Utmost Good Faith in Reinsurance Contracts:

Difficulties and Problems of Its Operation in an Evolution Time

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ABSTRACT

Reinsurance contract as a contract of uberrimae fidei, in contrast to ordinary commercial contracts, attracts a duty of utmost good faith requiring both parties to exercise their best effort and endeavor to help each other to make an informed decision and perform the contract concluded thereon without any dishonesty or deceit. There are various forms of reinsurance which adopt different ceding methods and have specific characters in the placing progress. The unique placing process in London subscription market of such complex and complicated reinsurance contracts by specialist brokers has to certain degree modified the operation of the doctrine of utmost good faith in reinsurance context. Moreover, from partial codification by the MIA 1906 to significant changed by Insurance Act 2015, it is fair to that the doctrine of utmost good faith has experienced one hundred years long revolution. The courts have taken many opportunities to structure the doctrine, establish rules of the tests, confine the scope and clarify remedies for qualifying breach. Such development of the doctrine itself has important affect upon its operation in reinsurance context too.

Modification of the doctrine in reinsurance occurs due to several reasons. First, the special placing process in London subscription market affects the formation procedure of reinsurance contracts, consequently reshapes operation of the doctrine. Secondly, the characters of reinsurance contracts distinguished from underlying insurance would have some impact on operation of the doctrine in reinsurance context. In addition, other significant common law rules such as the principle of waiver, which is in extensive use in the reinsurance market practice, will also modify the operation of the doctrine in reinsurance context. Moreover, evolution of the duty itself, from an absolutely strict duty to a duty only requiring fair presentation, and a proposal of a new proportionate regime of remedies brings potential problems of its operation in reinsurance context. Consequently, notwithstanding there has been a long history of the doctrine and clarification of many aspects of the doctrine comes from a reinsurance cases, difficulties and problems still exist in operating such duty smoothly and directly in reinsurance like in direct insurance context. Such problems extend to every specific aspect of operation of the duty in reinsurance context, from the formation to performance, and then remedies for qualifying breach of the duty in claim stage.
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DECLARATION OF AUTHORSHIP

I, Yao Lu, declare that the thesis entitled

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and the work presented in the thesis is my own and has been generated by me as the result of my own original research. I confirm that:

This work was done wholly while in candidature for a research degree at this University;

Where I have consulted the published work of others, this is always clearly attributed;

Where I have quoted from the work of others, the source is always given. With the exception of such quotations, this thesis is entirely my own work;

I have acknowledged all main sources of help.
INTRODUCTION

1. Background

Since the Marine Insurance Act 1906 partially codifies the doctrine of utmost good faith which derived from Lord Mansfield’s judgment in Carter v Boehm\(^1\), the courts have taken many opportunities to structure the doctrine, establish rules of the tests, confine the scope and clarify the remedy for qualified breach. It has been clearly settled for a long time that, in contrast to general rules applying to ordinary commercial contracts, there lives a doctrine of utmost good faith in contracts which can be categorised as uberrimae fidei. Under such doctrine both parties are obliged to exercise their best efforts and endeavours to help each other to make an informed decision and then perform the contract concluded thereon without any dishonesty or deceit. The two commonest aspects of the doctrine in Lord Mansfield’s judgment, i.e. the duty not to make misrepresentation and the duty not to conceal information, are reaffirmed as the most important but not inclusive elements of the doctrine, requiring both parties mutually and positively volunteer information and passively refrain from misrepresentation. Breach of such draconian duties brings harsh result which affords the innocent party an option to avoid the contract retrospectively, without any other remedies like damages. Although there has been a long history of the doctrine, it cannot be said that its whole framework is crystallly and clearly accomplished. S.17 of the existing Marine Insurance Act 1906 is quite broadly drafted, like an umbrella provision providing an overriding duty of utmost good faith. In addition, s.s 18-20 focus on the duties at pre-contractual stage. As a result the applicability of a continuing duty of utmost good faith at post contractual stage is still controversial and unsettled. Moreover, due to special practice in London subscription market, various submissions, arguments and pleadings have been arisen from unsettled issues on broker’s independent duty of disclosure codified in s.19. This long alive doctrine has experienced significant evolution in the last ten years. After being abolished in consumer insurance context, the current doctrine applicable to non-consumer insurance context is also going to have important changes after a new insurance act becomes into effect. The strict absolute duty is going to be replaced by a duty of

\(^{1}\) (1766)3 Burr 1905.
fair presentation. Also a notion of proportionality is introduced by the new regime of remedies of qualifying breach. Reinsurance, which is considered as typical class of non-consumer insurance will be significantly affected by the evolution of doctrine of utmost good faith.

