth Report of the Law Reform Committee, (1957) Cmnd. 62, para. 6. For the law relating to "basis of the contract" clauses generally see *MacGillivray & Parkington on Insurance Law* (6th ed., 1975) Chap. 10, especially paras. 635–638 and 814–912 and W.P. No. 73 paras. 78–79.

[331][1908] 2 K.B. 863.

risk. And in my opinion they would have been wise if they had contented themselves with this. Unfortunately the desire to make themselves doubly secure has made them depart widely from this position by requiring the assured to agree that the accuracy, as well as the bona fides, of his answers to various questions put to him by them or on their behalf shall be a condition of the validity of the policy . . . I wish I could adequately warn the public against such practices on the part of the insurance offices."[332]

In *Mackay* v. *London General Insurance Co.*[333] Swift J. said, when giving judgment for the insurer because of an incorrect, but immaterial, answer to a question where the policy contained a "basis of the contract" clause:

"I think he [the insured] has been very badly treated—shockingly badly treated. They [the insurers] have taken his premium. They have not been in the least bit misled by the answers which he had made."[334]

In *Glicksman* v. *Lancashire & General Assurance Co. Ltd.*[335] Lord Wrenbury said, when giving judgment for the insurers in similar circumstances:

"I think it a mean and contemptible policy on the part of an insurance company that it should take the premiums and then refuse to pay upon a ground which no one says was really material. Here, upon purely technical grounds, they, having in point of fact not been deceived in any material particular, avail themselves of what seems to me the contemptible defence that although they have taken the premiums, they are protected from paying."[336]

Such clauses have been judicially described as being "traps"[337] for the insured, and in one case[338] the court took the view that to give effect to such a clause would render the "policy [in which it was contained] . . . not worth the paper upon which it was written"[339] and liable to produce a result whereby "no prudent man [would] effect a policy of insurance with any Company without having an attorney at his elbow to tell him what the true construction of the document is".[340]

7.3 Extra-judicial criticism[341] of "basis of the contract" clauses has focused on two features. The first is that they give insurers the right to repudiate for what would otherwise be non-fraudulent immaterial misrepresentations. The second is that they give insurers the right to repudiate for statements which, although true to the best of the insured's knowledge and belief, are in fact inaccurate; this result has been considered particularly draconian in relation to proposal forms for life policies in which the insured is asked questions about the state of his health.

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[332]*Ibid.*, at p. 885.
[333](1935) 51 Ll.L.R. 201.
[334]*Ibid.*, at p. 202.
[335][1927] A.C. 139.
[336]*Ibid.*, at 144–145.
[337]*Zurich Insurance Co.* v. *Morrison* [1942] 1 All E.R. 529, 537 *per* Lord Greene M.R.
[338]*Anderson* v. *Fitzgerald* (1853) 4, H.L. Cas. 484, 10 E.R. 551.
[339]*Ibid.*, at (1853) 4 H.L. Cas. 484, 507, 10 E.R. 551, 560 *per* Lord St. Leonards.
[340]*Ibid.*, at (1853) 4 H.L. Cas. 484, 514, 10 E.R. 551, 563 *per* Lord St. Leonards.
[341]See R. A. Hasson "The 'basis of the contract clause' in insurance law" (1971) 34 M.L.R. 29; G. H. Treitel, *The Law of Contract* (5th ed., 1979) p. 300; *Cheshire & Fifoot's Law of Contract* (9th ed., 1976) p. 281.

7.4 On consultation most commentors agreed that the present law as to the legal effect of "basis of the contract" clauses is unsatisfactory and in need of reform, whilst a small number thought that the criticisms were adequately dealt with by the Statements of Insurance Practice.[342]

Reform of the present law

The mischief

7.5 It is clear from the foregoing criticisms that "basis of the contract" clauses constitute a major mischief in the present law. These clauses, to the extent that they apply to statements of past or present fact in proposal forms, seem to us to be objectionable on three main grounds. First, they enable insurers to repudiate the policy for inaccurate statements even though they are not material to the risk. Secondly, they entitle insurers to repudiate the policy for objectively inaccurate statements of fact even though the insured could not reasonably be expected either to know or to have the means of knowing the true facts. Thirdly, the elevation *en bloc* of all such statements into warranties binding on the insured means that, if the insurers can establish any inaccuracy, however trivial, in any of the statements, they can exercise their right to repudiate the policy, even when the statement is not material to the risk and even when it concerned matters beyond the insured's knowledge or means of knowledge. Such a repudiation is often referred to as one example of a "technical" repudiation.

7.6 Insurers contend (and indeed one sector of the insurance industry mentioned this on consultation) that in practice they only take advantage of technical defences, such as those founded on "basis of the contract" clauses, to repudiate policies when they suspect fraud which they are unable to prove. However, we reiterate the view taken in the working paper[343] that it is unsatisfactory for insurers to be able to repudiate policies on mere suspicion of fraud. It should be for the courts, and only for the courts, to make findings of fraud.[344] It seems quite unacceptable that insurers should in effect in many cases have a discretion to repudiate policies on technical grounds; their entitlement in this regard should depend on the law and not on their discretion.

7.7 The first of the above objections to "basis of the contract" clauses has already been met by our recommendation[345] that no provision of a contract of insurance should be capable of constituting a warranty unless it relates to a matter which is material to the risk. This of itself does not however go far enough, since it does not meet the second and third objections made in paragraph 7.5. Earlier in this report[346] we pointed out that it was unjust to the insured to require him, by means of a proposal form, to give objectively accurate answers to specific questions as to past and present facts which were outside his knowledge or means of knowledge. We accordingly reached the conclusion that such

[342]See paras. 3.27–3.30 above, for our conclusion that the Statements of Insurance Practice are not a satisfactory alternative to legislative reform of the law.

[343]W.P. No. 73, para. 84.

[344]See the Fifth Report of the Law Reform Committee (1957) Cmnd. 62, para. 11; *Aspects of Insurance Law*—a Report of the Contracts and Commercial Law Reform Committee of New Zealand (1975) para. 4: Issues Paper No. 2 of the Law Reform Commission of Australia, *Insurance Contracts* (June 1977) pp. 9–10.

[345]See para. 6.12, above.

[346]See para. 4.61, above.

injustice could best be avoided by a provision that the insured should be treated as having discharged his duty of disclosure if he has answered any such question to the best of his knowledge and belief, after making such enquiries as are reasonable, having regard both to the topics covered by the question and the nature and extent of the cover which is sought, even if his answer is *in fact* inaccurate.[347] In our view it would be unacceptable if insurers were able to circumvent the protection thus afforded to the insured by obtaining from him, by way of a "basis of the contract" clause, a warranty as to the accuracy of all or any of his answers. The Law Reform Committee undoubtedly had this mischief in mind when it suggested that a provision could be introduced into our law without difficulty whereby " . . . Notwithstanding anything contained or incorporated in a contract of insurance, no defence to a claim thereunder should be maintained by reason of any mis-statement of fact by the insured, where the insured can prove that the statement was true to the best of his knowledge and belief".[348]

7.8 Accordingly, our recommendation is that any "basis of the contract" clause should be ineffective to the extent that it purports to convert into a warranty any statement or statements by the insured as to the existence of past or present facts, whether the insured's statement is contained in a proposal form or elsewhere. However, it would defeat our recommendations if insurers were able to evade this ban on "basis of the contract" clauses by obtaining from the insured a separate warranty as to past or present fact or a series of such warranties, either in proposal forms or in documents which refer to proposal forms. We therefore *recommend* that no provision in a proposal form whereby the insured promises that a state of affairs exists or has existed should be capable of constituting a warranty. This would mean, for instance, that a promise by the insured in a proposal form that his house is constructed of brick and slate would not constitute a warranty. Furthermore, any provision either in or referring to the proposal form whereby the insured purports to undertake the accuracy of a statement or statements in the proposal form concerning past or present fact should be ineffective to create a warranty. This would mean for example that a provision of the policy whereby the insured declares that answers to specific questions in the proposal form are true would not constitute a warranty.

7.9 The object of these recommendations is twofold. The first is to deny any legal efficacy to the "basis of the contract" clause as regards warranties as to past or present facts. The second is to prevent the proposal form from being used as a vehicle for the creation of warranties as to past or present facts and to ensure that the parties' rights and duties as regards statements made by the insured in the proposal form as to past or present fact are governed exclusively by the recommendations we have made in Part IV of this report.

Effect of our recommendation

7.10 We should, however, make it clear that we do not intend to ban specific undertakings by the insured as to the existence of past or present facts or to

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[347]At para. 4.61, above.
[348](1957) Cmnd. 62, para. 14 (2).

prevent such specific undertakings from constituting warranties in all cases. If insurers consider it necessary to obtain such undertakings, they should be able to do so by introducing them into the policy as individual specific warranties, always provided, however, that the formal requirements which we have recommended[349] in regard to the creation of warranties are satisfied. Furthermore, we should point out that our other recommendations concerning warranties[350] substantially restrict the present rights of insurers to reject claims for breach of a warranty.

7.11 We turn next to promissory warranties. If an answer in a proposal form relates to the future, then under the present law a "basis of the contract" clause will elevate that statement into a promissory warranty.[351] We do not see the same objection to this as in relation to statements as to past or present fact because the safeguards and precautions which can be created by promissory warranties are clearly necessary for insurers and unobjectionable, and there appears to be no reason to prevent their creation by means of "basis of the contract" clauses as a matter of convenience. There is then the further possibility that, as noted above,[352] an answer in a proposal form may relate to past and present fact as well as containing a reference to the future. In such cases a "basis of the contract" clause will be effective under our recommendation only insofar as it creates a promissory warranty, and we consider this to be unexceptionable for the reasons stated above. Accordingly, we *recommend* that no change be made to this aspect of the present law. However, it is again necessary to point out that if insurers do create promissory warranties in this way they will still have to comply with the formal requirements we propose in relation to warranties,[353] and that their right to reject claims for breaches of any such warranty would be restricted.[354]

PART VIII

MISCELLANEOUS MATTERS

8.1 In this Part of the report we deal with two miscellaneous matters in respect of which we are making minor recommendations for reform. These are:

(*a*) the relationship between our recommendations as to non-disclosure and breach of warranty on the one hand and the existing law of misrepresentation and fraud on the other; and

(*b*) whether our recommendations should apply to contracts of reinsurance.

We also deal with the possibility of avoidance of our recommendations should they become law and with transitional provisions.

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[349]See para. 6.14, above.

[350]See paras. 6.12–6.23, above.

[351]See paras. 6.3 and 6.5, above.

[352]See para. 6.5, above.

[353]See para. 6.14, above. Insurers who provide a copy of the completed proposal form to the applicant in accordance with our recommendations at para. 4.63, will of course at the same time be confirming in writing the promissory warranties created by the "basis of the contract" clause, thereby complying with these formal requirements.

[354]See paras. 6.12–6.23, above.

Misrepresentation and fraud

8.2 In Parts IV, VI and VII of this report we put forward our recommendations for reform of the law relating to non-disclosure, warranties and "basis of the contract" clauses respectively. It is necessary briefly to examine the relationship between our recommendations and the existing law of misrepresentation and fraud. We should mention that on consultation very few comments were made on these topics.

Non-fraudulent misrepresentations

8.3 In the context of the matters dealt with in this report such misrepresentations are relevant where they consist of inaccurate or untrue statements made by the insured prior to the conclusion of the contract. They may be either oral or in writing and often take the form of answers to questions in the proposal form. Although they are not part of the contract, under the present law such misrepresentations may be incorporated into it as warranties as to past or present fact. A misrepresentation by an insured about a material fact may also amount to a breach of his duty of disclosure. The present effect of a misrepresentation by the insured is that it renders the contract voidable at the instance of the insurer if it is substantially false, if it concerns facts material to the risk and if it has induced the insurer to conclude the contract. In addition the insurer will have remedies under the Misrepresentation Act 1967.[355]

8.4 We deal first with the case where the misrepresentation also amounts to a breach by the insured of his duty of disclosure. In Part III we have discussed two ways in which the insured may be in breach of this duty: either by failing to volunteer material information to the insurers or by the giving of inaccurate information in response to (or the failure to answer) questions,[356] and in Part IV we made detailed recommendations to restrict the scope of the duty in both cases.[357] The purpose of these recommendations is to strike what we consider to be a fair balance between the interests of the insurer and the insured. On this basis we also consider that these recommendations should govern the rights and duties of the insurer and the insured to the exclusion of any rights and remedies which the insurer may have under the law of misrepresentation; otherwise the law of misrepresentation could be used as a means of upsetting this balance. We must now illustrate the consequences of this conclusion.

8.5 There are three cases in which the insurer should in our view be precluded from pursuing his remedies under the law of misrepresentation and should be confined to his remedies for non-disclosure.

(i) Where the insured has failed to disclose material facts to the insurer with the result that he is in breach of his duty of disclosure under the present law. If the undisclosed facts were such as would not have been disclosed by a reasonable man in the insured's position, having regard to the nature and the extent of the cover applied for, then the insured

[355]For the effect of misrepresentation generally in the law of insurance, see *MacGillivray & Parkington on Insurance Law* (6th ed., 1975), paras. 666–723.

[356]See paras. 3.8 and 3.10, above.

[357]See paras. 4.43–4.87, above.

would not be in breach of the modified duty of disclosure which we are recommending. However, although not in breach of the modified duty of disclosure, the insured might have made an actionable misrepresentation.

(ii) The insured may be in breach of the modified duty of disclosure which we are recommending and may also have made an actionable misrepresentation. In this case the insurer would have the alternative of pursuing his remedies under our recommendations for non-disclosure or for misrepresentation.

