INSURANCE LAW

MORAL HAZARD, OPPORTUNITY OR HAZARD?

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Answering the questions raised in the proposal form should not present a problem for most insured but what many insured do not realise is that their duties of disclosure go beyond the proposal form and include disclosure of "moral hazards". This can present a dangerous pitfall for the insured and an opportunity for the insurer to avoid the policy.

The assured is bound to disclose all material matters to the insurer at or before the policy commences and the presumption is that questions in a proposal form are material. In addition, however, the assured is bound to disclose all other material facts whether or not questions are asked in the proposal form. A failure to have asked the question is not a waiver by the insurer that an issue is material.

Materiality is "every circumstance which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will take the risk", Pan Atlantic v Pine Top [1994] 3 WLR 677, and is usually proved by the calling of expert evidence if materiality is in dispute. The time for the assessment of materiality is the time that the insurance was agreed.

Mr Justice Tugendhat put it quite nicely in M.Meisels & another v Norwich Union Insurance Limited [2006] EWHC 2811 (QB) where he summarised the position as "The test of materiality is by reference to what would influence the judgment of a prudent insurer. This is an objective test, and the characteristics to be imputed to a prudent insurer are in substance a matter for the courts to decide. There is room for a test of proportionality, having regard to the nature of the risk and the moral hazard under consideration. There may be things which are too old, or insufficiently serious to require disclosure, whether or not there is exculpatory material. And in cases where the information would be material and disclosable if there were no exculpatory material, the degree of conviction that the exculpatory
material must carry, must depend on all the circumstances known to the insured”.

The material non-disclosure must have induced the insurer to enter into the policy and the test is “(i) to avoid a contract of insurance or reinsurance, an insurer or reinsurer must prove on the balance of probabilities that he was induced to enter into the contract by a material non-disclosure or by a material misrepresentation (ii) There is no presumption of law that an insurer or reinsurer is induced to enter into the contract by a material non-disclosure or misrepresentation (iii) The facts may, however, be such that it is to be inferred that the particular insurer or reinsurer was so induced even in the absence from evidence from him (iv) In order to prove inducement the insurer or reinsurer must show that the non-disclosure or misrepresentation was an effective cause of his entering into the contract on the terms on which he did. He must therefore show at least that, but for the relevant non-disclosure or misrepresentation, he would not have entered into the contract on those terms. On the other hand, he does not have to show that it was the sole effective cause of his doing so”, Assicurazioni Generali Spa v Arab Insurance Group [2002] EWCA Civ 1642; [2003] 1 WLR 577 at para 62.

Of course, the obligation is only to disclose what is known, Hearts of Oak Building Society v Law Union Insurance [1936] 2 AER 619.

“Moral hazards” relate to the character of the insured and the insured’s officers and include all facts that are material to the business integrity of the proposer or the motive for seeking cover if it is not only on account of prudence but for other less honest reasons.

Previous convictions for dishonesty, where not caught by the Rehabilitation of Offenders Act 1974 (which provides for qualifying convictions “for all purposes in law” as though they have never occurred), are obvious candidates for disclosure. Even the convictions of a husband must be disclosed when, for example, he is a

However, avoidance is not inevitable and the facts can be infinitely variable as illustrated by *Drake Insurance plc v Provident Insurance plc* [2004] 1QB 601. The alleged non-disclosure was a road traffic accident and a speeding conviction. The insurer was not entitled to avoid the policy as at the time the policy was avoided the insurer knew or ought to have known that the facts that could give rise to avoidance were partly incorrect and that the undisclosed information would have made no difference to the cover provided (*i.e. there was no inducement*). Lord Justice Pill also found that a failure to make any inquiry of the insured before taking the drastic step of avoiding the policy was a breach by the insurer of the duty of good faith that required the insurer to at least tell the insured what it had in mind and give him an opportunity to respond to the allegation.

A far more difficult area is whether there is a duty to disclose allegations which at the time of the inception of the policy were on-going but by the time a claim was made the allegations were found to be untrue. In *Brotherton & Anr. v Aseguradora Colseguros S.A. & Anr.* [2003] EWCA Civ 705 the reinsured avoided the re-insurance for non-disclosure of reports in the Columbian media of allegations of misconduct and the related investigations involving the original insured's business and officers. The insurance was PII amongst other liabilities. The reinsurers' case was that the reports alone, and coupled with the fact of the investigations, were material to be disclosed, firstly as constituting circumstances which might give rise to claims under the reinsurances, and secondly as suggesting moral hazard. It was found that the assured were not entitled to rely on evidence that there was no substance in the allegations as the issue was not the truth of the allegations but that they had been made.

More recently, in *North Star Shipping Ltd & Ors v Sphere Drake Insurance plc & Ors* [2006] EWCA Civ 378 the directors of the companies that controlled the insured ship had been charged and were due to be tried on various allegations of dishonesty. Subsequently, the directors were acquitted but not before the policy
had been avoided for, inter alia, non-disclosure. It was held there was an obligation to disclose and a failure to have done so entitled avoidance by the insurer.

Insurers, however, do not always have it their way as is illustrated by Meisels. The claimant was a property developer who owned many properties. One was damaged by a flood and a claim was made. The insurers avoided the policy on a large number of grounds that included non-disclosure by the claimant of an adverse Inland Revenue assessment, facts relating to companies run by the claimant which had been dissolved for failing to file accounts and four companies which had been the subject of a creditors liquidation, and in particular to two of them where the Inland Revenue was identified as a creditor and the use by the claimant of an alias. HHJ Higgins, sitting in the Central London County Court, found neither material non-disclosure nor inducement and gave judgment for the insured. On appeal, Mr Justice Tugendhat was disinclined to interfere.

In conclusion, avoidance for material non-disclosure of matters not traversed in the proposal form can present an opportunity for avoidance. However, such is the variety of circumstances that can give rise to a basis for avoidance that each case does have to be approached with care- otherwise the costs of litigation may exceed the indemnity avoided- one suspects this was the case in Meisels.

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