Reinsurance, as defined as the insurance of insurers, is basically a contract of or for insurance under which the insurers seek cover for their exposure to liabilities occurred under the direct insurance policy. There are various forms of reinsurance contracts which adopt different ceding methods of risks. Basically, there are two general types of reinsurance agreement, facultative contracts and treaty arrangements. The distinction between these two main types is that a facultative contact is on a one-off basis on a particular risk; while treaty is a continuing arrangement, transferring risks of a type or certain types or even the whole book of reinsured’s business to the reinsurers. Treaty mechanisms are normally placed in three methods, namely obligatory treaty, facultative-obligatory treaty and non-obligatory treaty. Each of them has different nature. Some reinsurance agreement is only a framework stipulating how reinsurance risk will be underwritten in future rather than underwriting any specific risk. Therefore, it is debatable whether such contract is a contract of insurance, thus attracts duty of utmost good faith. On the other hand, provided that duty of utmost good faith is indeed attracted, it may still raise many difficulties in operation of the doctrine in reinsurance context. As reinsurance has some characters distinguished from underlying insurance contracts, it would have some impact on operation of the duty in reinsurance context. Also the specific placing process of reinsurance contracts in a subscription market will also reshape operation of the doctrine. In addition, the principle of waiver, which is a significant rule in common law, will also modify the operation of the doctrine in reinsurance context. Therefore, notwithstanding there has been a long history of the doctrine, even clarification of many aspects of the doctrine comes from reinsurance cases, it still cannot be said that the whole framework of the doctrine operates perfectly and crystal clearly in reinsurance context.

2. The aims and objectives of the thesis

This thesis mainly aims to analyse and solve problems and issues arising from operation of the doctrine of utmost good faith in reinsurance contracts, due to the specific characters and nature of reinsurance. Basically, the aims of the thesis will be fulfilled by evaluating current mechanisms, discovering defects and unsettled issues in applicability, duration, scope and modification of the doctrine in reinsurance context due to its unique placing process in subscription market, complex nature and complicated placing methods and development of the duty itself. And then suggestions and reforming will be proposed to resolve those deficiencies and difficulties. Eventually it can build a coherent framework of doctrine of utmost good faith which can better presenting the law in reinsurance context and service the reinsurance market better in practice. The research objectives can be approached by means of analysis of laws and the London market practice in UK. The thesis is composed of three parts, divided into eight chapters, provide background of operation of utmost good faith in reinsurance contract, and difficult issues emerging from it, for which solutions will be found. The structure and methodology of each chapter is briefly summarised as follows.

3. The structure and methodology of the thesis

This thesis comprises three parts. The first part introduces some basic conceptions of reinsurance agreements and describes the outline of doctrine of utmost good faith.

Chapter 1 gives a brief introduction on forms and types of reinsurance agreements, beginning with the definition, nature, function and main types of reinsurance. It is followed by separate scrutiny of facultative and treaty reinsurance contracts. Especially after the House of Lords’ decision in *Lexington Insurance Company v. WASA International Insurance Company Limited*[^2009] UKHL 40, the issue of nature of reinsurance contract, particularly the nature of facultative reinsurance plays a significant role in deciding the application of the full reinsurance clauses. Different types of reinsurance agreements have different ceding methods. Some distinct ceding methods make the agreement a contract...
for insurance rather than contract of insurance. Such distinction matters as it may affect whether the doctrine of utmost good faith would be attracted and how the duty operates, if it does be attracted.

