# *Duty of Disclosure in Insurance Contract*

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## INTRODUCTORY

*Insurance really is a part of people's life as risk is. As risk exist everywhere a cooperative device that not only shares the risk among many but also ensures proper indemnification in case of loss of life, property in the form of insurance contract is truly a blessing on human beings. In this sense, this paper describes an important element of insurance contract, duty of disclosure by the insured.*
*The paper basically has a simple core and objective that of identifying the nature of the duty of disclosure imposed on the insured, during an insurance contract. So the paper first proceeds with the general principle of Misrepresentation and Non-Disclosure in contract law in general, and then in the form of especial class of contract as insurance contract the paper then deals with the principle of non-disclosure in insurance. In so doing, the paper first put forwards the rationale of imposing such duty of disclosure on the insured and then identifies those facts that are not required to be disclosed in an insurance contract. Then finally in the 'nature of duty of disclosure' the paper describes various principles that have contributed to the analysis of the duty of disclosure in insurance law. In this section the paper deals with the general principle along with some of the types and nature of facts that need to be disclosed in an insurance contract.*

## *Table of Cases* ***(in the order they appear in the paper)***

*Prudential Insurance* v. *I.R.C.,* 2 K.B. 658 (1904)

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*Mackay* v. *London General,* 51 Ll. L.R. 701 (1935)

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*Re Marshall and Scottish Employers' Liability,* 85 L.T. 757 (1901)

*Thames & Mersey Marine* v. *Gunford,* A.C. 529 (1911)

Tate v. Hyslop, 15 Q.B.D. 368 (1885)

Pan Atlantic Insurance Co. v Pine top Insurance Co. Ltd, 1 Llyod's Rep 443 (1993)

## BACKGROUND

Whether in commercial transactions, life, property, risk always surrounds an individual. Those risks or uncertainties are due to operation of chance, misfortune or natural or uncontrollable calamities or contingencies[1]. Thus to secure as much surety in life, property, commercial transaction Insurance contract plays vital role. Being aleatory contract, insurance as a cooperative device, which "spreads the loss caused by a particular risk over a number of persons who are exposed to it and who agree to insure themselves against that risk."[2]

In *Prudential Insurance* v. *I.R.C.*[3] Channell J. said that insurance was a contract which bore a number of characteristics:

> "It must be a contract whereby for some consideration, usually but not necessarily in periodical payments called premiums, you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event. Then the next thing that is necessary is that the event should be one which involves some amount of uncertainty. There must be either uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time there must be uncertainty as to the time at which it will happen."

Indeed contract of insurance like any other contract is governed by the general principles of contract. As insurance contract also involves agreement to do something (indemnify the loss) in return of the payment of premiums, whereby creating legal relationship between the parties to the contract (insurer and insured) all the basic elements of 'normal' contracts are there to be found in an insurance policy or contract.

However, having identified the essential resemblance between contracts in general and insurance contract in particular, a number of special rules apply to insurance contract but not in other contracts. For instance, the contract of insurance is of the utmost good faith and extensive duties of disclosure are imposed on the parties to such contract. Similarly special rule of misrepresentation is also applicable in insurance contract. Apart

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[1] Bhattarai, Anil Raj, Classification of Insurance, Class note Kathmandu School of Law 2007

[2] Kuchhal, MC, Mercantile Law Fifth Revised Edition, Vikas Publishing House 2001, pg 427

[3] 2 K.B. 658, 663 (1904) cited in Merkin, Robert edt. Colinvaux's Law of Insurance, Seventh Edition Sweet and Maxwell 1997 pg 2

from such special rule a warranty in insurance law is a very different concept to that of the ordinary contractual warranty[4].

## GENERAL RULE OF DISCLOSURE AND MISREPRESENTATION

A contract involves offer and acceptance. And general principles of contract law requires that the parties to the contract while giving his offer or accepting someone else's offer should have *consensus ad idem*, that is between the parties to the contract there must be meeting of the mind. Hence, an acceptance, which law requires to be unqualified, unequivocal, final, explicit,[5] should correspond to the offer. And in such cases where the acceptance of a party do not comprehend the offer made, then such acceptance does not lead to the conclusion of the contract and hence the contractual liability do not originate for the parties involved in the said contract.