(iii) The insured may have given an inaccurate answer in response to a question in a proposal form and will therefore have made an actionable misrepresentation. However, if he has answered the question to the best of his knowledge and belief after carrying out such inquiries as are reasonable having regard to the subject-matter of the question and the nature and extent of the cover sought, he should be regarded as having fulfilled his duty of disclosure under our recommendations.[358]

In all these cases the insurers would have rights and remedies under the law of misrepresentation either at common law or under the 1967 Act, and in (ii) and (iii) these would or might be alternatives to the remedies available for breach of the modified duty of disclosure. If the law were left unchanged, then in (ii) and (iii) the insurers might well consider it more advantageous to pursue the remedies for misrepresentation rather than those for non-disclosure. Accordingly, in order to prevent the insurer from circumventing our recommendations as to non-disclosure, we *recommend* that in all these cases the insurer should not be entitled to pursue any remedy which is dependent upon the making of the misrepresentation as such but should be confined to his rights and remedies (if any) for non-disclosure.

8.6 It should however be emphasised that the above recommendation only applies where a misrepresentation of fact also amounts to a breach of the duty of disclosure. There may be cases where a misrepresentation induces the insurer to enter into a contract with the insured but the misrepresentation does not amount to a non-disclosure. For instance, an applicant for insurance might wrongly represent to an insurer that he was in a position to influence others to place their insurances with the insurer, the representation not having been made fraudulently but in the mistaken belief that it was true. If the insurer then entered into the contract in reliance on this statement, the statement would not be material to the risk and would therefore not amount to a non-disclosure. It would, however, be a collateral misrepresentation which induced the contract. Our recommendations are not intended to apply to such collateral misrepresentations, since these are not concerned with insurance as such. In the result these would continue to be actionable at common law and under the Misrepresentation Act 1967.

8.7 We now turn to the relationship between misrepresentation and warranties. As mentioned above, a misrepresentation may be incorporated into the

[358] See para. 4.61, above.

contract of insurance as a warranty as to past or present fact. In Part VI we made detailed recommendations restricting the right of insurers to reject claims in reliance upon breaches of warranty with the object of preventing "technical repudiations". It would in our view be unacceptable if insurers were able to evade these recommendations by treating the breach of warranty as a misrepresentation. We accordingly *recommend* that in this case, in parallel with the cases of non-disclosure mentioned in the preceding paragraph, the insurer should not be entitled to pursue any remedy for misrepresentation as such, but should be confined to his remedies (if any) for breach of warranty.

Fraudulent misrepresentation

8.8 Non-disclosure and breaches of warranty may also arise in cases in which the insured's breach constitutes a fraudulent misrepresentation. As we pointed out in our working paper[359] the insurer might in such cases have the alternative of pursuing his remedies under our recommendations in regard to non-disclosure or breach of warranty or of pursuing his remedies for fraud. He might regard the latter as more advantageous than the former. It seems to us that in cases of fraud different considerations from those relating to non-fraudulent misrepresentation apply. It has been said that fraud unravels everything,[360] and in our view no one should be deprived of any remedies when fraud is involved. We accordingly recommend that in cases of fraudulent misrepresentation there should be no change in the law.

8.9 The insured may also make fraudulent misrepresentations or otherwise act fraudulently when putting forward claims. However, this topic lies outside the ambit of this report and we are therefore not dealing with it.

Contracts of reinsurance

8.10 A contract of reinsurance is an agreement between two insurers whereby the original insurer (usually known as the reassured) reduces the extent of his liability by transferring or "ceding" a certain fixed share of the risk to another insurer (usually known as the reinsurer) upon the terms of the reinsurance contract.

8.11 There are various methods of placing reinsurances,[361] for example the "facultative" reinsurance of individually offered risks, "treaty" reinsurance whereby all risks falling within the contract must be ceded and accepted on the terms agreed, and other more complex arrangements commonly known as "open cover" and "pool" reinsurance. For present purposes, however, the differences between these methods are immaterial.

8.12 In our working paper[362] we concluded that our provisional recommendations should not apply to contracts of reinsurance for two main reasons. First, the parties to such contracts are insurers or occasionally insurance intermediaries and will therefore be aware of the well-known and long-standing rules

[359]W.P. No. 73, paras. 170–171.
[360]*Lazarus Estates Ltd.* v. *Beasley* [1956] 1 Q.B. 702, 712 *per* Denning L.J.
[361]For further details see e.g. R. L. Carter, *Reinsurance* (1979) pp. 73–79.
[362]W.P. No. 734, para. 173.

of law and practice governing the market in which they operate; they will therefore not require the protection provided by our recommendations. Secondly, our view was that the provisional recommendations in the working paper as regards non-disclosure and breach of warranty would be inappropriate for such contracts. We remain of this view with regard to the recommendations in this report and consequently propose that they should not apply to contracts of reinsurance. We should also mention that the proposed Directive does not apply to contracts of reinsurance.

8.13 However, it was pointed out to us on consultation that some anomalies might arise if different rules as to non-disclosure and breach of warranty were to apply to contracts of insurance and to contracts of reinsurance. Thus it was suggested that under the existing law a reinsurer might be entitled to repudiate liability under the contract of reinsurance in circumstances where under our recommendations the reassured would be bound to pay *his* insured's claim, with the unfair result that the reassured would be left to bear the loss alone.[363]

8.14 It may well be that this problem would not arise in practice. At present a reassured usually wishes to bind his reinsurers by his settlements and does so by the incorporation into the reinsurance contract of a provision giving the reassured the right to settle all claims at his discretion and to look to the reinsurer for an indemnity.[364] Depending on the exact wording of the provision, the reinsurer may therefore be bound to indemnify the reassured in respect of settlements even where there is doubt about the reassured's liability to pay his insured,[365] and some contracts go so far as to provide expressly that the reinsurer will indemnify the reassured even against *ex gratia* payments made to the insured.[366] We therefore doubt whether the implementation of our recommendations and their non-application to contracts of reinsurance would cause any difficulty in practice. Moreover, non-disclosures by an insured usually have no direct counterpart in contracts of reinsurance, and warranties given by the insured are only rarely passed on by the reassured.[367]

8.15 Nevertheless, in the light of the comments received on consultation and for the avoidance of any doubt, we consider that the legislation which we recommend should ensure expressly that there will be no possibility of any consequential imbalance between the liabilities under contracts of insurance and

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[363]One illustration given related to warranties. The contract of reinsurance may simply repeat warranties contained in the original insurance contract and state that the reinsurance is subject to the same terms and conditions as the original insurance. If the law relating to warranties were to be modified as we recommend, then the reassured would be liable to pay his insured's claim notwithstanding a breach of warranty by the insured where there was no connection between the breach of warranty and the actual loss. However, the reinsurer would then be entitled to reject the reassured's claim under the existing law of warranties, which would continue to apply to the contract of reinsurance.

[364]See R. L. Carter, *Reinsurance* (1979) p. 129. Thus, common provisions are "to follow all settlements" or "to pay as may be paid thereon".

[365]*Ibid.*, pp. 129–130.

[366]*Ibid.*, pp. 130–131.

[367]For the effect under the present law of a warranty by the reinsured as to the accuracy of facts represented to him by the insured see: R. L. Carter, *Reinsurance* (1979) p. 125. We understand that such clauses occur only very rarely.

contracts of reinsurance. We therefore *recommend* that reinsurers should have no greater rights against their reassured than the latter would have against their insured in either of the following circumstances:

(*a*) if as a consequence of the non-disclosure of a material fact by the insured, the reassured fails to disclose the fact to the reinsurers; or

(*b*) if the reassured substantially repeats a warranty broken by the insured.

Possible avoidance of our recommendations

Our recommendations with regard to non-disclosure

8.16 We must deal shortly with the possibility that insurers will seek by contract to avoid our recommendations. First, they may attempt to "contract out", *viz.* to impose heavier duties on the insured than are provided for by our recommendations, either in the contract of insurance itself, or in a collateral contract. We consider that it would be unacceptable for insurers to be able in this way to impose a more onerous duty of disclosure than that which results from our recommendations. Equally it would not be acceptable for our recommendations to be circumvented by a drafting device by which the insurer attempts to introduce a higher duty of disclosure as a condition precedent to liability. Accordingly we consider that such attempts to avoid our recommendations with regard to non-disclosure should be made ineffective.

Our recommendations with regard to warranties

8.17 We must also deal with the question whether any avoidance provision is required in regard to warranties. Insurers frequently limit their liability by inserting into contracts of insurance terms which are not warranties. Thus contracts of insurance contain conditions precedent, clauses limiting or describing the risk, or clauses excluding certain matters from the risk, to which none of our recommendations regarding warranties applies. We do not intend to interfere with the manner in which insurers describe or limit the risk which they are prepared to cover: this can be left to competition and market forces. Accordingly we do not think that any attempt should be made to control the use of such terms even though they may be used to achieve indirectly the functions which can be performed by a warranty.

8.18 It would therefore be possible for insurers to attempt to evade some or all of our recommendations as to warranties by an increased use of these other terms. We do not anticipate that this will happen, particularly in view of the fact that any such development would, we think, be likely to lead to administrative control of the terms of insurance contracts. Accordingly we make no recommendation in this regard.

Transitional Provisions

8.19 Contracts of insurance entered into before our recommendations are implemented will obviously have been entered into on the basis that the existing law as to non-disclosure and warranties will apply. We do not consider that any of our recommendations are of such a nature that they should be made to apply to such contracts. We *recommend* accordingly.

8.20 The question then arises as to whether our recommendations should apply to contracts of insurance which are entered into after our recommendations come into force, but which are contracts entered into by way of renewal of contracts entered into before that date. In law, as we have said, renewal constitutes the conclusion of a new contract; in practice, the disclosure upon which renewal is based and the terms of the new cover will almost invariably be very similar to, if not identical with, the disclosure upon which the original contract was based and the terms of the original cover. As the original contract will obviously have been entered into on the basis of the existing law, we consider it to be impracticable to apply our recommendations to renewal, thus altering the duty of disclosure and altering the effect of the warranties in the contract. In our view it would not be right for a particular non-disclosure to justify repudiation of a particular policy the day before expiry of the annual cover and yet, as a result of our recommendations, not to justify repudiation of what is in practice the same cover the day after what may be considered by the parties to amount to automatic renewal. It would also be undesirable if an analogous situation were to arise as a result of our recommendations as to warranties. In our view, therefore, our recommendations should not apply to subsequent renewals of contracts of insurance which were entered into before our recommendations come into force.

8.21 It is generally clear whether or not a contract of insurance is entered into by way of renewal of an existing contract. Thus where the parties to the later contract are the same as the parties to the earlier one and the later contract provides cover against the same or substantially the same risks as the earlier one it is convenient to regard the latter contract as having been entered into by way of renewal of the earlier contract. We do not intend that our recommendations should apply to such renewal of a contract originally entered into before our recommendations were implemented. However, it would not be satisfactory if, merely because the parties were the same and the cover were against the same or substantially the same risks, the parties were permanently "locked in" the existing law and if our recommendations could never become operative in such circumstances. We therefore propose that a renewal by way of a fresh proposal form or a renewal whereby it is expressly agreed that the cover is new cover should be treated as a fresh contract of insurance, to which the recommendations would accordingly apply.

PART IX

OUR CONCLUSIONS

The need for reform

9.1 The English law concerning non-disclosure and warranties has been strongly criticised by our courts and by academic writers.[368] The fact that its full application is capable of causing hardship to persons who insure in their "private" capacity is already recognised by the measures of self-regulation adopted by the insurance industry in the Statements of Insurance Practice.[369]

[368]See in particular paras. 3.17–3.22, above as to non-disclosure and paras. 6.9 and 6.10, above as to warranties.

[369]See para. 1.6, above.

However, we have no doubt that these do not provide any adequate substitute for the reform of the law which is clearly needed, particularly since they leave the insurer in the position of judge and jury as to whether or not the full rigour of the law should be applied in individual cases.[370] Further, so far as concerns the law of non-disclosure in particular, as long ago as 1957 the Law Reform Committee stated in its Fifth Report[371] that the state of the law was capable of leading to abuse, in the sense that a variety of circumstances might entitle insurers to repudiate liability as against an honest and at least reasonably careful insured, and that such abuses had in fact sometimes occurred, though not to any substantial extent.

9.2 Criticisms have not been levelled against the present law in the field of marine, aviation and transport insurance (MAT) to the extent that this operates between insurers and insured who can be regarded as engaged in the insurance market on a more or less professional basis, and who are therefore fully familiar with the law and practice, in particular with the Marine Insurance Act 1906. We have therefore concluded[372] that in this field the law should be left as it is, but (on the basis of representations made to us on consultation) that the Secretary of State should be empowered to apply the legislation which we recommend to certain private interests who insure in this field, such as owners of pleasure craft, whose insurances will otherwise continue to be governed by the present law and be affected by its defects. We have also carefully considered whether any other dividing line could or should be drawn, in particular by having special rules for "consumer" insurance. However, we have concluded[373] that this would be neither practicable nor desirable. In effect, therefore, the legislation which we recommend will apply to all insurances other than MAT, but subject to a power vested in the Secretary of State to apply this legislation to private interests within the MAT field if he considers it appropriate to do so.

