THE POST-CONTRACTUAL DUTY OF UTMOST GOOD FAITH

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Abstract

In the Litsion Pride case, Hirst J. held that the duty of disclosure, which stems from the continuing nature of utmost good faith, generally continues even after the contract is concluded in relation to the matters which are relevant to the post-contractual stage. This decision was followed by the Good Luck case. It seems that this interpretation is inconsistent with the traditional view that there is no duty to disclose supervening material facts which come to the knowledge of the insured, or any facts which become material after conclusion of the contract. This legal issue is related to the ambit of a continuing duty of utmost good faith. There have been two interpretations as to this question of ambit -a broad interpretation and a narrow interpretation. It would appear that the issues in the Litsion Pride were based on the contractual term requiring the insured to give notice to the insurer of some relevant facts in relation to the rearrangement of the premium in the policy after the contract was concluded. It was a contractual duty to give notice in essence, and it had to be discharged with utmost good faith. In other words, the duty of utmost good faith was applied to the discharge of the insured's duty to advise the insurer of the relevant facts. Therefore, the Litsion Pride case does not seem to be the authority to show whether or not the continuing duty of disclosure as a common law rule is actually applied in practice. The continuing duty of disclosure should not be recognized as a common law rule. It is more concerned with a contractual duty which stems from the particular terms in the policy.

Introduction

In the U.S.A., an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement has been prevalent and generally applied in practice in a positive way.[1] This tendency, i.e., the general recognition of the duty of good faith which is applied throughout the contract,

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[1] *Comunale v. Traders & General Ins. Co.* 328 P 2d 198, at p. 200 (Cal, 1958); Also see, *Kirke La Shelle Co. v. Paul Armstrong Co.* 263 N.Y. 79, at p. 87 (1933); *Beck v. Farmers Ins. Exchange* 701 P 2d 795 (Utha, 1985).

has been well established in German law and French law. It would appear that this concept has been also recently developed in Australia and Canada.

In English contract law, however, the principle of the duty of good faith which is applied throughout the contract has been only narrowly and less positively applied in practice. In other words, although some attempts to adopt this principle have been made, the widely accepted current tendency in English contract law is different from the general recognition of this principle.

A recognition of so-called duty of co-operation is a good example of English contract law's approach to this principle. In *Southern Foundries Ltd v. Shirlaw*[2], Lord Atkin expressed a duty of co-operation in the light of a continuing duty of good faith in the general law of contract, saying that;

> "... a positive rule of the law of contract that conduct of either promisor or promisee which can be said to amount to himself `of his motion' bringing about the impossibility of performance is in itself a breach."[3]

In *Nissho Iwai Petroleum Co. Inc. v. Cargill International S.A.*[4], Hobhouse J. also stated that;

> "Similarly, it is an implied term of a contract that one party shall not obstruct or prevent the other from performing the contract."[5]

This expression means that there is an implied term that neither party will do anything throughout the contract in question to cause a situation in which all or a part of the contract cannot be performed. This interpretation can be also understood as one of the attempts to adopt the above principle.

As regarding the continuing duty of utmost good faith in insurance contracts, it has been approved in England, although the question of the ambit of the duty, in particular in relation to the continuing duty of disclosure, is still debatable. For instance, Mathew L.J. in *Boulton v. Houlder Brothers & Co.*[6] said that;

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[2][1940] A.C. 701

[3]Ibid., at p. 717

[4][1993] 1 Lloyd's Rep. 80.

[5]Ibid., at p. 84; Also see, *Stirling v. Maitland* (1864) 5 B. & S. 840, at p. 852; *Agrimpex Hungarian Trading Co. for Agricultural Products v. Sociedad Financiere De Bienes Raices S.A. (The Aello)* [1960] 1 Lloyd's Rep. 623.

[6][1904] 1 K.B. 784.

> "It is an essential condition of a policy of insurance that the underwriters shall be treated with good faith, not merely in reference to the inception of the risk, but in the steps taken to carry out the contract. That being the meaning of the contract, effect is given to it by means of the order for discovery of ship's papers, and the affidavit with relation to them."[7]

A series of recent English insurance cases has confirmed that the requirement of utmost good faith survives beyond the time of the formation of the policy, and continues throughout the contractual relationship.[8] The concept of the continuing duty of good faith in insurance contracts has also been recognized by the Australian courts and legislation. Section 13 of the Insurance Contracts Act 1984 confirms it, saying;

> "A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith."[9]

In addition, in *Trans-Pacific Ins. Co. (Australia) Ltd v. Grand Union Ins. Co. Ltd*[10], Giles J. held that "the duty of good faith is not limited to the time of entry into the contract of insurance but subsists throughout the currency of that contract".[11] In fact, there is no doubt that, apart from the statutory recognition, it is an implied condition of every policy of insurance that the parties should observe good faith toward each other at all material times and in all material particulars.

Ambit of a Continuing Duty of Utmost Good Faith

Although the continuing nature of the duty of utmost good faith beyond the time of the formation of the insurance contracts is recognized in the statutes and in the courts, the scope of this concept is not clear. There have been two interpretations as to this question - a positive

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[7]Ibid, at pp. 791-792; Also see, *Leon v. Casey* [1932] 2 K.B. 576, at pp. 579-580.