Furthermore in contract law there are various other grounds under which even concluded contracts can be declared void. Among those grounds some are, Incapacity of the party, Duress, Undue Influence and Unconscionable Bargains, Mistake, Illegality, Misrepresentation and Non-disclosure.[6] Misrepresentation and Non-Disclosure being the chief concern of this paper, other grounds of declaring a contract void are not touched upon here.

Misrepresentation in a contract results when a party to the contract makes a misleading statement during the negotiations leading to the contract. However mere silence does not constitutes a misrepresentation.[7] But sometimes a partial non-disclosure may constitute a misrepresentation. For instance suppression of material facts can render that which is stated false, when the facts are known to the person making the statement or possibly if he or she has the means of knowledge.[8]

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[4] Id. at pg 9

[5] See for detail, Beatson J., Anson's Law of Contract 28th Edition Oxford University Press 2002 pg 37-50, UNIDROIT Principles of International Commercial Contracts 2004

[6] See for detail, id. at pg 207- 417

[7] *Keates* v. *Lord Cadogan* 10 C.B. 591 (1851) cited in id. at pg 237

[8] *Sindell* v. *Cambridgeshire C.C.* 1 W.L.R. 1016 (1994) cited in Beatson supra note 5 at pg 238 For example, a seller of the land told a purchaser that all the farms on the land were fully let, but omitted to inform him that the tenants had given notice to quite. Thus such representation of the fact was found to be a misrepresentation.

In case of misrepresentation, the party who was induced to enter into a contract by reason of a misrepresentation can refuse to carry out the undertaking, resist any claim for specific performance, and if necessary, have the contract set aside by means of the equitable remedy of rescission.[9]

Unlike misrepresentation, there is no general duty of disclosure in common law apart from some exception, one being as discussed earlier that a partial non-disclosure resulting into the misrepresentation. In fact, as mere silence does not constitute a misrepresentation, non-disclosure of facts alone cannot result into the contract being void. However, this being a special trait of common law system, in other legal systems traces of duty of disclosure can be traced.

For instance in Nepalese Contract Act 2000, the failure to disclose any information has been defined as fraud and hence has been identified as one of the grounds of declaring a contract void by the aggrieved party.[10] However the degree of "suppression of the information" envisioned by the Contract Act is probably hard to pin. As one can argue that as the act of suppression of the information has been defined as fraud in Contract Act the gravity of the suppression should be very high. Furthermore, even in civil law system which requires the duty of disclosure in contract, there is no duty to disclose information which is the product of one's own efforts in evaluating market conditions or ascertaining the attributes of property which enhance its value.[11] Thus making the duty of disclosure rather not absolute and stringent, even in civil law system and in Nepalese context.

However some contracts by their very nature and the reason they are entered into require greater amount of good faith (utmost good faith) between the parties and thus necessitates disclosure of all relevant facts and information by the parties to the contract. Such contracts *uberrimae fidei* require parties to disclose all information in their respective possession while entering into the contract, otherwise the failure could result

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[9] Beatson supra note 5 at pg 236

[10] Section 14 (1) (c) "A party to the contract or his agent shall be deemed to have committed fraud if he leads the other party or his agent to believe or takes any action to indicate that a particular thing is true, although he knows well that it is false, or ***suppresses any information in his possession***, or indulges in any other fraudulent act punishable under current law, with the intention of deceiving the other party or his agent." (***emphasis added***)

[11] Kotz, European Contract Law (1997) pg 207, cited in Beatson supra note 5 at pg 263

into the loss of contractual rights of the party failing to disclose information. And insurance contracts falls into this especial category of contracts *uberrimae fidei.*

## DUTY OF DISCLOSURE IN INSURANCE CONTRACTS

### Rationale

Generally, the rationale behind certain class of contracts requiring the parties to have duty of disclosure lies in two fold.[12] First in such class of contracts, one of the parties is presumed to have means of knowledge which are not accessible to the other. In insurance contract the insurer knows nothing about the person who comes to get insured however the person who wants to get insured knows everything about himself and risks that he has in his life. Second, some class of contract may involve parties who are not at all at par with each other and that one party may have some advantage over the other, either economically or with other resources, thus in place of commercial relationship trust and confidence should be in place, requiring higher degree of honesty and disclosure of information.