9.3 In this report we have identified four major mischiefs in the present law of insurance in relation to which we consider that reform is urgently needed and long overdue. These are as follows:—

(i) The duty of disclosure is far too stringent. It requires every insured to disclose any fact which a prudent insurer would consider to be material, and entitles the insurer to repudiate the policy and to reject any claim in the event of any breach of this duty. However, an honest and reasonable insured may be quite unaware of the existence and extent of this duty, and even if he is aware of it, he may have great difficulty in forming any view as to what facts a prudent insurer would consider to be material.[374]

(ii) The duty of disclosure under the present law operates particularly harshly on the insured, and produces something of a trap for him, in relation to proposal forms and renewals of the cover. In relation to proposal forms even a reasonable insured is likely to be unaware that

[370] See paras. 3.23–3.30, above.
[371] See para. 1.5, above.
[372] See paras. 2.8–2.16, above.
[373] See paras. 4.34–4.42, above.
[374] See generally paras. 3.17–3.22, above.

after answering a series of specific questions he remains under a residual duty to disclose any other material facts to which no question has been directed.[375] In relation to renewals even a reasonable insured is likely to be unaware that in law these constitute fresh contracts of insurance and that the duty of disclosure arises afresh on the occasion of every renewal, with the result that the insured is successively under a duty to disclose any material facts which may have arisen in the interim.[376] Moreover, since this duty will arise afresh on the occasion of every renewal, the insured will have even greater difficulty in complying with it if he does not have copies of any information previously supplied by him in a proposal form and on the occasion of prior renewals.[377]

(iii) The present law concerning warranties given by the insured (both as to past or present fact and promissory warranties) operates with great unfairness on the insured. It entitles the insurer to repudiate the policy and to reject any claim whether or not the warranty in question is material to the risk, and whether or not any breach of any particular warranty has had any connection with any particular claim which may have arisen.[378] Further, unless an insured is supplied with a copy of any warranty to which his policy may be subject, he will have difficulty in remembering its terms and, in appropriate cases, complying with it.[379]

(iv) The position under (iii) above is greatly exacerbated by the device frequently used in proposal forms of transforming all statements, and all answers given by the insured to questions in proposal forms, *en bloc* into warranties by means of "basis of the contract" clauses or similar provisions.[380]

The choice for reform

9.4 Having regard to the existence of the proposed EEC "Directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts"[381] the major choice for reform for the purpose of this report lies between this Directive and the enactment of the legislation which we recommend.[382] In our view, for the reasons summarised below, the Directive would provide an unsatisfactory and inadequate means of reforming the defects in our present law in comparison with the legislative reforms which we recommend. We therefore turn first to the Directive and then to a review of our recommendations.

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[375]See para. 4.56, above.
[376]See para. 4.70, above.
[377]See para. 4.70, above.
[378]See generally para. 6.9, above.
[379]See para. 6.14, above.
[380]See generally paras. 7.1–7.4, above.
[381]See generally paras. 1.7–1.13, above.
[382]See para. 1.20, above.

The proposed Directive

9.5 Our views on the proposed Directive can be summarised as follows:—

(i) Its *raison d'être* is to harmonise the insurance laws of the members of the EEC with the object of furthering the proper functioning of the Common Market and avoiding a distortion of competition between insurers within it. It might well be thought that its effect in this regard would be imperceptible and insignificant.[383]

(ii) It only deals with a relatively small part of insurance law. In particular, it does not touch the defects concerning promissory warranties referred to in paragraph 9.3 (iii) and (iv) above, and it does not apply to life insurance.

(iii) The enactment of the Directive by legislation would preclude Parliament from enacting any further legislation within the domain of the Directive, in particular any legislation for the protection of the consumer insured. The enactment of the Directive would therefore freeze our law indefinitely in an unsatisfactory state.[384]

(iv) In relation to the insured's duty of disclosure the Directive is generally too favourable to the insurer and in some respects still harsher on the insured than our present law, and it contains no provision such as we recommend for warning the insured about the duty of disclosure.[385]

(v) A central feature of the Directive is the "proportionality" principle. This mitigates the position under English law whereby an insurer is entitled to repudiate the policy and to reject any claim in the event of a non-disclosure by the insured, by providing that in this event the insurer will be liable to pay such proportion of any claim as equals the proportion which the actual premium paid bears to a notional premium which would have been charged by the insurer if the non-disclosure in question had not occurred. In our view the ascertainment of the sum payable on this basis presents great practical difficulties and would be likely to lead to much litigation, particularly in this country where premium tariffs are virtually unknown and there is no administrative control over the content of insurance policies. Proportionality has not worked well in Sweden or France, and in this country the defects relating to the law of non-disclosure can in our view be adequately dealt with by the legislation which we recommend without recourse to proportionality.[386]

(vi) The Directive draws unsatisfactory distinctions between breaches of the insured's duty of disclosure when these have occurred innocently, or when the insured "may be considered to have acted improperly", or when he may have broken it with the intention of deceiving the insurer, and these distinctions provide an unsatisfactory basis for the different and complex remedies available to the insurer in these various events.[387]

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[383]See paras. 1.14 and 1.22, above.
[384]See paras. 1.15–1.19, above.
[385]See paras. 4.2, 4.3, and 4.20, above.
[386]See generally paras. 4.7–4.17, above.
[387]See paras. 4.22–4.29, above.

(vii) The provisions of the Directive concerning the disclosure by the insured of increases and decreases in the risk during the currency of the contract, and prescribing complex procedures for cancellation of the contract or adjustment of premiums on a continuing basis, would be quite inappropriate in this country, where insurance contracts are generally concluded for a period of one year and not on a long-term basis. Furthermore, these provisions would be likely to lead to much litigation and the insured might often find himself without cover at short notice.[388]

(viii) The territorial scope of the Directive is unclear. In practice, however, it would have to apply to our insurance law on a world-wide basis if it comes into effect.[389]

9.6 As we see it, any justification for the acceptance of the proposed Directive by our Government in the Council of Ministers in Brussels would have to rest on grounds other than the improvement of English insurance law; for example on whether the prospect of our insurance industry being able to operate freely within the EEC depends on acceptance of the Directive. In its present form it cannot in our view be considered as a desirable instrument of law reform which would improve our law of insurance. On the contrary, in some respects it would make it worse, or would substitute other defects for the present ones, or would leave untouched some of the present defects in our law in relation to which reform is necessary in any event.[390] We therefore feel bound to say that, from the point of view of law reform, the Directive does not provide a satisfactory alternative to the recommendations made in this report. However, from the point of view of our EEC partners and the Commission of the European Communities in Brussels we can well see that the present state of the English law of insurance is unsatisfactory.[391] In this connection our hope would be that, if the legislation recommended in this report is enacted, our insurance law will have become sufficiently improved and acceptable to our EEC partners to render the Directive unnecessary.[392]

The effect of our recommendations

9.7 In Part X of this report we summarise the various recommendations which we make for the reform of our law. Their effect will be, in our opinion, to eradicate the main defects in our law which have been summarised in para. 9.3.

(i) The stringency of the duty of disclosure under the present law will be cured by the reduction of the duty, along similar lines to those suggested

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[388]See paras. 4.24–4.28, 4.31 and 5.1–5.16 and 5.18, above.

[389]See para. 1.10, above.

[390]See generally para. 9.5, above.

[391]Like our recommendations, the Directive does not apply to MAT insurance (see para. 2.8, above). Unlike our recommendations it does not apply to life insurance (see para. 2.17, above).

[392]Harmonisation of insurance law can also be achieved indirectly by ensuring that in appropriate cases the law of the state where the risk is situated, rather than that of, or prescribed by, the insurer, is to be applied to the contract. This is what Article 4 of the draft Non-Life Insurance Services Directive is designed to achieve: see para. 1.22, above.

in 1957 in the Fifth Report of the Law Reform Committee,[393] to a duty to disclose any material facts which the proposer knows or can be assumed to know and which a reasonable man in the position of the proposer would disclose, having regard to the nature and extent of the cover which is sought and the circumstances in which it is sought.[394]

(ii) The harshness of the present law, and the fact that it constitutes something of a trap for the insured, in the particular context of proposal forms and renewal notices, in that event a reasonable insured is unaware of his duty to volunteer information in addition to answering specific questions, will disappear with the introduction of our system of prominent warnings.[395] These warnings on proposal forms and renewal notices will make clear to the insured the extent of his duty of disclosure, that he should keep copies of information supplied by him to the insurer and that his duty of disclosure arises not only when he first makes a contract of insurance, but also on renewal. The insured will be further protected by the requirement that he be supplied by the insurer with a copy of the proposal form which he has completed and of any information which he has given to the insurer on renewal.[396]

(iii) The unfairness of the present law of warranties in that it permits the insurer to refuse to pay a claim in the case of a breach of warranty by the insured, even though the warranty was not material to the risk and its breach was unconnected with the loss, will be remedied. The only warranties which will be effective will be those material to the risk[397] and the insurer will not be able to rely on even those unless he has provided the insured with a copy of the warranty.[398] Furthermore, an insurer will only be able to reject a claim on the grounds of breach of warranty if there is a connection, a "nexus", between the breach of warranty and the event which gave rise to the claim.[399]

(iv) The use of the device of "basis of the contract" clauses which exacerbate the insured's difficulties under the present law of warranties by (for example) turning all the answers in proposal forms into warranties as to their correctness, will in future be ineffective in relation to warranties as to past or present facts.[400]

General

9.8 For the reasons stated in this report, we believe that the enactment of our recommendations will have the effect of putting the law relating to the duty of disclosure on a rational and acceptable basis and of achieving the same result in relation to the law concerning warranties. At the same time we believe that none of our recommendations should be unacceptable to the insurance industry, whose legitimate interests and concerns we have also constantly borne in mind.

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[393]See para. 1.5, above.
[394]See paras. 4.43–4.53, above.
[395]See paras. 4.60, 4.64 and 4.77–4.80, above.
[396]See paras. 4.63 and 4.78, above.
[397]See paras. 6.12 and 6.13, above.
[398]See para. 6.14, above.
[399]See paras. 6.15–6.22, above.
[400]See paras. 7.8 and 7.9, above.

As mentioned in various parts of this report, the comments which we received on consultation were in many cases diametrically opposed as between some of the commentators from the industry and some of the commentators concerned to achieve the maximum protection for the insured, particularly in relation to "consumer" insurance. Our objective throughout this report has been to make recommendations for the reform of the law where we consider reform to be clearly necessary, but in such a way as to preserve a fair balance between both parties.

9.9 We end by making one final point concerning the proposed Directive. For the reasons stated earlier[401] its future is uncertain. It is at present impossible to foresee whether it will ever be accepted by the Council of Ministers or, if it is, what its ultimate form and content will be. We recognise of course that it would be highly undesirable and impracticable to envisage legislation reforming our insurance law which is then to be followed by legislation giving effect to the Directive. On the other hand, the reforms which we recommend in this report (quite apart from the fact that some of them do not fall within the scope of the Directive[402]) are in our view greatly needed and much overdue. We therefore hope that the uncertain future of the Directive will not unduly postpone, let alone preclude, the enactment of the legislation which we recommend.

PART X

SUMMARY OF RECOMMENDATIONS

Introduction

10.1 In this Part of the report we summarise the conclusions and recommendations for reform set out in the earlier Parts. Where appropriate we identify the relevant clauses in the Bill which are aimed at putting into effect particular recommendations.

The classes of insurance contracts to which our recommendations should not apply

10.2 Our recommendations should not apply to contracts of insurance which, in respect of every risk covered, fall within "Marine, Aviation and Transport" (MAT) insurance. Our definition of MAT insurance for this purpose is based on the definition to be found in the Insurance Companies (Classes of General Business) Regulations 1977 (paragraphs 2.10 – 2.14 and Appendix A clause 1(1) (*c*) and the Schedule).

10.3 However, we recommend that the Secretary of State for Trade should be empowered to make orders to vary the classes of MAT contracts to be excluded from our recommendations after consultation with interested parties. Such orders should be subject to the affirmative resolution procedure (paragraph 2.14 and clauses 1(2) and 1(5)).

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[401] See paras. 1.8, 1.20 and 1.21, above.
[402] See para. 9.5, above.

10.4 If a contract of marine insurance within the meaning of the Marine Insurance Act 1906 becomes subject to our recommendations, either by reason of its being taken out of the excluded class of MAT insurance contracts by the Secretary of State in the exercise of his statutory powers, or because it does not fall within our definition of MAT insurance, then we recommend that in the event of any conflict between our recommendations and the provisions of the 1906 Act our recommendations should prevail (paragraph 2.16 and clause 1(4)).

Non-disclosure

10.5 The present law as to non-disclosure is defective. The mischiefs in the present law cannot be cured by voluntary measures of self-regulation by the insurance industry such as Statements of Insurance Practice. In the absence of effective administrative control of underwriting, reform of the law is therefore required (paragraphs 3.23 – 3.30).

10.6 The implementation of Article 3 of the proposed Directive would be an unsatisfactory way in which to reform our law; in particular, the adoption of the so-called "proportionality principle" would be undesirable from the point of view of the insured as well as being unworkable in practice (paragraphs 4.2 – 4.31).

10.7 The total abolition of any duty of disclosure would be undesirable and would distort underwriting practice in an unacceptable manner (paragraphs 4.32 – 4.33).

10.8 We recommend against the adoption of special rules for those who apply for insurance as consumers whereby they would either be subject to no duty of disclosure or would be subject to a special attenuated duty (paragraphs 4.34 – 4.42).

10.9 The duty of disclosure should be retained but it should be modified along the lines suggested in the Fifth Report of the Law Reform Committee. A fact should be disclosed to the insurer by an applicant if:—

(*a*) it is material in the sense that it would influence a prudent insurer in deciding whether to offer cover against the proposed risk and, if so, at what premium and on what terms; and

(*b*) it is either known to the applicant or it is one which he can be assumed to know; for this purpose he should be assumed to know a material fact if it would have been ascertainable by reasonable enquiry and if a reasonable man applying for the insurance in question would have ascertained it; and

(*c*) it is one which a reasonable man in the position of the applicant would disclose to his insurers, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought (paragraphs 4.43 – 4.53 and clause 2).

Proposal forms

10.10 Special provisions concerning proposal forms are required for the protection of the insured (paragraph 4.54).

10.11 It is neither necessary nor desirable to provide an exhaustive statutory definition of a proposal form. However, forms of application for advances on the security of freehold or leasehold property which state that cover will be arranged on behalf of the applicant should be treated as proposal forms for the purposes of our recommendations (paragraphs 4.54 and 4.68 and clause 14 (2)).

10.12 The standard required of an applicant for insurance when answering questions in a proposal form, other than questions which do not seek information in regard to a specific topic, should be to answer the questions to the best of his knowledge and belief, after making such enquiries as are reasonable having regard both to the subject-matter of the questions and to the nature and extent of the cover which is sought (paragraphs 4.61 and 4.82 and clause 6(4)).