[8]*Black King Shipping Corporation v. Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437; *Continental Illinois National Bank & Trust Co. of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos)* [1986] 2 Lloyd's Rep. 470; *La Banque Fianaciere v. Westgate Insurance Co.* [1990] 2 Lloyd's Rep. 377; *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep. 514.

[9]Also see, sections. 60(1)(a) and (b).

[10](1989) 18 New South Wales Law Review 675, at pp. 703-704 (hereinafter N.S.W.L.R.).

[11]Also see, *Distillers-Bio-Chemicals (Australia) Pty Ltd v. Ajax Ins. Co. Ltd.* (1973) 130 C.L.R. 1, at p. 31; *Dawson v. Monarch Ins. Co. Ltd* [1977] 1 N.Z..R. 372, at p. 378; *Deaves v. C.M.L. Fire & General Ins. Co. Ltd* (1979) 23 A.L.R. 539, at p. 580; *Sampson v. Gold Star Insurance Co. Ltd* [1980] 2 N.Z.L.R. 742, at p. 746; A. Tarr, "Dishonest Insurance Claims", (1988) 1 Insurance Law Journal 42, at pp. 57-58.

interpretation and a passive interpretation. One of the main criteria to distinguish two interpretations is to what extent the duty of disclosure in the post-contractual stage will be applied in practice.

1) POSITIVE (BROAD) INTERPRETATION

Prior to the decision in *Black King Shipping Co. v. Massie (The Litsion Pride)*[12] (hereafter The Litsion Pride), which has been regarded as a leading authority for the positive interpretation that the duty of utmost good faith including a positive continuing duty of disclosure is generally applied in practice beyond the formation of the contract, this duty had been only limitedly recognized in the context of claims and contractual terms where the insured failed to disclose relevant matters.

In *The Litsion Pride,* however, Hirst J. held that the duty of disclosure, which stems from the continuing nature of utmost good faith, generally continues even after the contract is concluded in relation to the matters which are relevant to the post-contractual stage where either party has an obligation, expressly or impliedly, to do something, or to say something or to abstain from doing something, or where one party enters into communication with the other whether in pursuance of a duty or not. In other words, according to the positive interpretation, the post-contractual duty of disclosure applies with full vigor, and thus where the insured communicates with the insurer at any time after the formation of the contract, the insured has a general duty to disclose material fact. Hirst J. stated that;

> "...it seems to be manifest that, as part of the duty of utmost good faith, it must be incumbent on the insured to include within it all relevant information available to him at the time he gives it; and in any event the self-same duty required the assured to furnish to the insurer any further material information which he acquires subsequent to the initial notice as and when it comes to his knowledge, particularly if it is materially at variance with the information he originally gave."[13]

Hobhouse J. in *The Bank of Nova Scotia v. Hellenic Mutual War Risk Association (Bermuda) Ltd, (The Good Luck)*[14] also expressed the similar view, saying;

> "... there can be situations which arise subsequently where the duty of utmost good faith makes it necessary that there should be further disclosure because the relevant facts are relevant to the later stages of the contract... A fortiori,

[12][1985] 1 Lloyd's Rep. 437.

[13]Ibid., at p. 512

[14][1988] 1 Lloyd's Rep. 514

those considerations can also apply to contracts of insurance and a duty of disclosure which can exist under the continuing duty to show the utmost good faith. The duty is a continuing one."[15]

It would appear that the first basis for the general recognition of the continuing duty of disclosure after the formation of the insurance contract is s. 17 of the Marine Insurance Act (MIA) 1906. This section indicates that there will be a post-contractual duty of disclosure, since there is no specific restriction of the duty to pre-contractual stage in the wordings. Therefore, the duty of utmost good faith in s. 17 could persist throughout the entire contract. As to the relationship between s. 17 and ss. 18-20 of the M.I.A. 1906, the Court of Appeal in *C.T.I. v. Oceanus*[16] clearly held that ss. 18-20 (non-disclosure and misrepresentation) were one aspect of the overriding duty of the utmost good faith in s. 17.[17] Based on this, the advocates for the positive interpretation maintain that the application of the duty of disclosure in s. 18 should be interpreted in the light of s. 17 and consequently, the post-contractual duty of disclosure may exist.

Secondly, it would appear that the 'held covered' provisions of the Institute Clauses in a marine policy is another ground for the recognition of the continuing duty of disclosure.[18] In case of deviation or change of voyage or any breach of warranty, the cover may still continue by the 'held covered' clause provided notice be given to the underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed. The assured seeking the benefit of this clause must give prompt notice to underwriters of his claim to be held covered as soon as he learns of the facts which render it necessary for him to rely upon the clause. The assured cannot take advantage of the clause unless he has acted in the utmost good faith. Likewise, the prerequisite for a 'held covered' clause is strongly related to the conduct based on the continuing duty of utmost good faith including the continuing duty of disclosure. McNair J., in *Overseas Commodities, Ltd v. Style*[19], clearly expressed the relationship between the 'held covered' clause and the continuing duty of utmost good faith;

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[15]Ibid., at pp. 545-546; Also see, *Phillips v. Foxall* (1872) L.R. 7 Q.B. 666; *Stag Line Ltd v. Tyne Shiprepair Group Ltd, The Zinnia* [1984] 2 Lloyd's Rep. 211; *Continental Illinois National Bank & Trust Co. of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos)* [1986] 2 Lloyd's Rep. 470.