On this basis, rationale for the duty of disclosure in insurance contract can be drawn accordingly. However, no such analogy can comprehensibly demonstrate the rationale behind the rule than Lord Mansfield's observation in *Carter* v *Boehm*[13], which probably is the single most authoritative paragraph in the matter as well as by far most cited authority across the academics in insurance law:

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

Hence, the principle of utmost good faith under which the duty of disclosure in insurance contract is applied bases itself to the principle of equity as well as more simpler idea of common sense whereby it is only natural that the information that one party knows but not the other should be disclosed in case where that piece of information can affect the consent of the parties entering into the insurance contract. For this reason, even

[12] See for detail, Beatson supra note 5 at pg 264, Merkin supra note 3 at pg 115-118

[13] 3 Burr. 1905, 1909 (1766)

though Lord Mansfield only talks about insured's duty of disclosure, such duty also lies on the insurer[14].

**Facts which need not be disclosed**

Before moving to what should the parties to the insurance contract need to disclose, it is essential first to wipe out rather more objective list of what the parties to the insurance contract need not to disclose. In fact such enlisting of fact which need not be disclosed is itself able to create the list of facts that the parties need to disclose. Anyways, according to professor Bird, facts which are material need not nonetheless be disclosed to the insurer if[15];

i. they diminish the risk[16]
ii. they are facts which the insurer knows or is presumed to know or are matters of common knowledge[17]
iii. they are facts of which the insurer waives disclosure[18]

Apart from the above list, facts which the insurer does not know need not be disclosed for simple reason that he cannot disclose. However at this point a difficult question may arise regarding the reasonable person test which requires the insurer 'should know' or have constructive knowledge about certain facts even though he does not[19]. Similarly facts which is superfluous to disclose by reason of any express or implied warranty. So where the assured warrants that the insured vessel will be used only for pleasure purposes, his failure to disclose his intention to use vessel as a demonstration model does not permit to use utmost good faith as a defense.[20]

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[14] See for detail Birds, John, Modern Insurance Law, Sweet & Maxwell, Third Edition 1993 pg 112-117, Merkin supra note 3 at pg 125-127 Srinivasan, MN Principles of Insurance Law Life-Fire-Marine-Motor and Accident, Wadhawa & Company 8th Edition 2006 pg 219-220

[15] Birds supra note 14 at pg 96

[16] Thus the assured need not disclose that the insured yacht will spend much of the period of the insurance in the builders' yard, for it is at less risk there than on the open sea. *Inversiones Manria* v *Sphere Drake insurance, The Dora* 1 Lloyd's Rep. 69 (1989) cited in Merkin supra note 3 at *fn* 79

[17] Insurer is generally presumed to know what other insurers in the same business know, trade usages, previous claims to the very insurer, and so forth see for detail Merkin supra note 3 at pg 122-123

[18] Waiver may take many forms, including an express statement by the insurer that the assured is under no duty of disclosure at all or that disclosure of particular forms of information is not required, and failure by the insurer to seek full information from the assured. Merkin supra note 3 at pg 123

[19] For detail see infra note 22, 23

[20] *Inversiones Manria* v *Sphere Drake insurance, The Dora* 1 Lloyd's Rep. 69 (1989) cited in Merkin supra note 3 at pg 123

**Nature of Duty of Disclosure**

Under the duty of disclosure, the insured is only require to disclose information on the basis of facts not opinion[21]. However by opinion it obviously does not mean that the insured's opinion regarding the materiality of the non-disclosed facts, rather by opinion it indicates the statement of such facts which the insured appreciates not on the factual basis but through his perception of probabilities and intuitions. This principle is inline with the preceding heading's content that insured need not disclose facts that he does not know.