10.13 The duty to volunteer information in addition to answering the questions in the proposal form should be retained. The duty would be the same as the duty of disclosure when there is no proposal form (paragraphs 4.57 – 4.59 and clause 2).

10.14 All proposal forms should contain certain clear and explicit warnings to the insured, presented in a prominent manner. The insured should be warned about the standard of answer to the questions that is required of him, and of the existence and extent of his duty to volunteer information, apart from answering the questions, and of the consequences of the failure to fulfill either of these obligations (paragraphs 4.60 and 4.64 and clauses 3(2) (*a*) and (*b*) and 3(4) (*a*) – (*c*)).

10.15 A copy of the completed proposal form should be supplied to the insured at the time he completes the form or as soon thereafter as is practicable in the circumstances of the case. The insurer should be able to comply with this requirement by providing a tear-off carbon copy of the proposal form which the insured can retain when he completes the form. The proposal form should contain a prominent warning to the insured of the importance of keeping the copy of the proposal form for future reference (paragraph 4.63 and clauses 3(2) (*c*), 3(3), 3(4) (*d*) and (*e*)).

10.16 If there is a failure to comply with any of the requirements set out in paragraphs 10.14 and 10.15, above, the insurer should not be entitled to rely on any non-disclosure by the insured. However, where there has been a non-disclosure by the insured of a material fact in circumstances in which the court is satisfied that the failure to comply with any of these requirements did not cause any prejudice to the insured with regard to his obligation to disclose such fact, then the court may give leave to the insurer to rely on the non-disclosure in question (paragraphs 4.65 – 4.67 and clause 3(5)).

Renewals

10.17 The duty of disclosure on renewal should be retained and the same standard of duty should apply as when the insured makes an original application for insurance (paragraphs 4.69 – 4.72 and clause 2).

10.18 As with proposal forms, the standard of answers required from an insured to questions asked in a renewal notice, other than questions which do not

seek information in regard to a specific topic, should be to answer the questions to the best of his knowledge and belief after making such enquiries as are reasonable having regard to the subject-matter of the question and the nature and extent of the insurance cover to be renewed (paragraphs 4.73 and 4.82 and clause 6 (4)).

10.19 All renewal notices, that is documents inviting the insured to renew the contract or informing him that it is or will be due for renewal (or the other documents referred to in paragraph 10.22, below), should contain clear and explicit warnings, presented in a prominent manner of the existence and extent of the insured's duty of disclosure and of the consequences of any breach by him of that duty (paragraphs 4.77 and 4.80 and clauses 4(3) and 4(4)).

10.20 Where the insured has previously completed a proposal form and he subsequently receives a renewal notice, the insured should be supplied on the occasion of each renewal (or as soon as practicable thereafter) with a copy of any information supplied by him on that renewal. The renewal notice should contain a prominent warning to the insured about the importance of keeping the copy supplied to him for future reference (paragraphs 4.78 and 4.80 and clause 5).

10.21 If any of the requirements set out in paragraphs 10.19 and 10.20, above are not complied with at the time of a particular renewal, or were not complied with at the time of any previous renewal, or, in cases where the insured has previously completed a proposal form if the requirements relating to proposal forms were not complied with, then the insurer shall not be entitled to rely on any failure by the insured to disclose any material change of circumstances on the occasion of any renewal. However, where there has been a non-disclosure by the insured in circumstances in which the court is satisfied that any failure to comply with any of these requirements did not cause any prejudice to the insured in connection with such non-disclosure, the court may give leave to the insured to rely on the non-disclosure in question (paragraphs 4.80 and 4.81 and clauses 4(5) and 5(5)).

10.22 "Renewal notices" should include documents which the insured may receive from his broker merely informing him that his insurance is due for renewal without expressly inviting renewal, as well as documents sent by or on behalf of a mortgagee to a mortgagor informing him that his insurance is due for renewal (paragraph 4.75 and clauses 4(1) and 4(2). For the reasons explained in paragraph 4.75 of the report, clause 4(2), (*b*) of the Bill, which relates to documents sent by brokers, is in square brackets).

Further matters concerning questions in and relating to proposal forms and renewal notices.

10.23 All questions in or relating to proposal forms or renewal notices which do not seek information in regard to a specific topic shall be construed as seeking no further information from the proposer than such information as he would be bound to disclose by virtue of the reduced duty of disclosure referred to in paragraph 4.47, above (paragraphs 4.62, 4.73 and 4.82 and clause 6(3)).

10.24 There should be no obligation on the insured to answer any immaterial questions. However, there should be a presumption that the subject-matter of any question asked by the insurer is material, though it should be open to the insured to rebut this presumption (paragraph 4.83 and clause 6(5)).

10.25 If a written question might reasonably be understood in more than one sense, and the insured adopts a construction of it which is not unreasonable in the circumstances, then the question shall be construed in the sense adopted by the insured (paragraph 4.84 and clause 6(2)).

10.26 The standard of answer required from the insured to written questions which arise out of matters dealt with in a proposal form or renewal notice, other than specific questions, should be to answer the questions to the best of his knowledge and belief, after making such enquiries as are reasonable having regard both to the subject-matter of the question and to the nature and extent of the cover which is sought (paragraph 4.82 and clause 6(4)).

Powers of the Secretary of State

10.27 The Secretary of State should be provided with a residual power to prescribe by order specific forms of warning for proposal forms and renewal notices, as well as warnings concerning any further aspects of the insured's duty of disclosure as may appear to him to be appropriate. In such cases the Secretary of State should also be empowered to prescribe how the warnings are to be presented in relation to type, size, colour or otherwise (paragraph 4.85 and clauses 7(1) – 7(3)).

10.28 If an order made by the Secretary of State is not complied with then the insurer should not be entitled to rely on any non-disclosure on the part of the insured unless the insurer satisfies the court that he took all reasonable steps to comply with the order and also that in the circumstances of the case it is just and equitable that he should have leave to rely on the non-disclosure in question (paragraph 4.86 and clause 7(6)).

10.29 If the Secretary of State prescribes the content and form or other matters concerning warnings for inclusion in proposal forms or renewal notices in relation to a particular class of insurance, then any proposal form or renewal notice relating to that class of insurance which complies with the order should also be treated conclusively as complying with the requirements in relation to such warnings (paragraph 4.87 and clauses 7(4) – 7(5)).

10.30 The insurer's rights in respect of non-disclosure should not be restricted further than provided for by our recommendations as outlined in paragraphs 10.9 to 10.29, above. In particular, we reject the suggestion that insurers should only be entitled to reject a claim on the ground of non-disclosure of a material fact if the undisclosed fact is in some way connected with the loss. We also reject the suggestion that the insurer's remedy for any breach of the duty of disclosure should be left to the discretion of the court (paragraphs 4.88 – 4.108).

Articles 4-6 of the proposed Directive

10.31 These Articles contain provisions to deal with the situation where the risk increases or decreases during the currency of the policy. We have numerous criticisms to make on the drafting of these provisions. In addition, we think that, whilst the constant adjustment of the premium and the complicated procedures envisaged in these Articles may be appropriate for the Continental type of long-term insurance extending over several years, these complicated procedures are inappropriate for English insurance practice (paragraphs 5.1 – 5.18).

Warranties

10.32 The present law in regard to warranties is defective. The mischiefs in the present law cannot be cured by voluntary measures of self-regulation by the insurance industry such as the Statements of Insurance Practice. We therefore think that reform of the law of warranties is necessary (paragraphs 6.9 – 6.10).

10.33 The ways in which warranties are created and the legal consequences of breach should be modified to the extent necessary to remove the defects which we have identified (paragraph 6.12).

10.34 A term of a contract of insurance should only be capable of constituting a warranty if it is material to the risk. There should be a presumption that a provision in a contract of insurance which possesses the attributes of a warranty at common law is material to the risk. The insured should be able to rebut this presumption by showing that the provision in question relates to a matter which is not material to the risk (paragraphs 6.12 – 6.13 and clauses 8(1) and 8(3)).

10.35 In order to create an effective warranty the insurer should be obliged to furnish the insured with a written document containing the warranty within a reasonable time of the insured having given the warranty in question. If the insurer fails to comply with this formal requirement he should be precluded from relying on a breach of the warranty in question in order to repudiate the policy or reject a claim. However, if a loss should occur before a reasonable time has elapsed for the provision by the insurer of such a document, then the insurer should be entitled to rely on an oral warranty (paragraph 6.14 and clause 8(2)).

10.36 Where the insured is in breach of warranty the insurer should *prima facie* be entitled to reject claims in respect of all losses which occur after the date of breach, provided that the formal requirements we have recommended have been complied with. However, if the insured can show either:

(*a*) that the broken warranty was intended to safeguard against the risk that a particular type of loss would occur and the loss which in fact occurs is of a different type; or

(*b*) that even though the loss was of a type which the broken warranty was intended to safeguard against, the insured's breach could not have increased the risk that the loss would occur in the way in which it did in fact occur,

then the insured should be entitled to recover. Nevertheless in such cases the insurer should remain entitled to repudiate the policy for the future on account of the breach of warranty (paragraphs 6.15 – 6.22 and clause 10(5)).

10.37 If insurers exercise their right to repudiate a policy for breach of warranty, that repudiation should take effect for the future only and should not be retrospective to the date of breach. The effective date of repudiation should be the date on which the insurer serves a written notice of repudiation on the insured. Although insurers would as a result remain on risk between the date of the breach and the effective date of repudiation, they should have the right to reject any claims arising during this period, subject to the recommendations in the previous paragraph (paragraph 6.23 and clauses 10(1) – 10(4)).

10.38 The rejection of a claim on account of a breach of warranty should not necessarily involve repudiation of the policy; insurers should be free to reject a particular claim without also repudiating the policy (paragraph 6.23 and clause 10(4)).

"Basis of the contract" clauses

10.39 The creation of various warranties as to past or present fact by the operation of a "basis of the contract" clause on answers in a proposal form constitutes a major mischief in the present law, and we recommend that such clauses should be ineffective for this purpose. If insurers consider it necessary to obtain specific undertakings by the insured as to the existence of past or present facts, they should be able to do so by introducing them into the policy as individual specific warranties, provided however that the formal requirements which we have recommended in regard to the creation of warranties are complied with (paragraphs 7.1 – 7.5 and 7.8 – 7.10 and clause 9).

10.40 No change is required to the rule of the present law whereby a "basis of the contract" clause is capable of elevating a statement in a proposal form relating to the future into a promissory warranty. If an answer in a proposal form relates to past or present facts as well as to the future, a "basis of the contract" clause should be effective insofar as it creates a promissory warranty (paragraph 7.11).

Non-fraudulent misrepresentation

10.41 In the following cases the insurer should not be entitled to rely upon the making of a non-fraudulent misrepresentation as such but should be confined to his rights and remedies (if any) for non-disclosure:—

(*a*) where the insured has made an actionable misrepresentation and has by so doing acted in breach of his duty of disclosure under the present law but not in breach of the modified duty of disclosure which we are recommending;

(*b*) where the insured has made an actionable misrepresentation and has by so doing acted in breach of the modified duty of disclosure which we are recommending;

(*c*) where the insured has made an actionable misrepresentation through having given an inaccurate answer in response to a question in a proposal form but is to be regarded under our recommendations as having fulfilled his duty of disclosure (paragraphs 8.3 – 8.5 and clause 12).

10.42 Where the insured has committed a breach of warranty which consists, wholly or in part, of the making of a non-fraudulent misrepresentation, the insurer should not be entitled to rely on the misrepresentation as such, but should be confined to his rights and remedies (if any) for breach of warranty (paragraph 8.7 and clause 12).

10.43 These restrictions on the insurer's right to rely on a non-fraudulent misrepresentation should not apply where the insured has made a collateral misrepresentation which induces the insurer to enter into the contract but which does not relate to matters which are material to the risk (paragraph 8.6).

10.44 There should be no change in the law relating to fraudulent misrepresentation (paragraph 8.8).

Contracts of reinsurance

10.45 Our recommendations should not apply to contracts of reinsurance. However, we recommend that reinsurers should have no greater rights against the reassured than the latter would have against the insured in either of the following circumstances:—

(*a*) if as a consequence of the non-disclosure of a material fact by the insured, the reassured fails to disclose that fact to the reinsurers; or

(*b*) if the reinsured substantially repeats a warranty broken by the insured (paragraphs 8.10 – 8.15 and clause 13).

"Contracting out"

10.46 We recommend that any provision of a contract should be void if it purports to entitle the insurers to avoid liability for the non-disclosure of a fact which the insured is under no duty to disclose under our recommendations (paragraph 8.16 and clause 2(5)).

Application of our recommendations

10.47 Our recommendations should only apply to contracts of insurance entered into after the recommendations are given the force of law unless those contracts are made by way of subsequent renewal of contracts entered into before that date. For this purpose, a contract of insurance is to be taken as having been entered into by way of renewal of an earlier contract if:—

(*a*) the parties to the later contract are the same as the parties to the earlier contract; and

(*b*) the later contract provides cover against the same or substantially the same risks as the earlier contract; and

(*c*) the insured did not fill in a proposal form in connection with his entering into the later contract; and

(*d*) the later contract is not described as a new contract which supersedes all previous contracts relating to its subject matter (paragraphs 8.19 – 8.21 and clauses 1(1) (*a*), 1(1) (*b*) and 14(4)).

(*Signed*) MICHAEL KERR, *Chairman.*
STEPHEN M. CRETNEY
STEPHEN EDELL
W. A. B. FORBES
PETER M. NORTH

BRIAN O'BRIEN, *Secretary.*
25th July, 1980.

APPENDIX A

Draft

Insurance Law Reform Bill

ARRANGEMENT OF CLAUSES

DRAFT

OF A

BILL

TO

Amend the law relating to contracts of insurance.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

Application of Act

Relevant contracts of insurance.

