



LAW REFORM
COMMITTEE
FIFTH REPORT

(Conditions and Exceptions in Insurance Policies)

*Presented by the Lord High Chancellor to Parliament
by Command of Her Majesty
January 1957*

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To the Right Honourable the Viscount KILMUIR, Lord High Chancellor of Great Britain.

MY LORD,

We were invited by your predecessor, Viscount Simonds, in July, 1954, to consider the effect on the liability of insurance companies of special conditions and exceptions in insurance policies and of non-disclosure of facts by persons effecting such policies. We decided to refer this matter in the first instance to a sub-committee under the chairmanship of Mr. Justice Devlin to which Professor Denis Browne of the University of Liverpool was co-opted with your Lordship's approval.

2. The sub-committee received memoranda from—

The British Insurance Association ;

The Corporation of Insurance Brokers ;

The General Council of the Bar ;

The Law Society ;

Lloyd's ;

The Society of Labour Lawyers ;

The Standing Joint Committee of the Royal Automobile Club, Automobile Association and Royal Scottish Automobile Club ; and

Mr. C. F. Flesch, Insurance Broker ;

and heard oral evidence from representatives of the Bar Council, the British Insurance Association, and Lloyd's.

We had also available to us a memorandum by the parallel sub-committee of the Law Reform Committee in Scotland and some material from the files of the Lord Chancellor's Office and of the motorists' organisations.

3. We conceive that our primary duty under our terms of reference is to summarise the practical effects, as we understand them, of the matters referred to on the liability of insurers ; this we have attempted in paragraphs 4 to 10 below. We assume, however, that there is further implied an invitation to indicate whether the situation disclosed is in our opinion such as to justify, or require, amending legislation ; our views on this question are contained in paragraphs 11 to 14. At an early stage we decided to exclude marine insurance from the scope of our enquiry. The general public is not interested in marine insurance and we have no reason to believe that the business circles who are concerned with the subject are in any way dissatisfied with the law as it stands.

4. The effect of non-disclosure may be considered first, since it is a consequence of the general law relating to insurance contracts and does not involve any express term or condition. We take it to be well settled law—

(a) that the duty of disclosure of material facts—or the rule of *uberrima fides* as it is often called—applies to all classes of insurance, and

(b) that the question in every case is whether the fact not disclosed was material to the risk, and not whether the insured, whether reasonably or otherwise, believed or understood it to be so.

Further, we see no reason to doubt that the definition of "material", adopted by the Privy Council in *Mutual Life Insurance Co. of New York v. Ontario Metal Products Co. Ltd.*¹ for the purposes of life assurance—namely

¹ [1925] A.C. 344.

that the fact, if disclosed, might have led a reasonable insurer to decline the risk or to stipulate for a higher premium—would be applied in all classes of insurance. This definition is substantially the same as that laid down in the Marine Insurance Act, 1906, and has been adopted by an English Court as a definition of materiality for the purpose of subsections (3) and (5) of section 10 of the Road Traffic Act, 1934.²

The practical effect of the law on this point is that insurers are entitled to repudiate liability wherever they can show that a fact within the knowledge of the insured was not disclosed which, according to current insurance practice, would have affected their judgment of the risk. Whether the insuring public at large is aware of this it is difficult to say; but it seems to us to follow from the accepted definition of materiality that a fact may be material to insurers, in the light of the great volume of experience of claims available to them, which would not necessarily appear to a proposer for insurance, however honest and careful, to be one which he ought to disclose.

5. The other factors affecting the liability of insurers which we have considered arise from express terms and conditions in common use in proposal forms and insurance policies. These may be grouped in four classes—

- (i) questions and answers in proposal forms;
- (ii) promissory warranties relating to the risk;
- (iii) clauses requiring the insured to do certain things after a loss has occurred;
- (iv) arbitration clauses.

We consider the effect of these factors in that order in the paragraphs which follow.