However the issue of constructive knowledge may sometimes prove very tricky. That is, in insurance law the word 'knowledge' in some occasion has been interpreted very widely, covering not only the actual knowledge an insured has but also the knowledge he ought to have[22]. Especially in the UK Marine Insurance Act 1906, in Section 18 the knowledge has been clearly expanded to the facts that the insured ought to know apart from the facts he already knows. So far the issue of constructive knowledge has been far from settled and the depth of this paper and the research involved is too shallow to seek a solution to this problem. Nevertheless according to Robert Bradgate, in other class (other than marine) of insurance contract it is doubtful if the insured's duty extends beyond facts actually known to the insured.[23]

In any case, the knowledge of the insured is only a means of identifying the material facts. And much effort should lie on identifying the materiality of facts that an insured need to disclose in an insurance contract. As material fact is defined as that fact whose disclosure "would have had an effect upon the mind of a notionally prudent insurer in estimating the risk".[24] Thus as discussed earlier, the question of materiality is

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[21] However misstated opinion is actionable only if not given in good faith. *Anderson* v. *Pacific Fire & Marine Insurance Co.* L.R. 7 C.P. 65. (1872) cited in Birds supra note 14 at pg 94

[22] *Australia and New Zealand Bank* v. *Colonial and Eagle Wharves Ltd*. 2 Lloyd's Rep. 241, 252 (1960) cited in Birds supra note 14 at pg 95, "The duty extends not only to facts which the insured knows but also to those which he, as a reasonable person, ought to have known and which are in fact material, whether he thinks them to be so or not." Singh, Avtar, Law of Insurance, Eastern Book Company, 1st Edition 2004 pg 16, "Answer should be true not merely literally, but also in substance" *Condogianis* v. *Guardian Assurance Co. Ltd*. 125 LT 610 (1921)

[23] Bradgate, Robert, Commercial Law Second Edition Butterworths 1995 pg 709

[24] Kent, Michael QC, Current Issues In Insurance Law, Material Non-Disclosure: Proportionality, Good Faith And Reasonableness, Crown Office Chamber 2005

purely a matter of fact. And whether or not a fact is material is to be assessed objectively from the point of view of a reasonable or prudent insurer. It is vital to note that the test for materiality is that of a 'reasonable insurer'[25], not that of a reasonable person which is often seen in negligence law.[26]

Furthermore on the issue of the appreciation of risk by the insurer, which has given rise to a big controversy regarding what should be the nature of the appreciation of risk. The issue has been settled to most part since House of Lords decision in the *Pan Atlantic Insurance Co.* v P*ine top Insurance Co. Ltd*[27] which confirmed that the test to be applied is not what the assured thinks, but whether a prudent and experienced insurer might be influenced in his judgment if he knew of it. Moreover it is not necessary to show that a prudent insurer's ultimate judgment would have been influenced, so that whether or not his ultimate judgment would have been the same is irrelevant. Similarly, the House of Lords rejected alternative and narrower tests that a fact must have a decisive influence on a prudent insurer or that the fact must be one which is capable of being treated by a prudent insurer as increasing the risk. [28] Thus imposing heavy burden on the insured in his duty of disclosure.

Now some of the types of material fact that an insured is required to disclose in an insurance contract will be discussed. At this point probably it is also essential to note that insurance law requires that the full disclosure of the facts must be made before the conclusion of the contract[29] and in case of insurance contracts requiring periodical renewal the duty also arise on the each successive renewal[30].

Coming to the type of materiality, the moral hazard as it is termed, the character of the insured regarding previous losses and claims under other policies[31], convictions

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[25] Test of prudent and reasonable insurer was conclusively adopted for non-marine insurance purposes in *Lambert* v. *Co-operative Insurance Society* 2 Lloyd's Rep. 485 (1975)

[26] Vamplew, John A. The Life Insured's Duty To Disclose And The Consequences of Material Misrepresentation And Non-Disclosure, Whitelaw Twining May 2003

[27] 3 All E. 581 (1995)

[28] See for detail Merkin supra note 3 at pg 130-131

[29] *Looker* v. *Law Union* 1 K.B. 554 (1928), cited in id. at pg 118

[30] *Lambert* v. C. *Co-operative Insurance Society* 2 Lloyd's Rep. 485 (1975)

[31] *Arterial Caravans* v. *Yorkshire Insurance* 1 Llyod's Rep. 169 (1973) cited in Merkin supra note 3 at pg 133

material to the risk,[32] concealment of the identity,[33] previous refusals of claim especially in non-marine insurance contract[34], existence of other insurances against the same risk[35], deliberate and intentional over-insurance[36], facts affecting subrogation rights[37], and so forth.