1.—(1) This Act applies to every contract of insurance other than—

(*a*) a contract entered into before the appointed day ;

(*b*) a contract entered into by way of renewal of a contract entered into before the appointed day ; and

(*c*) a contract which, in respect of every separate risk covered, falls within a class for the time being specified in the Schedule to this Act.

(2) The Secretary of State may by order made by statutory instrument amend the Schedule to this Act—

(*a*) so as to add a further class of contract to those specified in that Schedule, or

(*b*) so as to exclude a particular class of contract from those so specified ;

and an order under this section may describe the class of contract to be so added or excluded by reference to such factors as appear to the Secretary of State to be appropriate (whether or not similar to those used to described the classes for the time being specified in the Schedule).

(3) A contract of insurance to which this Act for the time being applies is in the following provisions of this Act referred to as a relevant contract of insurance.

(4) In the event of any conflict, in relation to a relevant contract of insurance, between the provisions of this Act and those of the Marine Insurance Act 1906, the provisions of this Act shall prevail.

1906 c. 41.

(5) No order may be made under subsection (2) above unless a draft of it has been laid before Parliament and approved by a resolution of each House ; and an order under that subsection may contain such transitional and supplementary provisions as the Secretary of State considers appropriate.

EXPLANATORY NOTES

Clause 1 and the Schedule

1. The purpose of clause 1 is to distinguish between the contracts of insurance which are subject to the provisions of the Bill and those which are not.

2. Subsection (1) identifies three categories of contracts of insurance which are not subject to the provisions of the Bill and provides that the Bill is to apply to the remainder.

3. Paragraphs (*a*) and (*b*) of subsection (1) give effect to the recommendations in paragraphs 8.19 – 8.21 of the Report and contain provisions which are transitional in nature but which, because of their importance, are placed at the beginning of the Bill. These paragraphs provide that the Bill shall not apply to a contract of insurance which is entered into before the day appointed for that purpose under clause 15(2) or which is made by way of subsequent renewal of an existing contract entered into before that day. The term "renewal" is construed according to clause 14(4).

4. Paragraph (*c*) of subsection (1), which gives effect to the recommendation in paragraphs 2.8 – 2.16 of the Report, provides that the Bill shall not apply to a contract of insurance which, in respect of every risk covered, falls within the excluded classes of contracts of insurance set out in the Schedule to the Bill. The excluded classes of contracts of insurance contained in this Schedule are based on the categories of insurance business under the headings of "Marine, Aviation and Transport" contained in Schedule I to the Insurance Companies (Classes of General Business) Regulations 1977 (S.I. No. 1552) which were made under section 2(2) of the European Communities Act 1972 and which amend section 83 of the Insurance Companies Act 1974. The only category of insurance business in Schedule I which has been omitted from the classes in this Schedule is the category concerned with contracts of insurance relating to death or injury arising out of travelling as a passenger or to the contracting of certain diseases as a result of travelling as a passenger. This category has been omitted because its exclusion from the recommendations set out in the Report would be inappropriate.

5. Subsection (2) gives effect to the recommendations in paragraph 2.14 of the Report and empowers the Secretary of State to make orders by statutory instrument adding to or excluding from the classes of insurance contract contained in the Schedule such classes of insurance contracts as he considers appropriate.

6. Subsection (3) introduces the term "relevant contract of insurance" to describe a contract of insurance to which the provisions of the Bill apply.

7. Subsection (4) is necessary because of the possibility that certain contracts of marine insurance may be removed by an order made by the Secretary of State under subsection (2) from the classes of insurance contracts excluded from the ambit of the Bill by the Schedule, or that certain contracts of non-marine insurance may fall within the Marine Insurance Act 1906 by virtue of section 2 of that Act, with the result that the provisions of both the Bill and of the Marine Insurance Act 1906 would apply to them.

8. Subsection (5) provides that any orders made by the Secretary of State under subsection (2) will be subject to the affirmative resolution procedure whereby a draft of the order must be approved by each House of Parliament.

The duty of disclosure

Modification of the general duty of disclosure.

2.—(1) The duty of disclosure imposed by law on a person (in this section referred to as "the proposer") proposing to enter into a relevant contract of insurance (whether initially of by way or renewal of an earlier contract) shall be limited to those material facts—

(*a*) which are actually known to the proposer or which, by virtue of subsection (3) below, he is assumed to know; and

(*b*) which a reasonable man in the position of the proposer would disclose to the insurer, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought.

(2) For the purposes of this Act any fact or other matter is material, in relation to a contract of insurance, if it would influence the judgment of a prudent insurer—

(*a*) in deciding whether to offer insurance against the risks covered by that contract ; or

(*b*) in deciding the premium or other terms on which he would be prepared to offer that insurance.

(3) For the purposes of subsection (1) above, the proposer shall be assumed to know of any fact which could have been ascertained by reasonable inquiry and would have been so ascertained by a reasonable man proposing to enter into the contract of insurance in question.

(4) Notwithstanding the duty of disclosure referred to in subsection (1) above, the liability of an insurer under a relevant contract of insurance shall not be affected by the non-disclosure of any material fact if the circumstances in which the contract came into being (or, as the case may be, was renewed) were such that the proposer might reasonably conclude that the insurer was not concerned about the disclosure of that fact.

(5) Any provision of a contract (whether a contract of insurance or not) which purports, directly or indirectly, to enable the insurer under a relevant contract of insurance to avoid the contract on account of, or to rely for any other purpose on, a failure by the insured to disclose any fact which, having regard to the provisions of this section and sections 3 to 6 below, he is under no duty to disclose shall be void.

EXPLANATORY NOTES

Clause 2

1. This clause gives effect to the recommendations in paragraphs 4.47 – 4.53 of the Report and modifies the ambit of the duty of disclosure imposed by law on a person proposing to enter into a relevant contract of insurance. The present law as to the duty of disclosure was confirmed in *Lambert* v. *Co-operative Insurance Society Ltd.* [1975] 2 Lloyds Rep. 485 in which it was held that the duty of disclosure on application for non-marine insurance is substantially the same as that laid down by section 18 of the Marine Insurance Act 1906. Under section 18 the proposer is obliged to disclose every material circumstance which is known to him, and 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. Subsection (1), which gives effect to the recommendations in paragraph 4.47 of the Report, limits the material facts and circumstances which a proposer is obliged to disclose to the insurers to those material facts within his actual or assumed knowledge which a reasonable man in his position would disclose to the insurer, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought.

2. Subsection (2) defines material facts in a way similar in substance to the definition contained in section 18(2) of the Marine Insurance Act 1906 and in terms along the lines of section 149(5) (*b*) of the Road Traffic Act 1972.

3. The existing law in regard to contracts of non-marine insurance is uncertain as to the extent to which the duty of disclosure extends beyond material facts actually known by the insured. Subsection (3), which gives effect to the recommendation in paragraph 4.50 of the Report, provides that, for the purpose of subsection (1) (*a*), the proposer is to be assumed to know and is therefore bound to disclose any fact which is ascertainable by reasonable enquiry and which a reasonable man proposing to enter into the contract of insurance in question would have ascertained.

4. Subsection (4) preserves and clarifies the existing law regarding the circumstances in which the insurer may be taken to have waived the duty of disclosure.

5. Subsection (5) gives effect to the recommendation made in paragraph 8.16 of the Report and prevents the insurer from imposing by contract a more onerous duty of disclosure than is provided for by clauses 2 to 6 of the Bill.

Proposal forms and renewal notices

Proposal forms: requirements for reliance on duty of disclosure.

3.—(1) The provisions of this section apply where, in connection with his entering into a relevant contract of insurance, the insured gave answers to some or all of the questions in a proposal form supplied to him by or on behalf of the insurer.

(2) Except where the court gives leave under subsection (5) below, the insurer shall not be entitled to rely for any purpose on a failure by the insured, prior to his entering into the contract, to disclose any material fact unless—

(*a*) the proposal form contained a warning to the insured with respect to each of the matters referred to in subsection (4) below ; and

(*b*) those warnings were presented in a prominent manner; and

(*c*) a copy of the proposal form and of the answers given by the insured to the questions in it was supplied to the insured immediately after those answers were given or as soon thereafter as was practicable in the circumstances of the case.

(3) For the purposes of this Act, the requirements of subsection (2)(*c*) above shall be taken to have been complied with if—

(*a*) attached to the proposal form supplied to the insured was a copy of that form; and

(*b*) the form and the copy were constructed so as to secure that a duplicate of any answers written on the proposal form would be automatically reproduced on the copy.

(4) The matters with respect to which the insured is to be warned as mentioned in subsection (2)(*a*) above are as follows:—

(*a*) the obligation on the insured to answer every question in the proposal form to the best of his knowledge and belief, after making such inquiries as are reasonable in the circumstances;

(*b*) the obligation on the insured to disclose to the insurer any fact which is not the subject of a question in the proposal form but which—

(i) he knows or could ascertain by reasonable inquiry; and

(ii) might reasonably be considered to influence the judgment of a prudent insurer in deciding whether and on what terms to provide the cover which is sought;

EXPLANATORY NOTES

Clause 3

1. This clause contains provisions imposing certain obligations upon an insurer with regard to the proposal form and it lays down certain restrictions on an insurer's right to rely upon a non-disclosure by the insured if the insurer has failed to comply with any of these obligations.

2. Under clause 14(2) proposal forms include, *inter alia,* application forms for loans on the security of freehold or leasehold property.

3. Subsection (1) provides that the clause applies where the insured has completed a proposal form before entering into a contract of insurance.

4. Subsection (2) implements the recommendations made in paragraphs 4.60 and 4.63–4.64 of the Report by laying down certain conditions which, subject to subsection (5), must be satisfied if the insurer is to rely on any non-disclosure. The conditions are that the proposal form must contain a prominent warning to the insured with regard to various matters and a copy of the completed proposal form must be supplied to the insured as soon as practicable in the circumstances of the case.

5. Under subsection (3) a way of complying with the latter condition would be to attach a tear-off carbon copy of the proposal form for the insured to retain after he has completed the form.

6. Subsection (4) gives effect to the recommendation in paragraph 4.64 of the Report and lays down the matters with respect to which the insured must be warned.

(*c*) the consequences to the insured of a failure to fulfil the obligations referred to in paragraphs (*a*) and (*b*) above;

(*d*) the importance to the insured of keeping the copy of the proposal form and of his answers which is supplied to him by virtue of subsection (2)(*c*) above ; and

(*e*) the importance to the insured of retaining a copy of any additional information which he gives to the insurer and of which a copy is not supplied to him by virtue of subsection (2)(*c*) above.

(5) If, in a case where—

(*a*) prior to his entering into the contract the insured failed to disclose a material fact which he was under a duty to disclose, and

(*b*) any of the requirements of subsection (2) above were not complied with,

the court is satisfied that the non-compliance has not caused prejudice to the insured with regard to his obligation to disclose that fact, the court may give leave to the insurer to rely on the non-disclosure of that fact.

Clause 3 (continued)

7. Subsection (5) implements the recommendation in paragraph 4.67 of the Report by providing that if the conditions set out in subsection (2) are not complied with, the court may nevertheless give leave to the insurer to rely on a non-disclosure provided that the court is satisfied that the non-compliance with any of the conditions has not prejudiced the insured.

Renewal notices: requirements for reliance on duty of disclosure.

4.—(1) The provisions of this section apply where the insured under a relevant contract of insurance receives a renewal notice, that is to say, a document sent by or on behalf of the insurer (whether in the form of a notice, letter or otherwise) inviting the insured to renew the contract or informing him that it is or will be due for renewal.

(2) Notwithstanding that they may not be documents sent by or on behalf of the insurer, the following documents shall also be regarded as renewal notices for the purposes of this Act, that is to say,—

(*a*) in relation to a contract of insurance providing cover in respect of freehold or leasehold property, a notice, letter or other document sent by or on behalf of a mortgagee to a mortgagor informing him that the contract is or will be due for renewal ; [and

(*b*) a notice, letter or other document sent by an insurance broker informing the insured that a contract of insurance is or will be due for renewal].

(3) Except where the court gives leave under subsection (5) below, the insurer shall not be entitled to rely for any purpose on a failure by the insured, at the time of the renewal of the contract, to disclose any material fact unless—

(*a*) the renewal notice contained a warning to the insured with respect to each of the matters referred to in subsection (4) below and, where appropriate, section 5(2) below ; and

(*b*) those warnings were presented in a prominent manner.

(4) Subject to section 5(2) below, the matters with respect to which the insured is to be warned as mentioned in subsection (3)(*a*) above are as follows:—

(*a*) the obligation on the insured to disclose to the insurer any fact which—

(i) he has not previously disclosed, and

(ii) he knows or could ascertain by reasonable inquiry, and

(iii) might reasonably be considered to influence the judgment of a prudent insurer in deciding whether and on what terms to renew the contract ; and

(*b*) the consequences to the insured of a failure to fulfil that obligation.

EXPLANATORY NOTES

Clause 4

1. This clause gives effect to the recommendations made in paragraphs 4.74 –4.77 of the Report. Under subsection (1) the clause applies where the insured receives a "renewal notice"—that is a document sent by or on behalf of the insurer inviting the insured to renew the contract or informing him that it is or will be due for renewal.

2. A document sent by an insurance broker to an insured informing him that his cover is or will be due for renewal and a document to the same effect in relation to the renewal of cover on mortgaged land sent by or on behalf of a mortgagee to a mortgagor are, by reason of subsection (2), to be regarded as renewal notices for the purposes of this clause and the rest of the Bill. The reasons for the square brackets around subsection (2)(*b*) are explained in paragraph 4.75 of the Report.

3. Under subsection (3) the insurer is not entitled to rely on a failure by the insured to disclose a material fact at the time of renewal unless the renewal notice contains a prominent warning to the insured about certain matters.

4. Subsection (4) lays down the matters about which the insured must be warned. A further matter about which the insured must be warned in cases where a proposal form has been previously completed is contained in clause 5(2).