Chapter 2 describes the whole outline of the doctrine of utmost good faith by analysing the structure of the doctrine, the rules of tests and remedies for breaches of the duty. In existing legislation the doctrine is partially codified in Marine Insurance Act 1906. However, the legislation currently governing operation of the doctrine in reinsurance context is to be reformed by Insurance Act 2015.\textsuperscript{4} Significant changes brought by the new act have been analysed in this chapter. Conclusion of an insurance contract can be regarded as the division line in the operation of the doctrine. Since Lord Mansfield first time brought forward the theory, English law has focused on the duty which applies at the pre-contractual stage, structured the duty, established a two elements test, and set rules of remedies. Only recently emerges a trend to extend the duty to post-contractual stage. However, it is still controversial and arguable whether there is a continuing duty of utmost good faith during performance of the contract. After the draft Insurance Contracts Bill introduced by the Law Commissions finally received the royal assent,\textsuperscript{5} the doctrine of utmost good faith is officially to be replaced by a new duty of fair presentation in non-consumer insurance context. In addition a new default regime of proportionate remedies is built up to replace the current harsh remedies regime. However it is arguable whether such reform has resolved the difficulties and problems arising from the operation of the doctrine in reinsurance context. The details will be discussed in the following two parts.

Part two of the thesis focuses on specific issues relating to broker’s role in the disclosure process during placing reinsurance.

Reinsurance brokers play significant roles in reinsurance market, because they have always been relied upon heavily to produce reinsurance business in London market which is one of the world’s most important centers for trade of reinsurance. Especially in Lloyd’s, it is a broker-orientated market and the whole

\textsuperscript{4} This Act is to make new provision about insurance contracts. It will apply to every insurance policy written in England and Wales, Scotland and Northern Ireland, and the Act will come into effect in August 2016, 18 months after the date it was passed.

\textsuperscript{5} Following agreement by both Houses on the text of the Bill, it received Royal Assent on 12 February 2015. The Bill is now an Act of Parliament (law).
business system is built up on such tradition. It is a special relationship that is
beyond a simple agent-client relationship developed between brokers and
underwriters in practice. In subscription market, reinsurance brokers play
various important roles, not only in placing reinsurance contracts but also in
performing a number of administrative functions for underwriters. So in addition
to his fundamental role of agent of the reinsured who gives placement
instructions, the broker may also involve in other capacities, like retaining
underwriting documents for underwriters, undertaking circulation of adjuster’s or
lawyer’s reports among underwriters, drafting the policy wordings, processing
premium payments and handling claims for underwriters, and even effecting
retrocession covers for reinsurers.

As illustrated in chapter 2, in the MIA 1906 an insurance contract as a contract
uberrimae fidei attracts the duty of utmost good faith on both parties under
ss.17, 18 and on the placing broker under s.19. Therefore before conclusion of
a reinsurance contract, the reinsured’s placing broker has a separate duty to
fully disclose and truly represent all material facts which a prudent underwriter
would consider in deciding whether to accept the risks or not and on what terms.
Such duty is significantly changed by Insurance Act 2015. However, placing
reinsurance in a subscription market is a complicated formation process which
may modify the formation of a reinsurance contract, subsequently has some
effect upon the performance of the broker’s duty of disclosure. As a result, it
raises problems and difficulties which particularly affect the broker’s
performance of duty of disclosure in the reinsurance context. Although a
reinsurance broker performs a similar role to that of a broker placing direct
insurance, there are several issues which come up more frequently in the
context of reinsurance. This part will make scrutiny into how a reinsurance
broker performances the duty of disclosure, of himself or on behalf of the
reinsured in the unique placing process in a subscription market, mainly based
on the sources of statute and common law authorities. Particular attention will
be paid on specific issues in context of reinsurance broker’s role in disclosing
process, caused by the particular characteristics and special placing process of
reinsurance contracts. It comprises two parts, chapter 3 on practical difficulties
and problems in performing the duty of utmost good faith by reinsurance
brokers, and chapter 4 on problems of performance of the duty in broker’s placing process in a subscription market.