[16][1984] 1 Lloyd's Rep. 476.

[17]Ibid., at pp. 492 and 512; Also see, *Glicksman v. Lancashire & General Assurance* [1925] K.B. 593, at p. 609 and [1927] A.C. 139, at pp. 143-144.

[18]Clause 10 of Institute Cargo Clauses (A) (B) and (C); Clause 3 of Institute Time Clauses (Hulls); Clause 2 of Institute Voyage Clauses (Hulls); Clause 2 of Institute War and Strikes Clauses (Hulls-Time and Hulls-Voyage); Clause 4 of Institute Time Clauses (Freight); Clause 3 of Institute Voyage Clauses (Freight); Clause 2 of Institute War and Strike Clauses (Freight-Time and Freight-Voyage).

[19][1958] 1 Lloyd's Rep. 546, at p. 559.

> "To obtain the protection of the `held covered' clause, the assured must act with the utmost good faith towards the underwriters, this being an obligation which rests upon them throughout the currency of the policy."[20]

Lastly, it would appear that the practice of ship's papers is also related to a continuing duty of utmost good faith. According to this practice, an underwriter is entitled at the earliest stage of an action on a policy of insurance to an affidavit of ship's papers. One of the reasons the Common Law Courts invented the order for ship's papers is a recognition of the plain fact that the underwriter is entitled to be treated with utmost good faith throughout the currency of the policy and the underwriter is entitled to get information from the insured as regarding all that has been done with reference to the subject-matter of the insurance.[21] Scrutton L.J. in *Leon v. Casey*[22] expressed the relationship between the practice of ship's papers and a continuing duty of utmost good faith, explaining the origin of the order for ship's papers;

> "... and partly of the fact that insurance has always been regarded as a transaction requiring the utmost good faith between the parties, in which the assured is bound to communicate to the insurer every material fact within his knowledge not only at the inception of the risk, but at every subsequent stage while it continues, up to and including the time when he makes his claim, the Common Law Courts invented the order for ship's papers, an order which is made as soon as the writ is issued in an action on a policy of marine insurance."[23]

With the above rationale, the advocates of the positive interpretation argue that the duty of disclosure which stems from the duty of utmost good faith is generally applied even after the formation of the contract. As to the ambit of the information which the insured should disclose to the insurer after the formation of the contract, the positive interpretation maintains that the post-contractual duty of disclosure will be related to the matters which affect the future conduct of the insurer under the policy such as the claims process. In relation to this issue, the proper test of materiality will be that a circumstance is material if non-disclosure of it would influence the prudent insurer's judgment in making the relevant decisions, at the post-contractual stage, such as the fixing of additional premium or a variety of decisions in relation to a claim, for instance, accepting, rejecting, or compromising a claim.

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[20] Also see, *Liberian Insurance Agency Inc. v. Mosse* [1977] 2 Lloyd's Rep. 560, at p. 568.

[21] *Harding v. Russel* [1905] 2 K.B. 83, at pp. 85-86.

[22] [1932] 2 K.B. 576, at pp. 579-580.

[23] Also see, *China Traders Insurance Co. Ltd v. Royal Exchange Assurance Corporation* [1898] 2 Q.B. 187, at pp. 192-193; *Boulton v. Houlder Brothers and Co.* [1904] 1 K.B. 784, at pp. 791-792.

2) PASSIVE (NARROW) INTERPRETATION AND CRITICISM

This interpretation suggests that there are substantial differences in the scope of the duty of utmost good faith as it applies pre and post-contract, although the continuing nature of the duty of utmost good faith is recognized. According to this interpretation, once the contract is concluded, the duty of utmost good faith is no more than a duty to abstain from bad faith, whereas the duty of utmost good faith at the pre-contractual stage applies in its fullest amplitude. In other words, the duty of utmost good faith at the post-contractual stage is simply not to act fraudulently, either in supplying information under the terms of the contract or in the making of a claim on the policy. Therefore, general application of the duty of disclosure at the post-contractual stage is not necessarily required. This interpretation seems to be related to the precedent that there is no duty to disclose material facts which arise after the contract is concluded. For example, in *Lishman v. Northern Maritime Insurance Co.*[24], Blackburn J. stated that;

> "... the obligation to disclose material facts does not ... extend to making it necessary to disclose facts after the underwriter is once bound in honor and so tempt him to break his engagement."

In addition, Lord Sumner in *Commercial Union Assurance Co. v. Niger Co. Ltd*[25] expressed his negative view of the continuing duty of disclosure beyond the formation of the contract, pointing out the absurd situation easily incurred as a result of the extending the duty to that stage;

> "The object of disclosure being to inform the underwriter's mind on matters immediately under his consideration, which reference to the taking or refusing of a risk then offered to him, I think it would be going beyond the principle to say that each and every change in an insurance contract creates an occasion on which a general disclosure becomes obligatory, merely because the altered contract is not the unaltered contract, and therefore the alteration is a transaction as the result of which a new contract of insurance comes into existence. This would turn what is an indispensable shield for the underwriter into an engine of oppression against the assured."[26]

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[24](1875) L.R. 10 C.P. 179, at pp. 182-183.