(5) If, in a case where—

(*a*) at the time of the renewal of the contract the insured failed to disclose a material fact which he was under a duty to disclose, and

(*b*) any of the requirements of subsection (3) above were not complied with,

the court is satisfied that the non-compliance has not caused prejudice to the insured with regard to his obligation to disclose that fact, the court may give leave to the insurer to rely on the non-disclosure of that fact.

Clause 4 (continued)

5. Subsection (5) implements the recommendations made in paragraph 4.81 of the Report by providing that, if the conditions set out in subsection (3) are not complied with, the court may nevertheless give leave to the insurer to rely on a non-disclosure provided that the court is satisfied that the non-compliance with any of these conditions has not prejudiced the insured.

Additional requirements for renewal notices where proposal form was completed.

5.—(1) If, in connection with his entering into a relevant contract of insurance, the insured gave answers to some or all of the questions in a proposal form supplied to him by or on behalf of the insurer, the provisions of this section have effect (in addition to the provisions of section 4 above) where the insured receives a renewal notice relating to that contract.

(2) The matters with respect to which the insured is to be warned as mentioned in section 4(3)(*a*) above shall include the importance to the insured of keeping the copy, supplied to him by virtue of subsection (3)(*a*) below, of any information given by him to the insurer.

(3) Except where the court gives leave under subsection (5) below, the insurer shall not be entitled to rely for any purpose on a failure by the insured, at the time of the renewal of the contract, to disclose any material fact unless—

(*a*) a copy of any information given to the insurer by the insured on the occasion of the renewal was supplied to the insured at or before the time the contract was renewed or as soon thereafter as was practicable in the circumstances of the case ; and

(*b*) the requirements of section 4(3) above and of paragraph (*a*) of this subsection were complied with in relation to every renewal notice received by the insured on the occasion of a previous renewal of the contract in question ; and

(*c*) the requirements of section 3(2) above were complied with in relation to the proposal form.

(4) If the renewal notice received by the insured invited him (whether by questions or otherwise) to give information to the insurer by writing it on the renewal notice and returning the notice to the insurer, the requirements of subsection (3)(*a*) above, so far as they relate to information so given, shall be taken to have been complied with if—

(*a*) attached to the renewal notice received by the insured was a copy of that notice ; and

(*b*) the notice and the copy were constructed so as to secure that a duplicate of any information written on the notice would be automatically reproduced on the copy.

EXPLANATORY NOTES

Clause 5

1. This clause implements the recommendations made in paragraph 4.78 of the Report. Under subsection (1) the clause applies where the insured has previously completed a proposal form and subsequently receives a renewal notice inviting him to renew his cover.

2. Subsection (2) lays down an additional matter about which the insured must be warned in order for the insurer to comply with the provisions of clause 4(3).

3. Subsection (3) provides that, subject to subsection (5), the insurer shall not be entitled to rely upon a failure by the insured to disclose a material fact at the time of renewal unless certain conditions are complied with, or have been complied with, in regard not only to the information supplied by the insured on the occasion of that renewal, but also in regard to all previous renewal notices and in regard to the proposal form which was previously completed.

4. Subsection (4) provides a means by which the requirement under subsection (3)(*a*) (copy of information given by the insured to be supplied to him) may be satisfied so far as it relates to information returned to the insurer on the renewal notice.

(5) If, in a case where—

(*a*) at the time of the renewal of the contract the insured failed to disclose a material fact which he was under a duty to disclose, and

(*b*) any of the requirements of, or referred to in, paragraphs (*a*) to (*c*) of subsection (3) above were not complied with as mentioned in those paragraphs,

the court is satisfied that the non-compliance has not caused prejudice to the insured with regard to his obligation to disclose that fact, the court may give leave to the insurer to rely on the non-disclosure of that fact.

Clause 5 (continued)

5. Subsection (5) implements the recommendation made in paragraph 4.81 of the Report by providing that if any of the conditions set out in subsection (3) are not complied with, the court may nevertheless give leave to the insurer to rely on a non-disclosure provided that the court is satisfied that the non-compliance with these conditions has not prejudiced the insured.

Questions in and arising out of proposal forms and renewal notices.

6.—(1) The provisions of this section have effect in relation to—

(*a*) questions in proposal forms and renewal notices relating to relevant contracts of insurance ; and

(*b*) further questions which are put to the proposer or insured in writing and which arise out of matters dealt with in a proposal form or renewal notice ;

and any reference in the following provisions of this section to a question, the proposer or the insured shall be construed accordingly.

(2) If a question might reasonably be understood in more than one sense and the proposer or insured adopts a construction of it which is not unreasonable in the circumstances of the case, that construction shall be conclusively presumed to be the correct construction for the purposes of this Act.

(3) In so far as a question is so framed that, in order to answer it accurately, the proposer or insured needs to consider whether any fact is or might be relevant to a risk covered by the contract in question or to the premium or other terms appropriate to covering that risk, the question shall be construed as seeking from the proposer or insured no facts beyond those which, had the question not been asked, he would have been required to disclose by virtue of the duty of disclosure referred to in section 2 above.

(4) With respect to any question, other than one to which subsection (3) above applies, the proposer or insured shall be regarded as having fulfilled the duty of disclosure referred to in section 2 above if, after making such inquiries as are reasonable, having regard to—

(*a*) the subject-matter of the question, and

(*b*) the nature and extent of the insurance cover which is sought,

he answers the question to the best of his knowledge and belief.

(5) Unless the contrary is proved, the subject-matter of every question shall be presumed to be material to the contract in question, but neither the duty of disclosure referred to in section 2 above nor any other obligation (whether contractual or otherwise) shall be taken to impose on the proposer or insured any duty to answer a question the subject-matter of which is not material.

EXPLANATORY NOTES

Clause 6

1. Under subsection (1) this clause applies to questions in proposal forms and renewal notices and further written questions which arise out of matters dealt with in a proposal form or renewal notice.

2. Subsection (2) implements the recommendation made in paragraph 4.84 of the Report by providing that if a question might reasonably be understood in more than one sense and the insured adopts a construction of that question which is not unreasonable in the circumstances then that construction shall be conclusively presumed to be the correct construction.

3. Subsection (3) gives effect to the recommendations made in paragraphs 4.62 and 4.73 of the Report by providing that a question other than a question which seeks information in regard to a specific topic shall always be construed as seeking no further information from the proposer than such information as he would be bound to disclose by virtue of the reduced duty of disclosure resulting from section 2.

4. Subsection (4) implements the recommendations in paragraphs 4.61 and 4.73 of the Report by laying down the standard which is required from an insured when he answers questions which seek information in regard to a specific topic.

5. Subsection (5) implements the recommendation in paragraph 4.83 of the Report by providing that questions shall be presumed to be material to the contract in question, unless the insured proves otherwise, and that the insured is under no duty to answer a question the subject matter of which is not material.

Power to require use of prescribed form of warning in certain cases.

7.—(1) If it appears to the Secretary of State to be desirable to do so in the interests of ensuring that persons proposing for insurance under, or renewing, relevant contracts of insurance of a particular description are made fully aware of the nature and extent of the duty of disclosure imposed on them by law and of the consequences of a failure to fulfil that duty, he may make an order under this section.

(2) An order under this section—

(*a*) shall specify the description of proposal forms or renewal notices to which it applies ;

(*b*) shall set out, for use in a proposal form or renewal notice to which it applies, a form of warning as to the matters referred to in paragraphs (*a*) to (*c*) of section 3(4) above or, as the case may be, in section 4(4) above ; and

(*c*) may also specify, in relation to the presentation of that warning, such requirements (whether as to the type, size, colour or disposition of the lettering or otherwise) as the Secretary of State considers appropriate for securing that the content of the warning comes to the attention of a person reading the proposal form or renewal notice.

(3) A warning set out in an order under this section may, in addition to dealing with the matters referred to in subsection (2)(*b*) above, contain such additional information relating to the duty of disclosure as the Secretary of State considers appropriate.

(4) Where an order is in force under this section in relation to proposal forms of a particular description,—

(*a*) to the extent that the provisions of section 3(2)(*a*) above require a proposal form of that description to contain a warning to the insured with respect to each of the matters referred to in paragraphs (*a*) to (*c*) of section 3(4) above, those provisions shall be complied with if, and only if, the proposal form contains the warning specified in the order ; and

(*b*) if the order specifies requirements such as are mentioned in subsection (2)(*c*) above, then, to the extent that the provisions of section 3(2)(*b*) above require the warnings referred to in paragraph (*a*) above to be presented in a prominent manner, those provisions shall be complied with if, and only if, the requirements so specified are complied with.

(5) Where an order is in force under this section in relation to renewal notices of a particular description,—

(*a*) to the extent that the provisions of section 4(3)(*a*) above require a renewal notice of that description to contain a warning to the insured with respect to each of the matters referred to in section 4(4) above, those provisions shall be complied with if, and only if, the renewal notice contains the warning specified in the order; and

EXPLANATORY NOTES

Clause 7

1. This clause implements the recommendations made in paragraphs 4.85–4.87 of the Report and gives power to the Secretary of State to make an order regulating the content and lay-out of the warnings which are required by clauses 3 and 4 to be included in proposal forms and renewal notices.

2. Subsection (1) gives the Secretary of State power to make an order if he considers it desirable to do so in the interests of ensuring that an insured is made fully aware of the nature and extent of the duty of disclosure imposed upon him by law. The Secretary of State may make such an order in relation to relevant contracts of insurance of a particular description.

3. Paragraphs (*a*) and (*b*) of subsection (2) set out the matters which the Secretary of State must include in any order that he makes. Paragraph (*c*) of subsection (2) empowers the Secretary of State to include in any order further requirements as to the lay-out and presentation of warnings referred to in paragraph (*b*).

4. Subsection (3) provides that the Secretary of State is empowered to set out in an order under this clause additional information which the warning in relation to the duty of disclosure should contain.

5. Subsections (4) and (5) provide that where an order is in force under this clause in relation to proposal forms of a particular description, or in relation to renewal notices of a particular description, then the requirements under clauses 3 and 4 respectively relating to both the content and the prominence of the warnings that are required in proposal forms or in renewal notices shall only be complied with if a proposal form or renewal notice of that description contains the warning specified in the order, and, where appropriate, if the lay-out of the warning complies with the order.

(*b*) if the order specifies requirements such as are mentioned in subsection (2)(*c*) above, then, to the extent that the provisions of section 4(3)(*b*) above require the warnings referred to in paragraph (*a*) above to be presented in a prominent manner, those provisions shall be complied with if, and only if, the requirements so specified are complied with.

(6) If, in a case where an order is in force under this section,—

(*a*) a proposal form or renewal notice to which the order applies does not contain the warning set out in the order, or

(*b*) there is, in respect of such a proposal form or renewal notice, a failure to comply with any requirements specified under subsection (2)(*c*) above in relation to that warning,

the court shall not give leave under section 3(5) above or, as the case may be, section 4(5) or section 5(5) above unless it is satisfied—

(i) that the insurer took all reasonable steps to secure that the warning was contained in the proposal form or renewal notice or, as the case may be, to secure that the requirements were complied with; and

(ii) that in the circumstances of the case it is just and equitable to give leave.

(7) The power to make an order under this section shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Clause 7 (continued)

6. Subsection (6) provides that where an order is in force under this clause and the proposal form or renewal notice does not contain the warning set out in the order, or the lay-out of the warning does not comply with the lay-out prescribed under subsection 2 (*c*), then the court shall not give leave under clause 3(4) or clause 4(5) or 5(5) to the insurer to rely on a non-disclosure unless the court is satisfied that the insurer took all reasonable steps to secure that the warning contained in the proposal form or renewal notice did comply with the relevant requirements and that in the circumstances it would be just and equitable to give leave.

Warranties

Warranties to be limited to provisions material to the contract.

8.—(1) A provision of a relevant contract of insurance whereby the insured—

(*a*) affirms or denies the existence of, or gives his opinion with respect to, any fact or state of affairs at any time (whether past, present or future), or

(*b*) undertakes that any particular state of affairs will continue or that a particular course of action will or will not be taken,

shall not be capable of constituting a warranty unless it relates to a matter which is material.

(2) An insurer shall not be entitled to rely for any purpose on a breach of a warranty in a relevant contract of insurance unless, at or before the time the contract was entered into or as soon thereafter as was practicable in the circumstances of the case, a written statement of the provision which constitutes the warranty was supplied to the insured.

(3) If the insurer under a relevant contract of insurance seeks for any purpose to rely on a breach of a provision of the contract as a breach of warranty then, unless the contrary is proved, that provision shall be presumed to be material.

EXPLANATORY NOTES

Clause 8

1. Under the common law the parties to an insurance contract can create a warranty irrespective of the materiality of its subject-matter, and regardless of whether the warranty relates to past or present fact or whether the warranty is a promissory warranty. Subsection (1), which gives effect to the recommendation in paragraph 6.12 of the Report, alters the common law by providing in respect of both types of warranty that a provision of a contract of insurance is only to be capable of constituting a warranty if it relates to a matter which is material.

2. Subsection (2) gives effect to the recommendation in paragraph 6.14 of the Report and provides for the confirmation in writing of warranties.

3. Subsection (3) gives effect to the recommendation in paragraph 6.13 of the Report and provides that warranties in insurance contracts shall be presumed to be material unless the insured proves otherwise.

Restrictions on creation of warranties as to past or present facts.

9.—(1) Without prejudice to section 8 above, if, in connection with a relevant contract of insurance, the insured makes a statement affirming or denying the existence of, or giving his opinion with respect to, any fact or state of affairs at any time past or present, that statement—

(*a*) shall not be capable of constituting a warranty if it is contained in, or is made by reference to any provision of, a proposal form; and

(*b*) shall not be capable of being converted into a warranty by means of any provision purporting to incorporate it into the contract, either alone or together with other statements (and whether by declaring the statement to form the basis of the contract or otherwise).

(2) Nothing in this section relates to promissory warranties, that is to say, warranties consisting of undertakings such as are mentioned in section 8(1)(*b*) above and warranties relating to any fact or state of affairs which may or may not come into existence at a future time.