6. In certain classes of insurance, a proposer is required to answer detailed and specific questions relating to the risk to be insured. In life and motor vehicle insurance this practice may be regarded as invariable; in fire insurance, we understand that it is unusual; in other classes the practice probably varies. Where such questions are asked, it is usual for the proposal form to contain a clause whereby the proposer agrees that the truth of his answers shall be the basis of the contract. The balance of authority on the construction of such clauses is overwhelmingly in favour of interpreting "truth" to mean "accuracy".³ The result of the presence of such a clause in a proposal form is therefore to render irrelevant any question either of the materiality of the information so obtained, or of the honesty or care with which it was given. If the answer given was inaccurate, the insurers are at liberty to repudiate. Further, we think that it is clear that, as a matter of law, the answering of specific questions, however detailed and searching, does not relieve the proposer from his duty to disclose material facts,⁴ although in practice, especially in life insurance, the exhaustive nature of the inquiry may be such as to make it highly improbable that any possible material fact will not be covered.

7. Arising out of the question discussed in the previous paragraph, we considered the effects of the widespread practice of negotiating insurance through agents nominated by insurance companies. This practice, whether or not it is strictly within our terms of reference, has proved on occasion directly relevant to the liability of the insurer. A proposer who negotiates

² *Zurich General Accident and Liability Insurance Co. Ltd. v. Morrison* [1942] 2 K.B. 53.

³ e.g. *Thomson v. Weems* (1884) 9 App. Cas. 671.

⁴ e.g. *Joel v. Law Union and Crown Insurance Co.* [1908] 2 K.B. 863.

his insurance through such an intermediary is apt to assume that a true and complete disclosure of facts (whether material in themselves or the subject-matter of questions in the proposal form) to the agent is disclosure to the insurer, whereas on the authorities as they stand the better opinion is that, in relation at any rate to the filling up of a proposal form, such a person must be regarded as the agent of the proposer.⁵ The result may be, and in some of the reported cases apparently has been, that insurers can repudiate liability because an agent has been allowed by the proposer to fill up the proposal form, and has carelessly or deliberately falsified therein the oral information given to him by the proposer. In industrial assurance, where the danger is especially obvious, the insured is at least partially protected from it by legislation.⁶

8. The effect of any promissory undertaking by the insured relating to the risk (in the law of insurance, contrary to general usage, always called a warranty) is perfectly clear. Ever since the time of Lord Mansfield⁷ it has been consistently held that warranties must be strictly and literally complied with, and that any breach entitles the insurer to repudiate. The result may be very serious for the insured, since the breach on which the insurers rely may have been quite unconnected with the loss. In this context we would refer briefly to the authorities⁸ which show that in any particular case it may be very difficult for the court to discover, from the wording of the proposal form or policy, whether the form of words used should be construed as (a) a statement of present fact or intention, (b) a promissory warranty, or (c) a description of the risk. The solution may well be decisive, since in case (a), if the statement was true at the time it was made, the insured is covered, in case (b) any departure, whether at the time of loss or not, entitles the insurers to repudiate, and in case (c) the insured is covered if the state of affairs described obtained at the time of the loss, irrespective of whether there had been any departure from it earlier.

9. The effect of conditions relating to things to be done by the insured after the occurrence of a loss differs according to whether they are interpreted as conditions precedent to the liability of the insurers, or merely as collateral undertakings the breach of which gives rise to a claim for damages. The answer depends on the construction of the individual condition, but the general tendency has been to construe them as conditions precedent. The presence of such clauses is a very valuable protection to the insurers, since their function is usually to facilitate prompt investigation after a loss, to ensure control by the insurers of any litigation or negotiations with third parties, or to protect their interest in matters of salvage or subrogation. They are not, we think, normally calculated to be prejudicial to an insured who takes the trouble to read his policy, except perhaps the condition, common in certain types of policy, which requires notice of loss to be given within so many days. Circumstances may arise, examples of which were brought to our notice, which render compliance with such a condition impossible. For example, where the discovery of one irregularity on the part of an employee leads to the discovery of a series of embezzlements in the past, the presence of such a clause in a fidelity policy taken out to ensure against such losses will entitle the insurers to refuse compensation for any of the losses except the last.

⁵ *Newsholme Brothers v. Road Transport and General Insurance Co. Ltd.* [1929] 2 K.B. 356.

⁶ Industrial Assurance Act, 1923, s. 20(4).

⁷ *De Hahn v. Hartley* (1786) 1 T.R. 343.

⁸ e.g. *Farr v. Motor Traders Mutual Insurance Society Ltd.* [1920] 3 K.B. 669; *Provincial Insurance Co. Ltd. v. Morgan* [1933] A.C. 240.