[25](1922) 13Ll.L.R. 75, at p. 82.

[26]Also see, Ibid., at p. 77 (Lord Buckmaster) and at p. 78 (Lord Atkinson); See, *Cory v. Patton* (1872) L.R. 7 Q.B. 304, at pp. 308-309; *Pim v. Reid* (1843) 6 M. & G. 1.

Likewise, according to the passive interpretation, the duty of utmost good faith at the post-contractual stage is simply not to act fraudulently and it does not necessarily include the duty of disclosure. The current practice of a duty of co-operation in a general contract, which has been recognized as one aspect of the continuing duty of good faith, might lend further weight to this passive interpretation. In England, a duty of co-operation has only applied in the case of absolute necessity and its application in practice seems to be less positive. This principle does not go so far as to require one party actually to perform positive acts to further the other's enjoyment. In other words, the purpose of this principle in England seems to have been restricted to prohibiting acts which harm the enjoyment of the other party, as the English law of contract does not require a high attention by one party to the other which amounts to absolute "good faith."[27] For instance, Devlin J. said in *Mona Oil Equipment & Supply Co. Ltd v. Rhodesia Railways Ltd*[28];

> "It is, no doubt, true that every business contract depends for its smooth working on co-operation, but in the ordinary business contract, and apart, of course, from express terms, the law can enforce co-operation only in a limited degree - to the extent that is necessary to make the contract workable."

Likewise, once the contract is concluded, the contract is subject only to ordinary good faith.[29] This is the general common law position on this issue. In other words, there is no general duty to disclose material facts which occur during the period of insurance.[30] It would appear that this passive interpretation seems to be consistent with the test of materiality for the duty of disclosure in s. 18(2) which seems to preclude a post-contractual duty of disclosure, focusing on acceptance of the risk and fixing the premium.

The courts have not developed in detail the general principle of a post-contractual duty of disclosure applicable to the insured beyond the formation of the contract. It would appear that the application of the duty of utmost good faith beyond the time of the formation of the policy

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[27] J. Burrows, "Contractual Co-operation and the Implied Term", (1968) 31 Modern Law Review 390, at pp. 395-405.

[28] [1949] 2 All E.R. 1014, at p. 1018.

[29] Of course, this position may be changed by specific provisions in the contract. This issue will be discussed later.

[30] *Morrison v. Muspratt* (1827) 4 Bing 60; *British Equitable Insurance v. Great Western Railway Co.* (1869) 20 L.T. 422; *Iondies v. Pacific Fire and Marine Insurance Co.* (1872) L.R. 7 Q.B. 517; *Lishman v. Northern Maritime Insurance Co.* (1875) L.R. 10 C.P. 179, at p. 182; *Canning v. Farquhar* (1886) 16 Q.B.D. 727, at p. 733; *Re Marshall and Scottish Employers' Liability and General Insurance Co.* (1901) 85 L.T. 757; *Hadenfayre Ltd v. British National Insurance Society Ltd.* [1984] 2 Lloyd's Rep. 393, at p. 398; *Container Transport International Ins. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd.* [1984] 1 Lloyd's Rep. 476, at p. 486.

will be made only in exceptional cases. In *La Banque Financiere de la Cite S.A. v. Westgate Insurance Co. Ltd*,[31] Lord Jauncey, in relation to the reciprocity of the duty of disclosure, limited the insurer's obligation to disclose material facts to the pre-contractual context, referring to the examples of the "arrived ship" or "demolished house" by linking the insurer's duty of disclosure and the facts which would reduce the risk.

He expressed the restrictive view as to the operation of the continuing duty of utmost good faith after conclusion of the contract, saying that;

> "There is, in general, no obligation to disclose supervening facts which come to the knowledge to either party after conclusion of the contract, subject always to such exceptional cases as a ship entering a war zone or an insured failing to disclose all facts relevant to a claim."[32]

In other words, even though the concept of the continuing duty of disclosure is recognized, it may be imposed on the insured only in exceptional and limited cases which are related to the express terms of the insurance policy by which the insured is required to disclose to the insurer further information after the formation of the contract, or which are related to the claim process. In practice, a promissory warranty, in particular in fire insurance, may impose a duty on the insured to disclose facts occurring during the insurance which substantially increase the risk. However, even though a duty of disclosure may be imposed during the period of insurance by this practice, its nature is different from that imposed as a result of the principle of utmost good faith. In addition, the duty of disclosure which stems from the 'held covered clause' can be also interpreted as a duty from the contractual term between the parties.

It would appear that the issues in *The Litsion Pride* were based on the contractual term requiring the insured to give notice to the insurer of some relevant facts in relation to the rearrangement of the premium in the policy after the contract was concluded. It was a contractual duty to give notice in essence, and it had to be discharged with utmost good faith. In other words, the duty of utmost good faith was applied to the discharge of the insured's duty to advise the insurer of the relevant facts. Therefore, *The Litsion Pride* does not seem to be the authority to show whether or not the continuing duty of disclosure as a common law rule is actually applied in practice. The continuing duty of disclosure should not be recognized as a common law rule. It is more concerned with a contractual duty which stems from the particular terms in the policy.[33]

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[31] [1990] 2 Lloyd's Rep. 377.