EXPLANATORY NOTES

Clause 9

1. This clause gives effect to the recommendation in paragraph 7.8 of the Report and changes the law by rendering "basis of the contract" clauses and similar provisions of no legal effect in so far as they purport to create warranties as to past or present facts.

2. Subsection (2) makes it clear that this clause does not affect the creation of promissory warranties.

Effect of breach of warranty.

10.—(1) If an insurer seeks to avoid a relevant contract of insurance in reliance on a breach of warranty, the repudiation shall not be effective with respect to any time prior to the date on which notice in writing of the repudiation is served on the insured.

(2) The following provisions of this section apply where—

(*a*) the insured under a relevant contract of insurance is in breach of a warranty in that contract; and

(*b*) after the date of the breach an event occurs which gives rise to a claim under the contract.

(3) If, in a case falling within subsection (2) above,—

(*a*) the insurer seeks to avoid the contract in reliance on the breach, but

(*b*) by virtue of subsection (1) above, the effective date of the repudiation is after the date of the event which gives rise to the claim,

then, notwithstanding that the relevant contract of insurance continues in force until the date of the service of the notice of repudiation, the insurer shall not be liable to meet the claim unless the case falls within subsection (5) below.

(4) If, in a case falling within subsection (2) above, the insurer—

(*a*) does not seek to avoid the contract as mentioned in subsection (3) above, but

(*b*) seeks to reject the claim by notice given to the insured,

the contract of insurance shall continue in force but the insurer shall not be liable to meet the claim unless the case falls within subsection (5) below.

(5) In a case to which subsection (3) or subsection (4) above applies the insurer shall be liable to meet the claim if the insured proves either—

(*a*) that the warranty concerned was intended to safeguard against, or was otherwise related to, the risk of the occurrence of events of a description which does not include the event which gave rise to the claim; or

(*b*) that the breach of warranty could not have increased the risk that the event which gave rise to the claim would occur in the way in which it did in fact occur.

EXPLANATORY NOTES

Clause 10

1. This clause alters the existing law whereby the insurer is entitled to avoid a contract of insurance for a breach of warranty with effect from the date of breach and is entitled to do so even where the loss is unconnected with the breach.

2. Subsection (1), which gives effect to the recommendation in paragraph 6.23 of the Report, provides that in a case where the insurer repudiates the contract in reliance upon a breach of warranty, the repudiation only takes effect from the date on which a written notice of repudiation is served on the insured.

3. Subsection (2) provides that subsections (3) to (5) are to apply when an event which gives rise to a claim occurs after the insured has committed a breach of warranty.

4. Subsection (3) provides that an insured shall not be prevented from recovering his claim where—

(*a*) the event occurs before the insurer's repudiation takes effect under subsection (1); and

(*b*) the insured proves the matters set out in subsection (5).

5. *In West* v. *National Motor Insurance Union Ltd.* [1955] 1All E.R. 800 the Court of Appeal decided that an insurer is not entitled to reject a claim for a breach of warranty without at the same time repudiating the policy. Subsection (4) which gives effect to the recommendation in paragraph 6.23 of the Report, reverses this decision and provides that if in the circumstances envisaged by subsection (2) the insurer seeks to reject a claim without repudiating the policy he will not be entitled to do so if the insured proves either of the matters set out in subsection (5). Thus where the insured cannot prove either of these matters, the insurer will be entitled to reject a claim without repudiating the policy.

6. Subsection (5) gives effect to the recommendation in paragraph 6.22 of the Report and alters the present law by providing that the insured, notwithstanding a breach of warranty, shall be entitled to recover his claim if he proves either of the matters set out in paragraph (*a*) or (*b*). Paragraph (*a*) deals with the relationship between the event which gave rise to a particular claim and the intended ambit of the warranty. Paragraph (*b*) deals with the relationship between the breach of the warranty and the risk that the event which gave rise to the claim would occur in the way in which it did in fact occur.

Service of notice of repudiation.

11.—(1) For the purposes of section 10 above, a notice in writing of the repudiation of a relevant contract of insurance may be served on the insured—

(*a*) if he is an individual, by delivering it to him; or

(*b*) by leaving it, addressed to him, at his proper address; or

(*c*) by sending it to him by post at that address.

(2) For the purposes of section 10 above, a notice of repudiation which is served on the insured as mentioned in subsection (1)(*b*) above shall be treated as served on him on the date on which it was left at his proper address.

1978 c.30.

(3) For the purposes of this section and of section 7 of the Interpretation Act 1978 (service by post) in its application to the service of a notice of repudiation, the proper address of the insured under a relevant contract of insurance is—

(*a*) the address stated in the contract as the address of the insured; or

(*b*) if the insured has given notice in writing to the insurer of some other address for the receipt of communications relating to that contract, that address.

Clause 11

This clause makes certain provisions as to how a written notice of repudiation may be served on the insured in order to comply with clause 10(1).

Miscellaneous

Exclusion of remedies for innocent misrepresentation in certain cases.

12.—(1) In each of the following cases relating to a relevant contract of insurance, that is to say,—

(*a*) where a breach of warranty on the part of the insured consists, in whole or in part, of his having made a misrepresentation,

(*b*) where the answer given by the insured to a question falling within subsection (1) of section 6 above consists, in whole or in part, of a misrepresentation but is such that the insured is to be regarded, by virtue of subsection (4) of that section, as having fulfilled the duty of disclosure imposed on him by law, and

(*c*) where the insured is in breach of the duty of disclosure imposed on him by law, or would be in breach of that duty if section 2 above had not been enacted, and the breach consists (or would but for section 2 above consist), in whole or in part, of his having made a misrepresentation,

the insurer shall not be entitled to rely for any purpose upon the misrepresentation as such unless it was made fraudulently.

(2) Nothing in subsection (1) above affects any right which the insurer may have in respect of a breach of warranty as such or a breach of the duty of disclosure as such.

Clause 12

This clause gives effect to the recommendation in paragraphs 8.5 and 8.7 of the Report. The clause prevents the insurer from relying on a non-fraudulent misrepresentation by the insured in cases where such reliance would be available as an alternative to the rights and remedies which are available as a result of the Bill. The insurer's rights and remedies in relation to a fraudulent misrepresentation are not affected.

Contracts of re-insurance.

13.—(1) Nothing in the preceding provisions of this Act applies to a contract of re-insurance.

(2) In any case where—

(*a*) an insurer under a relevant contract of insurance (in this subsection referred to as "the primary insurer") is liable to meet a claim, and

(*b*) if any of the preceding provisions of this Act had not come into force the primary insurer would have been entitled, having regard to the existence of any facts or circumstances, to reject that claim on account of non-disclosure, breach of warranty or misrepresentation, and

(*c*) the risk which gives rise to that claim is the subject of a contract of re-insurance,

the re-insurer under the contract of re-insurance shall not be entitled to avoid any liability under that contract on account of a default of the primary insurer which is attributable to the facts or circumstances referred to in paragraph (*b*) above.

EXPLANATORY NOTES

Clause 13

1. This clause gives effect to the recommendation in paragraph 8.15 of the Report.

2. Subsection (1) provides that the Bill shall not apply to contracts of re-insurance.

3. Subsection (2) applies in cases where the re-assured is liable to pay his insured's claim but would not have been so liable if this Bill had not been enacted. In certain cases provision is made to prevent anomalies arising where the re-insurer would be able to escape from his liability by virtue of the continued application to a contract of re-insurance of the present law of non-disclosure, breach of warranty and misrepresentation.

Interpretation.

14.—(1) In this Act—

"appointed day" means the day appointed under section 15(2) below or, if more than one day is so appointed, the first of those days;

"material", except where the context otherwise requires, shall be construed in accordance with section 2(2) above;

"proposal form" shall be construed in accordance with subsection (2) below;

"question" and "answer", in relation to a proposal form or renewal notice, shall be construed in accordance with subsection (3) below;

"relevant contract of insurance" has the meaning assigned to it by section 1(3) above;

"renewal", in relation to a contract of insurance, shall be construed in accordance with subsection (4) below;

"renewal notice" shall be construed in accordance with subsections (1) and (2) of section 4 above; and

1974 c. 49.

"vessels" includes hovercraft to which the Insurance Companies Act 1974 applies.

(2) Any reference in this Act to a proposal form includes a reference to—

(*a*) any document containing questions to which a person proposing to enter into a contract of insurance is asked, in connection with that proposal, to give answers (whether in the document or not); and

(*b*) a form of application for an advance on the security of freehold or leasehold property which states (in whatever terms) that insurance cover on the property will be arranged on behalf of the applicant, whether by the prospective lender or some other person.

(3) In relation to a proposal form or renewal notice—

(*a*) any reference in this Act to a question includes a reference to a provision which is designed to elicit information (whether from a choice of prepared answers, by the use of symbols or in any other way); and

(*b*) any reference in this Act to an answer to a question includes a reference to information elicited in response to such a provision as is mentioned in paragraph (*a*) above and any reference to answering shall be construed accordingly;

and for the purpose of determining whether a particular document is, by virtue of subsection (2)(*a*) above, included in the expression "proposal form", paragraphs (*a*) and (*b*) above shall also apply (in relation to any document) to the references in that subsection to questions and answers.

EXPLANATORY NOTES

Clause 14

1. Subsection (1) provides for the construction of various words and phrases used in the Bill.

2. Subsection (2) implements the recommendation made in paragraph 4.68 of the Report in regard to the meaning to be assigned to the phrase "proposal form". The subsection does not exhaustively define the phrase; it sets out types of documents which will be included. Paragraph (*a*) deals with documents containing questions and paragraph (*b*) deals with application forms for loans on the security of freehold or leasehold property.

3. Subsection (3), following paragraph 4.55 of the Report, provides that any reference in the Bill to questions shall include other techniques used by insurers in proposal forms and renewal notices to elicit information from the insured and that references to answers shall be construed accordingly. It also provides that such techniques shall constitute questions for the purpose of determining whether or not a document is a proposal form under subsection (2) (*a*).

(4) For the purposes of this Act, a contract of insurance is entered into by way of renewal of a contract entered into at an earlier time if—

(*a*) the parties to the later contract are the same as the parties to the earlier contract or are persons to whom rights and obligations under the earlier contract have passed by assignment or by operation of law; and

(*b*) the earlier contract provided cover against certain risks for a particular period and the later contract provides cover against the same or substantially the same risks for a further period (whether or not in respect of the same subject-matter); and

(*c*) in connection with his entering into the later contract, the insured was not asked to give answers to questions in a proposal form supplied to him by or on behalf of the insurer; and

(*d*) the later contract is not expressed to be a new contract superseding all previous contracts relating to the same or substantially the same risks;

and references in this Act to renewing a contract shall be construed accordingly.

Clause 14 (*continued*)

4. Subsection (4) implements the recommendation in paragraph 8.21 of the Report in regard to the circumstances in which a contract of insurance is entered into by way of renewal of a contract entered into at an earlier time.

Short title, commencement and extent.

15.—(1) This Act may be cited as the Insurance Law Reform Act 1980.

(2) This Act shall come into force on such day as the Secretary of State may by order made by statutory instrument appoint; and different days may be so appointed for different provisions of this Act and for different purposes of the same provision.

(3) An order under subsection (2) above may make such transitional provisions as appear to the Secretary of State to be expedient in connection with the provisions thereby brought into force.

(4) This Act extends to England and Wales only.

EXPLANATORY NOTES

Clause 15

1. Subsections (1) and (4) provide for the short title and extent of the Bill.

2. Subsection (2) of the clause allows for different provisions of the Bill to be brought into force at different times. The purpose of the final phrase of subsection (2) and of subsection (3) can be illustrated by an example. If it were thought appropriate to bring clauses 8 to 11 into force before clauses 2 to 6, it might seem desirable to bring clauses 12 and 13 into force at the same time as clauses 8 to 11, but only for the purpose of its application to breaches of warranty: this could be done as a result of the final phrase of subsection (2). If another order were then made bringing clauses 2 to 7 into force on a later date, it would be desirable, in order to avoid any suggestion of retrospection, to ensure that those clauses did not apply to, or to the renewal of, relevant contracts of insurance which had been entered into between the date on which clauses 8 to 11 came into force (which would be "the appointed day" for the purposes of clause 1(1) and the day appointed for the coming into force of clauses 2 to 7). This could be achieved by the use of the power conferred by subsection (3) of the clause.

SCHEDULE

EXCLUDED CLASSES OF CONTRACTS OF INSURANCE

Marine

1. Contracts of insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.

2. Contracts of insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third-party risks and carrier's liability.

Aviation

3. Contracts of insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.

4. Contracts of insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.

Transport

5. Contracts of insurance against loss of or damage to railway rolling stock.

6. Contracts of insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.

EXPLANATORY NOTES

Schedule

See notes to clause 1.

APPENDIX B

THE FIRST STATEMENT OF INSURANCE PRACTICE

This Statement is restricted to non-life insurances of policyholders resident in the UK and insured in their private capacity only.

1. Proposal Forms

(*a*) The declaration at the foot of the proposal form should be restricted to completion according to the proposer's knowledge and belief.

(*b*) If not included in the declaration, prominently displayed on the proposal form should be a Statement:—

(i) drawing the attention of the proposer to the consequences of the failure to disclose all material facts, explained as those facts an insurer would regard as likely to influence the acceptance and assessment of the proposal;

(ii) warning that if the proposer is in any doubt about facts considered material, he should disclose them.

(*c*) Those matters which insurers have found generally to be material will be the subject of clear questions in proposal forms.

(*d*) So far as is practicable, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgment on the part of the proposer.

(*e*) Unless the prospectus or the proposal form contain full details of the standard cover offered, and whether or not it contains an outline of that cover, the proposal form shall include a statement that a copy of the policy form is available on request.

(*f*) Unless the completed form or a copy of it has been sent to a policy holder, a copy will be made available when an insurer raises an issue under the proposal form.