The starting point of this part is difficulties and problems arising in current framework of the broker’s duty of disclosure in placing reinsurance contract. It analyses the problems in three aspects, i.e. the legal basis of the broker’s personal duty of disclosure, who is the relevant agent under the duty, and the scope of the duty of disclosure of the agent to insure. After clarifying the specific issues in those above three aspects, it proceeds to how a reinsurance broker will perform his duty of disclosure under a reinsurance contract in the subscription market. Difficulties arise because the duty cannot apply straightforward when reinsurance is effected in subscription procedures. It will be discussed in Chapter 4 how current doctrine operates in reinsurance broker’s placing process. The difficulties will be analysed in following aspects, i.e. when the reinsurance contract is concluded in the subscription procedure, and then attracts the duty of utmost good faith. In addition, problems may arise in performance of the duty of utmost good faith due to the specific characters of the subscription procedure. Solutions will be found to cover the gap in both common law and market practice aspects. So that it can draw a whole picture of the broker’s duty of disclosure in placing reinsurance contract, which is different from that in context of direct insurance.

Part III mainly discusses difficult issues arising in the operation of the doctrine of utmost good faith in reinsurance contracts. The issues relating to applicability, duration of the duty, the scope of the material circumstances subject to disclosure, modification by the principle of waiver, and remedies regime for qualifying breaches will be under detailed scrutiny.

In early time, the law relating to reinsurance contracts is largely based on facultative marine insurance contract, which is effected on an individual offer and acceptance basis like a retail business. The relationship between reinsured and reinsurer under a facultative reinsurance is simply similar to the direct insurance. While after the developments such as treaty reinsurance coming into existence and taking most percentage of the market share, the relationship between the insurer and reinsurer under a reinsurance contract become more complicated and quite different from the relationship between insured and
insurers under a direct insurance contract. It is more closely aligned with the market practice that the reinsurance relationship is more like a partnership in the subscription market, where each party to the contract shares in the risk underwritten. As a result, the reinsurance relationship may be left with some problems which cannot be resolved by the MIA 1906 Act and existing common law rules. As the development of the legislation governing reinsurance contracts have not taken in account the later developments such as appearance of treaty reinsurance. The essential elements of the duty of disclosure can be summarised as three aspects, including timing, scope and content, i.e. that the duty of disclosure arises before the contract is concluded; that any material facts must be disclosed; and scope of disclosure is confined to the assured’s actual knowledge and blind eye knowledge. Although the essential elements have been long and clearly established by the Act and common law cases, the doctrine of utmost good faith may still create some anomalies and deficiencies in applying to reinsurance area in certain cases. Notwithstanding reinsurance is recognised as insurance for insurer, it is not a crystallised principle that all reinsurance contracts can be categorised as contracts uberrimae fidei to attract the duty of utmost good faith. Where a duty of utmost good faith is attracted, it deserves scrutiny what the scope and duration of the duty is, and what material facts should be disclosed, specially relating to reinsurance contract. Moreover it is worthy an analyse what happens when the duty is curtailed by the principles of waiver in reinsurance context, and whether the proposed proportionate remedy regime that is to reform the current remedy regime can serve better in reinsurance market practice.

Actually in business insurance market practice the duty of disclosure under the MIA 1906 Act has become onerous to a certain degree, especially for complex business of large size and complicated nature. As identification, collection and collation of all material information related to the risks can be extreme difficult tasks involving multiple sources of information, proportionate to the size, nature and complexity of business insurance. To minimise the difficulties and the deficiency of enforcing the law, the reinsurers commonly follow the current business insurance market practice by designing particular standards and procedure of disclosure and inserting a specially draft clause in the reinsurance

\[ Airmic, \text{Disclosure of Material Facts and Information in Business Insurance (2011).} \]
contracts overriding the current legal rules set out in the MIA, rather than seeking enforcement of the full requirements of the act. In addition, it is necessary to clarify what the material facts are under reinsurance agreements. As information and facts which are material in the reinsurer’s underwriting assessment may vary according to the distinct placing methods by which the premium and losses are distributed between the reinsureds and the reinsurers under each individual reinsurance contract. Therefore chapter 5 will discuss in details circumstances which are commonly recognised as material information and particular concerns in placing risks under reinsurance contracts, besides the general material facts commonly recognised relating to the underlying risks under direct insurance.