[32] Ibid., at p. 389.

[33] *Trans-Pacific Insurance Co. (Australia) Ltd v. Grand Union Insurance Co. Ltd.* (1989) 18 N.S.W.L.R. 675, at p. 704.

This interpretation was supported in *New Medical Defence Union Ltd v. Transport Industries Ins. Co. Ltd*[34]. In this case, the insurer argued that the insured was in breach of the duty of utmost good faith because he did not disclose a fact during the period of cover that would have been relevant to decisions that the insurer might have made during the contract. Rogers J. stated that, although the duty of utmost good faith could continue even after the contract was concluded, it did not impose on the insured a general post-contractual duty of disclosure. He also said that where an insurance policy did not impose upon the insured any duty, to which the continuing duty of good faith could be attached, to supply information, there was no breach of the continuing duty of good faith arising out of the insured's failure to volunteer to the insurer relevant information during the term of the insurance.[35] Based on this, Rogers J. rejected the insurer's argument. This decision clearly shows that, although there is a continuing duty of the utmost good faith, the application of the continuing duty of disclosure, which stems from the duty of utmost good faith, should not be generally extended beyond the formation of the contract. The continuing nature of the duty of disclosure should be limited to the discharge by the insured of his obligation under the contract.

In addition, as to s. 17 of the M.I.A. 1906 which is regarded as one of strong grounds for the positive interpretation, it might be possible to construe the meaning of this section in a different way. There is no doubt that there is no time limit for the principle of utmost good faith in the wordings in s. 17, and thus it persists beyond the formation of the contract. However, s. 17 is placed under the heading of 'Disclosure and Representation'. At common law, it is widely accepted that there is a time limitation in relation to the application of the duty of disclosure. Considering the fact that one of the functions of the heading in the statute is to delimit a boundary line of the following sections, it might be possible to say that the application of the duty of disclosure which stems from the principle in s. 17 is limited in accordance with the application of the duty of disclosure in s. 18 where there is a time limit i.e., the duty must be made up to the moment when the contract is concluded. In other words, considering s. 17's location in the M.I.A. 1906, the general application of the continuing duty of disclosure beyond the formation of the contract, which is one aspect of the broader concept of the duty of utmost good faith, might be restricted under the heading of "Disclosure and Representation" and might need harmony with other sections under the same heading.[36] Therefore, in this sense, it might be said that s. 17 cannot be the strong ground for the general recognition of the continuing duty of disclosure beyond the formation of the contract. Based on the above analyses, the passive (narrow) interpretation seems to be more convincing.

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[34](1985) 4 N.S.W.L.R. 107

[35]Ibid., at pp. 111-112.

[36]E.R. Hardy Ivamy, *General Principle of Insurance Law* (6th ed., 1993), Butterworths, London, p. 137.

As to the effect of the breach of continuing duty of utmost good faith, *La Banque Fianaciere v. Westgate Insurance Co.*[37] held that any breach of this duty gives rise to rescission and restitution of premium only, rejecting the possibility of awarding damages. This case particularly deals with the issue of breach of the insurer's duty of utmost good faith to the insured after the formation of the contract. Considering the fact that any breach of this duty is mostly found after a loss has occurred, the insured's right to rescind the policy without recovery of damages will not be an effective remedy. A Canadian case, which also dealt with the insurer's continuing duty of disclosure in the claims process, justified awarding damages to the insured by way of classifying the relationship between the insured and the insurer as a fiduciary relationship.[38] This approach could provide a new idea as to the issue of the possibility of awarding remedy of damages, although it might have been regarded as an unorthodox way from the point of view of English insurance contract law.

Duty of Utmost Good Faith in the Claims Process

1) GENERAL CONSIDERATIONS

Some recent judgments, which clearly show that the duty of utmost good faith continues throughout the currency of the policy, recognized the duty of utmost good faith in the claim process. In other words, the duty of utmost good faith applies when the insured claims insurance money. For instance, in *The Litsion Pride* where the insured did not disclose deliberately to the insurer that the insured vessel had entered into a war zone without the requisite notice to the insurer in relation to a claim, it was held that the insurer could avoid the policy for breach of the continuing duty of utmost good faith, because the insured withheld details of his own breaches of the policy terms which have eventually contributed to the loss. In *Continental Illinois National Bank of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos)*[39], Evans J. also held that the insured should disclose the facts of previous fraudulent attempts to demolish the subject matter in the policy when a claim was made by the insured.[40]

Likewise, the continuing duty of utmost good faith in the claims procedure in insurance contracts has been widely recognized. It would appear that, although the general recognition of the duty of disclosure after the formation of the contract is still very much controversial, the duty of disclosure in the claim process is far less debatable. In other words, although the courts have not developed any general concept of the insured's post-contractual duty of disclosure, they have recognized that the insured has a duty to disclose to the insurer all material facts surrounding

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[37] [1988] 2 Lloyd's Rep. 513.