10. Arbitration clauses are common form in insurance policies. They usually follow the form which fell to be considered by the House of Lords in the case of *Scott v. Avery*⁹ and provide that the insurer's obligation is to pay whatever sum may be awarded by the arbitrator, arbitration being made a condition precedent to liability. While arbitration clauses have no direct effect on the liability of the insurer, it has been suggested to us that they may operate harshly against the insured in two ways, for (i) legal aid is not available in an arbitration and (ii) an insurer who proposes to rely on a technically valid but unmeritorious defence may, by insisting on arbitration, avoid the damaging publicity which would attend such tactics if they were employed in court. We incline to think that the prevalence of such clauses, which has operated, here as elsewhere in commercial law, to reduce the number of decided (and therefore of reported) cases to a fraction of what it used to be, may be largely responsible for the difficulty which we have felt in deciding whether injustice is in fact suffered in this field to an extent which could justify legislative interference.

11. It appeared to us that such a state of the law, combined with the prevalence of such terms and conditions in insurance policies as we have described in the preceding paragraphs, is capable of leading to abuse, in the sense that a variety of circumstances may entitle insurers, after a loss has occurred, to repudiate liability as against an honest and at least reasonably careful insured. Material was available to us, in the form both of reported cases and of instances within the experience of those who supplied us with information, which showed that such abuses had in fact sometimes occurred. It was forcefully represented to us by those representatives of insurance interests who submitted memoranda or gave oral evidence that no reputable insurer would rely on a purely technical defence to defeat an honest claim. This may well be true, and we think that in general it is true, but it does not alter the fact that the ease with which a technical defence may be found means that in many cases an insurer is in a position to substitute his own judgment of the claimant's bona fides for that of a court.

12. It does not, however, seem to us that the mere fact that a branch of the law is theoretically open to criticism, or even that it is susceptible of abuse, in itself justifies a positive recommendation that it should be amended. Most of the situations, potentially prejudicial to the interests of the insured, to which we have drawn attention, are the product of express contractual stipulations rather than of rules of law in the ordinary sense; any proposal to alleviate such situations in the interest of the insured would involve interference with the liberty of contract of the insurer. The desirability or otherwise of such legislation seems to us a broad question of social policy outside our competence. We do not therefore set out here the reasons given to us by the representatives of the insurance interests for the insertion of provisions of this kind in contracts of insurance or their views as to the likely consequences of the omission of such provisions. Were there evidence sufficient to justify the conclusion that insurers abuse their undoubtedly powerful legal position to any substantial extent, the position might be different, but the evidence we have received falls far short of that.

13. So far as the use of arbitration clauses is concerned, the position has materially altered since we began our inquiry because the British Insurance Association and Lloyd's have now stated that members of the Association and Lloyd's underwriters have agreed to refrain in general from insisting upon the enforcement of arbitration clauses if the insured prefers to have the question of liability, as distinct from amount, determined by a court in the United Kingdom. We understand that this arrangement does not apply

⁹ (1856) 5 H.L.C. 811.

where the terms of the insurance are contained in a policy which has been specially negotiated and in which an arbitration clause has been inserted by express agreement between the parties. Nor does it apply to marine insurance; to contracts of reinsurance; or to certain aspects of aircraft insurance, for example, insurance against the loss of or damage to an aircraft, the insured's liability to third parties or to passengers in the aircraft, or to loss of or damage to, or liability in respect of, cargo consigned by air. We think, however, that the new arrangement should prove a valuable concession and should go far to remove the complaint that compulsory arbitration has tended to obscure whether or not insurance companies abuse their position, and if so to what extent.

14. While it is not for us to determine whether legislation is desirable, we think that we can properly consider to what extent it is practicable to introduce any new provisions into existing insurance law and what form such provisions should take. We think that any or all of the following provisions could be introduced into the law and that no legal difficulties would arise in their application—

- (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;
- (3) that 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 deemed to be the knowledge of the insurers.

We do not propose any amendment of the law in regard to arbitration clauses in view of the new arrangements recently announced by the British Insurance Association and Lloyd's to which we have drawn attention in paragraph 13. It is true that the Association and Lloyd's cannot speak for all bodies carrying on insurance business, but we express the hope that other insurers will follow the lead which has now been given.

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