## CONCLUSION

"A failure to disclose, however innocent, entitles the insurer to avoid the contract *ab initio*, and upon avoidance it is deemed never to have existed"[38] Hence the stringent rule of duty of disclosure in insurance contract is very essential element that any person willing to get an insurance policy should take into consideration. Indeed as discussed earlier in case of duty of disclosure the burden on the insured is lot higher, thus an insured should be very careful before filling up the forms for insurance.

Even though in many occasions through decisions in the cases of insurance dispute[39] regarding non-disclosure and even in academic writings[40], the burden that an

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[32] *Lambert* v. C. *Co-operative Insurance Society* 2 Lloyd's Rep. 485 (1975), *Woolcott* v. *Sun Alliance* 1 All E.R. 1253 (1978), *Mackay* v. *London General* 51 Ll. L.R. 701 (1935) cited in Merkin supra note 3 at pg 133, 134

[33] In *Galle´ Gowns* v. *Licenses & General* 47 Ll. L.R. 186 (1933) change of the name was found to a material fact whose non-disclosure cost the insured his insurance policy.

[34] *Locker & Woolf* v. *Western Australian Insurance* 1 K.B. 408 (1936), cited in Merkin supra note 3 at pg 134

[35] The existence of other insurances against the same risk is generally material in the case of life or accident policies where, the principles of indemnity not applying, such insurances are of special imp ortance. *London Assurance* v. *Mansel* 11 Ch. D. 363, 370 (1879), *Re Marshall and Scottish Employers' Liability* 85 L.T. 757, 758 (1901) cited in Merkin supra note 3 at pg 134

[36] Over-valuation will entitle the insurer to avoid the policy even if it cannot be shown to be fraudulent. The gross over-insurance by an agent of his own interest in an adventure will be material in the insurance by him of his principal's interest in it, notwithstanding that the agent's own insurance was effected by means of an honour po licy. Lord Shaw in *Thames & Mersey Marine* v. *Gunford* A.C. 529, 542 (1911) cited in Merkin supra note 3 at pg 135

[37] Sometimes facts affecting the subrogation rights of the insurers are material. Thus where the owner of goods makes a special contract with a carrier relieving him of all liability, such fact may affect the premium or the willingness of the insurers to take the risk, in which case it must be disclosed. *Tate* v. *Hyslop* 15 Q.B.D. 368, 377 (1885) cited in Merkin supra note 3 at pg 136

[38] Birds supra note 14 at pg 93

[39] Appeal Chamber decision in *Pan Atlantic Insurance Co*. v P*ine top Insurance Co. Ltd* 1 Llyod's Rep 443 (1993) tried to put forward narrower test in deciding the duty of disclosure.

[40] Schaerer, Enrique R., Half-Truths, Whole Lies, & the Duty of Disclosure in Insurance Law, Yale Law School Student Scholarship Series *Year* 2007 *Paper* 42 <http://lsr.nellco.org/yale/student/papers/42>

insured has to bear regarding disclosure has been narrowed. However the fact remains at present, no such endeavor has worked and still insured bear most of the burden. Probably given the nature of the contract and relationship between the insured and the insurer it is right and as this paper did not set out to judge in this matter, so this matter has been left for other occasion to be discussed and debated.

At last, probably, instances of and types of duty of disclosure developed in the bulging catalogue of insurance case law is colossal. Thus to point out all types of disclosure is not only a difficult task but also to an extent futile, even though such acquisition of types could immensely help in compiling the information for the judges and lawyers to seek an analogy in their respective cases in front of them. However, when one understands the basic notion of burden of disclosure then the nature and types can contemporaneously pinned according to the nature of the insurance contract and the dispute in hand. In fact such approach of case by case basis can bring commonsense and pragmatism in deciding case and can bring both parties to the insurance contract at par.

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