[38] *Plaza Fiberglass Manufacturing Ltd v. Cardinal Insurance Co.* 68 D.L.R. (4th) 586 (1990).

[39] [1986] 2 Lloyd's Rep. 470.

[40] Also see, *Bucks Printing Press Ltd v. Prudential Assurance Co.* (1991, unreported).

the claim in the claim process. In fact, the duty of utmost good faith in the claim procedures is a good example of the insured's duty to act with the utmost good faith which continues beyond the conclusion of the contract. Accordingly, the claim must be honestly made and the insured must not hold back all material facts surrounding the claim in question.[41] The principle of the reciprocity of the duty of utmost good faith in the claim process requires an insurer to react reasonably and fairly to a claim made by the insured in insurance contracts. For instance, there is a duty not to take a long time to settle the claim and a duty to disclose the adjusters' reports to the claimant. In addition, the duty to insist on a full and searching investigation into the case where there are circumstances of suspicion is imposed on the insurers to the public and to their shareholders, if they are a company.[42] Likewise, the insurer has a duty to disclose to the insured all facts which would influence the judgment of the prudent insured in deciding whether or not to compromise the claim or to issue proceedings.[43]

2) THE SCOPE OF BREACH OF DUTY IN THE CLAIM PROCESS

There is no doubt that the making of a fraudulent claim under the policy is a breach of the duty of utmost good faith allowing the insurer to refuse the claim or to avoid the contract.[44] Does this principle extend to a reckless non-disclosure in the claims process? According to the traditional view, the making of a fraudulent claim was a sufficient breach of the duty. However, in *The Litsion Pride*, Hirst J. extended the ambit of the duty of utmost good faith in the claims context, saying ;

> "... in contrast to the pre-contract situation, the precise ambit of the duty in the claims context has not been developed by the authorities... It must be right, I think, by comparison with the *Style* and *Liberian* cases, to go so far as to hold that the duty in the claims sphere extends to culpable misrepresentation or non-disclosure."[45]

This passage means that the scope of breach of the continuing duty of utmost good faith in the claim procedure might include the case where there is a culpable misrepresentation or non-disclosure of a material fact. In other words, if the insured completely disregards the truth of the material fact when he discloses material information in support of a claim, it is also a breach

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[41] *Shephered v. Chewter* (1808) 1 Camp. 274, at p. 275.

[42] *Chapman v. Pole* (1870) 22 L.T. 306, at p. 307,

[43] A. Pincott, "Growing Pains: Two English Decisions on the Duty of Good Faith" (1988) 1 Insurance. Law Journal 27, at pp. 33-34.

[44] *Ewer v. National Employers Mutual General Insurance Association* [1937] 2 All E.R. 247; *Piermay Shipping Co. S.A. & Brandt's Ltd v. Chester (The Michael)* [1979] 1 Lloyd's Rep. 55.

[45] [1985] 1 Lloyd's Rep. 437, at p. 512.

of the duty. Two recent cases, *Bucks Printing Press Ltd v. Prudential Assurance Co.*[46] and *Re Ontario Securities Commission and Osler Inc.*[47], indicated that fraud was not a necessary requirement, saying that recklessness on the insured's part was enough for the breach of the duty of utmost good faith.

It would appear that Hirst J.'s reasoning is based on the nature of the concept of utmost good faith. As a matter of general principle, the breach of the duty of utmost good faith does not depend upon fraud. It surely includes the insured's negligent or reckless non-disclosure of the circumstances which would influence the prudent insurer's decision to accept, reject or compromise the claim in question. Considering the fact that reasonableness or prudence is a standard in relation to the duty of disclosure, it would appear that the extension of the scope of breach of the duty to the reckless or negligent non-disclosure is understandable.

However, it is as yet uncertain whether or not the duty to disclose all material facts surrounding the claim will operate beyond the general requirement that the insured must refrain from fraud or recklessness. One remaining question is whether the duty of utmost good faith entitles the insurer to reject the claim on the grounds of the insured's innocent non-disclosure of a material fact without fraud or negligence in the claims context. Hirst J. in *The Litsion Pride* did not discuss this issue. A possible answer is that, considering the fact that the degree of disclosure which is required in a claims process is different from that at the formation of the contract, the insured's innocent non-disclosure in the claims process does not defeat a claim. The extension of the insurer's right to innocent non-disclosure is undoubtedly too heavy a burden on the insured and is unjustified.[48] This view seems to be supported by *Re Ontario Securities Commission and Osler Inc.*[49] and *Bucks Printing Press Ltd v. Prudential Assurance Co.*[50], which only referred to fraudulent and reckless non-disclosure in relation to the breach of the duty in the claim process.

3) EFFECT OF BREACH OF DUTY IN THE CLAIM PROCESS

The submission of a fraudulent claim is a breach of the continuing duty of utmost good faith. In practice, an express condition is usually inserted in the policy to the effect that if the claim is

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[46](1991, unreported.)

[47](1991) 82 D.L.R. (4th) 599.