2. Claims

(*a*) Under the conditions regarding notification of a claim, the policyholder shall not be asked to do more than report a claim and subsequent developments as soon as reasonably possible except in the case of legal processes and claims which a third party requires the policyholder to notify within a fixed time, where immediate advice may be required.

(*b*) Except where fraud, deception or negligence is involved, an insurer will not unreasonably repudiate liability to indemnify a policyholder:—

(i) on the grounds of non-disclosure or misrepresentation of a material fact where knowledge of the fact would not materially have influenced the insurer's judgment in the acceptance or assessment of the insurance;

(ii) on the grounds of a breach of warranty or condition where the circumstances of the loss are unconnected with breach.

The previous paragraph 2(*b*) does not apply to Marine and Aviation policies.

3. Renewals

Renewal notices should contain a warning about the duty of disclosure including the necessity to advise changes affecting the policy which have occurred since the policy inception or last renewal date, whichever was the later.

4. Commencement

Any changes to insurance documents will be made as and when they need to be reprinted, but the Statement will apply in the meantime.

5. EEC

This Statement will need reconsideration when the EEC Contract Law Directive is taken into English/Scots Law.

THE SECOND STATEMENT OF INSURANCE PRACTICE

This statement relates to long-term insurance effected by individuals resident in the UK in a private capacity. Although the statement is not mandatory, it has been recognised by members of the LOA and ASLO as an indication of insurance practice, it being understood that there will sometimes be exceptional circumstances where the statement would be inappropriate.

Industrial life assurance policyholders are already protected by the Industrial Assurance Acts 1923 to 1968 and regulations issued thereunder, to an extent not provided for ordinary branch policyholders. The statement will, therefore, be modified in its application to industrial assurance business in discussion with the Industrial Assurance Commissioner.

Life assurance is either very largely or else entirely a mutual enterprise and the aim of the industry in recent years has been to reduce to a minimum the formalities—and therefore the expense to the policyholder—involved in issuing a new life policy subject only to the need to protect the general body of policyholders from the effects of non-disclosure by a small minority of proposers.

1. Claims

(*a*) An insurer will not unreasonably reject a claim. (However, fraud or deception will, and negligence or non-disclosure or misrepresentation of a material fact may, result in adjustment or constitute grounds for rejection). In particular, an insurer will not reject a claim on grounds of non-disclosure or misrepresentation of a matter that was outside the knowledge of the proposer.

(*b*) Under any conditions regarding a time limit for notification of a claim, the claimant will not be asked to do more than report a claim and subsequent developments as soon as reasonably possible.

2. Proposal forms

(*a*) If the proposal form calls for the disclosure of material facts a statement should be included in the declaration, or prominently displayed elsewhere on the form or in the document of which it forms part:—

(i) drawing attention to the consequences of failure to disclose all material facts and explaining that these are facts that an insurer would regard as likely to influence the assessment and acceptance of a proposal;

(ii) warning that if the signatory is in any doubt about whether certain facts are material, these facts should be disclosed.

(*b*) Those matters which insurers have commonly found to be material should be the subject of clear questions in proposal forms.

(*c*) Insurers should avoid asking questions which would require knowledge beyond that which the signatory could reasonably be expected to possess.

(*d*) The proposal form or a supporting document should include a statement that a copy of the policy form or of the policy conditions is available on request.

(*e*) A copy of the proposal should be made available to the policyholder when an insurer raises an issue under that proposal—information not relevant to that issue being deleted where necessary to preserve confidentiality.

3. Policies and accompanying documents

Life assurance policies or accompanying documents should indicate:—

(*a*) the circumstances in which interest would accrue after the assurance has matured; and

(*b*) whether or not there are rights to surrender values in the contract and, if so, what those rights are.

(*Note:* The appropriate sales literature should endeavour to impress on proposers that whole life or endowment assurance is intended to be a long-term contract and that surrender values, especially in the early years, are frequently less than the total premiums paid.)

4. Commencement

Any changes to insurance documents will be made as and when they need to be reprinted but the statement will apply in the meantime.

APPENDIX C

ARTICLES 3–6 OF THE PROPOSED COUNCIL DIRECTIVE ON THE CO-ORDINATION OF LAWS, REGULATIONS AND ADMINISTRATIVE PROVISIONS RELATING TO INSURANCE CONTRACTS WITH RELEVANT PARTS OF THE EXPLANATORY MEMORANDUM

Article 3

1. When concluding the contract, the policyholder shall declare to the insurer any circumstances of which he is aware which may influence the insurer's assessment or acceptance of the risk. The policyholder shall not be obliged to declare to the insurer circumstances which are already known to the latter or which are common knowledge. Any circumstance in respect of which the insurer has asked specific questions in writing shall, in the absence of proof to the contrary, be regarded as influencing the assessment and acceptance of the risk.

2. (*a*) If circumstances which were unknown to both parties when the contract was concluded come to light subsequently or if the policyholder has failed to fulfil the obligation referred to in paragraph 1, the insurer shall be entitled, within a period of two months from the date on which he becomes aware of the fact, to propose an amendment to the contract.

(*b*) (i) The policyholder shall be entitled to a period of fifteen days from the date on which he receives the proposal for an amendment in which to accept or reject it. If the policyholder rejects the proposal or fails to reply within the above time limit, the insurer may terminate the contract within a period of eight days by giving fifteen days' notice.

(ii) If the contract is terminated, the insurer shall refund to the policyholder the proportion of the premium in respect of the period for which cover is not provided.

(iii) If a claim arises before the contract is amended or before the termination of the contract has taken effect, the insurer shall provide the agreed cover.

3. If the policyholder has failed to fulfil the obligation referred to in paragraph 1 and may be considered to have acted improperly, the insurer may terminate the contract or propose an amendment to it.

(*a*) The insurer shall choose either to terminate the contract or to propose an amendment to it within two months from the date on which he becomes aware of such facts. Termination shall take effect fifteen days after the date on which the policyholder is notified thereof at his last known address.

If the insurer has proposed an amendment to the contract, the policyholder shall be entitled to accept or reject it within fifteen days from the date on which he receives the proposal for an amendment.

If the policyholder refuses the proposal or fails to reply, the insurer may terminate the contract within eight days by giving fifteen days' notice.

(*b*) If the contract is terminated the insurer shall refund to the policyholder the proportion of the premium in respect of the period for which cover is not provided.

(*c*) If a claim arises before the contract is amended or before the termination of the contract has taken effect, the insurer shall be liable to provide only such cover as is in accordance with the ratio between the premium paid and the premium that the policyholder should have paid if he had declared the risk correctly.

4. If the policyholder has failed to fulfil the obligation referred to in paragraph 1 with the intention of deceiving the insurer, the latter may terminate the contract.

(*a*) The insurer shall take such action within two months from the date on which he becomes aware of such facts.

(*b*) By way of damages, premiums paid shall be retained by the insurer who shall be entitled to the payment of all premiums due.

(*c*) The insurer shall not be liable in respect of any claim.

5. In the cases referred to in paragraphs 3 and 4, the burden of proof of fraudulent or improper conduct on the part of the policyholder shall rest on the insurer.

Article 4

1. From the time when the contract is concluded, the policyholder shall declare to the insurer any new circumstances or changes in circumstance of which the insurer has requested notification in the contract. Such declaration shall be made not later than the time when the risk increases where this is attributable to an intentional act of the policyholder; in all other cases, it must be made immediately the policyholder becomes aware of the increase.

2. The insurer may, within two months of the date on which he was notified of the increase of the risk, propose an amendment to the contract in accordance with the procedure laid down in Article 3(2) (*b*).

3. If the policyholder has failed to fulfil the obligation referred to in paragraph 1, such failure to give notice shall not give rise to any sanction where it relates to a new circumstance or change in circumstances which is not liable to appreciably and permanently increase the risk and lead to an increase in the premium.

4. If the policyholder has failed to fulfil the obligation referred to in paragraph 1, the insurer may, within two months of the date on which he becomes aware of such fact, propose an amendment to the contract in accordance with the procedure laid down in Article 3(2) (*b*).

5. If the policyholder has failed to fulfil the obligation referred to in paragraph 1 and may be considered to have acted improperly, Article 3 (3) shall apply.

6. If the policyholder has failed to fulfil the obligation referred to in paragraph 1 with the intention of deceiving the insurer, the latter may terminate the contract.

(*a*) The insurer shall take such action within two months from the date on which he becomes aware of such fact;

(*b*) By way of damages, any premiums paid shall be retained by the insurer who shall be entitled to the payment of all premiums due.

(*c*) The insurer shall not be liable in respect of any claim arising after the increase of the risk.

7. In the cases referred to in paragraphs 5 and 6, the burden of proof of fraudulent or improper conduct on the part of the policyholder shall rest on the insurer.

Article 5

Any unjustified payment made pursuant to Articles 3 and 4 shall be refunded.

Article 6

If, while the contract is in force, the risk has diminished appreciably and permanently because of circumstances other than those covered by the contract, and if this justifies a reduction in the premium, the policyholder shall be entitled to terminate the contract without compensation if the insurer does not consent to reduce the premium proportionately.

The right to terminate the contract shall arise immediately the insurer refuses to reduce the premium or, where he fails to reply to the policyholder's proposal, after a period of fifteen days following such proposal.

Where the contract is terminated, the insurer shall refund to the policyholder a proportion of the premium corresponding to the period for which cover is not provided, less the administrative costs involved.

Explanatory Memorandum

The harmonization of contract law in connection with freedom to provide services and freedom of choice of applicable law has a twofold objective. Firstly, to guarantee the policyholder that whatever the choice of applicable law, he will receive identical protection as regards the essential points of the contract. Secondly, to eliminate as competition factors for undertakings the fundamental differences between national law. Such is the object of this directive.

The extent of harmonization has been deliberately restricted to what was considered necessary and adequate, at least initially, to attain these objectives. In this respect, the great majority of Government experts and the professional bodies consulted considered that the following points should be co-ordinated as a matter of priority: declaration of the risk, obligations of the policyholder during the contract period, payment of premiums, declaration of the claimable event, duration of the contract.

Soon, however, freedom of choice of applicable law will already be effective with regard to certain risks, which are defined in Article 4(2) of the second Directive on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services. The co-ordination proposed in the present directive must not be considered as automatically entailing freedom of choice of the law applicable to contracts covering mass risks or those risks in respect of which insurance is compulsory. Any extension of freedom of choice in the case of such risks must be dealt with in special directives laying down the exact conditions and limits of such extension.

Article 3—Declaration of Risk

The existence of a questionnaire does not free the policyholder from his general obligation to declare the risk. The questionnaire is a tool for the insurer and a guide for the policyholder; its main effect is to establish a presumption that the circumstances to which the questions relate have an influence on the risk.

Where one of these circumstances, although existing at the outset, becomes known to the insurer only in the course of the contract, and no blame may be attributed to the policyholder, it is sufficient to allow the parties to rapidly reach an agreement on an appropriate amendment to their contract.

If it can be proved that the policyholder has not fulfilled his obligation as regards declaration, the insurer may terminate the contract, and any claim arising before the modification of the contract gives rise only to a proportional payment. On the other hand, if the policyholder has acted with the intention of deceiving the insurer, the latter is entitled to terminate the contract and retains the right to the premiums payable in respect of the current insurance period, while the policyholder for his part loses his right to cover.

The burden of proof of the existence of either of the last two situations lies on the insurer.

Article 4—Increase of Risk

Once the contract has been concluded, only changes in circumstances of which the insurer has requested notification have to be declared by the policyholder.

Otherwise, the consequences of such changes, and sanctions where declaration is not made, are based on those laid down in the preceding article relating

to circumstances existing at the conclusion of the contract; in particular, the same time-limits and the same rules governing proof are applicable.

Articles 3 and 4 do not apply to the existence or emergence of circumstances excluded from the insurance cover, or the causes of withdrawal of cover, or where the risk has changed fundamentally.

Article 5—Return of Unjustified Payments

This is a general provision which applies in any case referred to in the two preceding articles, except that of fraud, whoever has made the payment. It confirms the fact that the measures taken under the preceding articles are retrospective to the conclusion of the contract or the date of the increase in the risk, as the case may be.

Article 6—Reduction of Risk

This article complements Article 4 and gives the policyholder the right to receive a reduction in the premium corresponding to a reduction in the risks. It is laid down in the first paragraph that this rule does not apply where the risk diminishes as a result of a partial claim.

APPENDIX D

List of persons and organisations who sent comments on Working Paper No. 73

The Association of British Chambers of Commerce
Professor P. S. Atiyah
The Automobile Association
The Joint Working Party of the Bar and the Law Society
Messrs. Beaumont and Son
British Insurance Association
British Insurance Brokers' Association
British Insurance Law Association
The Building Societies Association
Mr. H. Caplan
The Civil Service Motoring Association Ltd.
Confederation of British Road Passenger Transport
Consumers' Association
Department of Trade
Professor A. L. Diamond
The Honourable Mr. Justice Donaldson
The Honourable Mr. Justice Goff
Professor Jan Hellner (University of Stockholm)
Mr. G. J. R. Hickmott
Institute of Public Loss Assessors
The Law Society of Scotland
Mr. Nicholas Legh-Jones
The Life Offices' Association
Lloyd's
Lord Chancellor's Department
Messrs. Markbys
The Right Honourable Lord Justice Megaw
Mr. R. Merkin
The Honourable Mr. Justice Mustill
National Consumer Council
National Federation of Consumer Groups
Office of Fair Trading
Police Federation of England and Wales
Mr. D. G. Powles
The Right Honourable Lord Justice Roskill
Russell Scanlon Insurance
Scottish Consumer Council
Society of Conservative Lawyers
Mr. A. Tettenborn

Printed in England by Burrup, Mathieson & Co., Ltd., and published by Her Majesty's Stationery Office
B748737/MP Dd. 627974 K16 10/80

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ISBN 0 10 180640 X