[48]Merkin & McGee, *Insurance Contract Law*, (1988), Kluwer, London, at A.5.2-08 (hereinafter Merkin & McGee); M. Clarke, *The Law of Insurance Contracts*, (2nd ed., 1994), Lloyd's of London Press Ltd. at p. 708 (hereinafter, M. Clarke).

[49](1991) 82 D.L.R. (4th) 599.

[50](1991, unreported.).

fraudulent, the benefit under the policy is to be forfeited.[51] In *Britton v. Royal Insurance Co.*[52], Willes J. stated that;

> "The law is that a person who has made such a fraudulent claim could not be permitted to recover at all. The contract of insurance is one of perfect good faith on both sides, and it is most important that such good faith should be maintained. It is the common practice to insert in fire-policies conditions that they shall be void in the event of a fraudulent claim; ... It would be most dangerous to permit parties to practice such frauds and then, notwithstanding their falsehood and fraud, recover the real value of the goods consumed."[53]

At common law, the obligation not to submit a fraudulent claim or not to make claims in breach of the duty of utmost good faith has been regarded as an implied term in the policy.[54] If the insured submits a claim in which material facts relating to the extent or amount of the loss or relating to the circumstances of the loss have been fraudulently omitted, the insurer has the right to terminate the contract for the breach of the duty of utmost good faith, or he has the right to reject the claim in question, affirming the policy.

In other words, if the insured submits a fraudulent claim, the whole contract, and not just the particular claim which was fraudulently made, is avoidable, if it is the insurer's wish. Even in the absence of any express term in the policy as to the fraudulent claim, the insured who made a fraudulent claim cannot be protected as a result of the implied term in the policy. It is not important whether the insured's fraud affects the whole or only part of the claim.[55]

One question of whether the effect of 'avoidance' runs *ab initio* or from the date of the breach of the duty still remains. In practice, a special fraudulent claim clause which gives the insurer the right to repudiate the policy from the date of breach is often inserted in insurance policies, particularly in fire policies. From this clause, it is clear that the prior honest claims which have been already settled and paid by the insurer are not affected by the insurer's repudiation of the

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[51] *Harris v. Evans* (1924) 19 Ll.L.R. 303; *Central Bank of India Ltd v. Guardian Assurance Co. and Rustomji* (1936) 54 Ll.L.R. 247.

[52] (1866) 4 F. & F. 905, at p. 909.

[53] Also see, *Thurtell v. Beaumont* (1823) 1 Bing. 339; *Goulstone v. Royal Insurance Co.* (1858) 1 F. & F. 276, at p. 279; *McKirby v. North British Insurance Co.* (1858) 20 Dunl (Ct of Sess) 463; Baker Welford and Otter-Barry, *The Law Relating to Fire Insurance*, (4th ed., 1948), at p. 289.

[54] See, *Britton v. Royal Insurance Co.* (1866) 4 F. & F. 905, at p. 909; *Black King Shipping Co. v. Massie, The Litsion Pride* [1985] 1 Lloyd's Rep. 437, at pp. 518-519; M. Clarke, at pp. 715-716; Merkin & McGee, at C.1.3.-01.

[55] *Britton v. Royal Insurance Co.* (1866) 4 F. & F. 905; *Lek v. Mathews* (1927) 29 Ll.L.R. 141.

contract. Therefore, as far as the prior honest claims are concerned, they can be protected, if avoidance operates from the date of the breach of the duty.

However, Hirst J. in *The Litsion Pride* expressed a different view. He held that the submission of a fraudulent claim was a breach of a general duty of utmost good faith in s. 17 of the M.I.A. 1906 which shows that the duty of utmost good faith continues throughout the currency of the policy. As to the meaning of the word "avoid" in that section, Hirst J. stated;

> "In my judgment, "avoidance" in s. 17 means avoidance ab initio. Certainly this is the case in relation to pre-contract avoidance ..., and I see no reason for putting a different meaning on the word in relation to post-contractual events..."[56]

Therefore, according to his reasoning, the insurer is entitled to avoid the whole contract *ab initio* for a fraudulent claim, if it is his wish.[57] If his interpretation is adopted, it means that the law regards the policy in question as never having existed. Therefore, it would prevent the insured from recovering for a previously unsettled claim under the policy.[58] In addition, it may deprive the insured of the benefit of all previously settled claims.[59] Consequently, the previous losses which the insured honestly suffers may not be protected by the policy under this interpretation.

However, it would appear that Hirst J's decision on this issue seems to be incompatible with his interpretation as to the nature of the duty not to submit a fraudulent claim. Hirst J. said;

> "I am prepared to hold that the duty not to make fraudulent claims and not to make claims in breach of the duty of utmost good faith is an implied term of the policy, since I prefer the authority of *Blackburn v. Vigors* in the Court of Appeal to the obiter dicta in the *Merchants & Manufacturers* case."[60]

In other words, Hirst J. regarded the duty not to submit a fraudulent claim as an implied term in the policy. In general, the effect of the breach of an implied term of the policy, like a breach of condition, is repudiation of the policy from the date of breach, not avoidance *ab initio*.

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[56][1985] 1 Lloyd's Rep. 437, at p. 515; Also see, *Continental Illinois National Bank of Chicago v. Alliance Insurance Co. Ltd (The Captain Panagos)* [1986] 2 Lloyd's Rep. 470.

[57]Obviously, section 17 of the M.I.A. 1906 provides that the policy *may* be avoided, not that it *must* be avoided. Therefore, the insurer is not bound to avoid the whole contract for a fraudulent claim.

[58]Merkin & McGee, at A.5.2-07.

[59]*Magee v. Pennine Insurance Co. Ltd* [1969] 2 Q.B. 507.

[60][1985] 1 Lloyd's Rep. 437, at pp. 518-519; Also see, Merkin & McGee, at C.1.3.-04.

Therefore, his two decisions seems to be inconsistent with each other. Clearly, Hirst J.'s decision as to the right to avoid the policy *ab initio* for a fraudulent claim seems to be too harsh to the insured.[61] In *Gore Mutual Insurance Co. v. Bifford*[62], the Canadian court held that the insurers were entitled to terminate the contract from the date of breach where a fraudulent claim was made. In practice, it is rare for the insurer to set up a defence relying on a breach of the implied duty of utmost good faith in the claims procedure, since the insurance policies, in particular the fire policies, usually include an express term that the insurer is entitled to repudiate the policy for a fraudulent claim from the date of breach.

As to the remedy for the insurer who has already paid out the money for the insured's claim which later turned out to be a fraudulent one, the insurer is entitled to recover the money he has paid. As to the extra money the insurer has spent to investigate the claim to decide whether or not it is a fraudulent one, the prevailing view is that the insurer is not allowed to recover the money as damages for breach of contract.[63] However, there might be a possibility to bring an action in the tort of deceit against the insured as regarding the question of awarding damages in fraudulent claims in insurance contracts.[64]

A Continuing Duty of Utmost Good Faith to a Third Party

The courts in *La Banque Financiere v. Westgate Insurance*[65] and *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)*[66] held that the insurer owed a continuing duty of utmost good faith to the insured. Does an insurer, then, owe a duty of utmost good faith to the third parties who have interests concerning the validity of the insurance policy? The courts in *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck*) held that the insurer owed the continuing duty of utmost good faith only to the insured, not to the assignee of the proceeds of the policy, even though the assignee of the proceeds of the policy has interests in the validity of the cover given by the insurer to the insured.

The reason is that an assignment of the proceeds of an insurance policy, i.e., an assignment of the right to recover under an insurance policy, does not make a new contract between the

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[61] *Johnson v. Agnew* [1980] A.C. 367; Also see, M. Clarke, at pp. 715-716.

[62] (1988) 45 D.L.R. (4th) 763, at p. 765.

[63] *London Assurance v. Clare* (1937) 57 Ll.L.R. 254; *La Banque Financiere de la Cite S.A. v. Westgate Insurance Co. Ltd* [1988] 2 Lloyd's Rep. 513; S. 2(2) of the Misrepresentation Act 1967 which stipulates the discretion to award damages does not apply to the breach of the duty to disclose material fact.

[64] *London Assurance v. Clare* (1937) 57Ll.L.R. 254, at p. 270.

[65] [1990] 2 Lloyd's Rep. 377.

[66] [1991] 2 Lloyd's Rep. 191.

assignee and the insurer. Therefore, the assignor still remains as an insured in the insurance policy in question. As to this issue, Hobhouse, J., at first instance, said;

> "The duty of the utmost good faith is an incident of the contract of insurance. It is mutual. The assignee of the benefit of such a contract does not initially owe any duty of the utmost good faith to the insurer, nor on the basis of mutuality is there, initially, any duty owed by the insurer to the assignee. The insurer's duty is to the shipowner, and if that duty is broken as against the shipowner, the assignee can have the benefit of the rights and remedies that arise from such a breach. The rights of the assignee can only arise from obligations to the assignor."[67]

On the contrary, the duty to speak from the letter of undertaking, which was issued by the insurer to assist the assignee in this case, is a different one. By this letter of undertaking, the insurer undertakes to inform the assignee in the event that the policy ceases. The courts held that the insurer had a duty to speak from the letter of undertaking to the third party, as this promise is a part of the contract which is enforceable against the insurer. In other words, a contractual duty to speak is imposed on the insurer to the third party by the letter of undertaking, and this duty is different from the duty of utmost good faith in essence.

Conclusion

Hirst J. in the Litsion Pride case held that the duty of disclosure generally continues even after the contract is concluded in relation to the matters which are relevant to the post-contractual stage. This decision is inconsistent with the traditional interpretation that full disclosure of material facts affecting the risk in question must be made up to the time when a binding contract is concluded. However, it would appear that the issues in the Litsion Pride were based on the contractual term requiring the insured to give notice to the insurer of some relevant facts in relation to the rearrangement of the premium in the policy after the contract was concluded. It was a contractual duty to give notice in essence, and it had to be discharged with utmost good faith. Therefore, the Litsion Pride judgement does not seem to be the authority to show whether or not the continuing duty of disclosure as a common law rule is actually applied in practice. The continuing duty of disclosure should not be recognized as a common law rule.

[67] [1988] 1 Lloyd's Rep. 514, at p. 546; Also see, [1989] 2 Lloyd's Rep. 238, at p. 264.