Moreover, where the reinsurance contract comes into existence before the direct insurance law due to the specific practice in the subscription market, the requirement that both policies are in existence at the same cannot be satisfied any more. Also where business was ceded to the reinsurer for example by use of bordereau so that the reinsurance agreement between reinsurer and reinsured are contracts for insurance rather than contact of insurance synonymous to the direct insurance, such reinsurance agreement works more like a contract of agency between the reinsurer and the reinsured rather than creating a partnership. In such circumstances, it is more complicated than the direct insurance as applicability and duration of the doctrine varies under different types of reinsurance agreements depending on their placing methods. The mandatory or non-obligatory nature of the ceding methods in placing reinsurance contract brings in different results. The chapter 6 will discuss the anomalies and difficulties created by modification of applicability and duration of the duty operating in reinsurance contracts.

In addition, in contrast with the consumer insurance market which is regulated under a mandatory regime, commercial insurance market is inclined to allow equivalently sophisticate and professional parties to adapt provisions which are appropriate in their particular circumstances and suitable for their own business interest. Commercial parties, who are normally in equivalent business power, will and should be allowed to modify and then perform the duty of utmost good faith in their own way. Therefore, the application of doctrine of utmost good faith
may be affected by the principle of waive which is a separate principle in common law. That's to say, the parties of a reinsurance contract should be entitled to expressly contract out of the default regime, to design their own rules by clear and unambiguous contract terms which can bring sufficient attention to the business, or to curtail the doctrine of utmost good faith by implied waiver of their right or remedy. In chapter 7, it will analyse the difficulties arising in deciding the extent and requirements of the alteration of the default legal regime by reinsurance parties. As to express contracting out provisions, it is suggested to be a question of construction of the parties' intention in interpreting the contracting out provisions in individual cases. The approach of construction will be analysed and advices will be given to the parties on how to draft a proper term to achieve the purpose of contracting out successfully, and to reduce the uncertainty to the reinsurance contract at the same time. In addition problems may be caused relating to the permissible scope of contracting out provisions in reinsurance contract; especially in the circumstances where express terms are drafted purporting exclusion of the reinsured's liability for his broker's fraud and to limit the reinsurer's right of avoidance on the ground of such fraud. It will be discussed whether the public policy should come to prevent such exclusion or limitation of the right or remedy, and whether there is any possibility to develop a room for a lawful contracting out right where the agent to insure commits fraud against the reinsured. If the answer is positive, then it need be considered how to find out a solution to be consistent with current reinsurance market practice. In respect of the reinsurer' implied waiver of the duty, the parties in the disclosing or representing process will face practical problems as to whether the reinsurers need to ask questions and if so how far the reinsurers are obliged to ask questions in the placing process, and then whether the reinsurer's non-inquiry, general or limited questions indicates his waiver of disclosure of those information falling outsider the questions. Comparison will be made in the following sections between the Australian law and English law to find a proper approach of establishing implied waiver to purport the purpose of prompting both of the reinsurance parties to make fair effect to get relevant material information disclosed.

Last but not least, the chapter 8 will discuss about the difficulties and problems of the current and future regimes of remedies for breach the duty of utmost
good faith under a reinsurance contract. It is fair to say that the current regime of remedies for breach of the duty of utmost good faith is firmly established under English law. Such regime of remedies which adopts an ‘all or nothing’ approach receives more and more criticism as it gradually shows deficiencies in practice. This chapter will focus on the deficiencies and difficulties of the current regime of remedy applying in reinsurance context, and suggest a proper solution to those problems by proposing a proportionate remedy regime after comparing the regime under the ICA 1984 in Australian law, the current English law regime and the new regime proposed under Insurance Act 2015. It will start with the summary of the regime of remedies under current English law, and then proceed to scrutinise of the deficiencies, shortcoming of the current regime of remedy and difficulties caused by it to reinsurance practice. Due to those practical difficulties caused by the harshness and disproportionability of current regime of remedy, alternative proportionate approaches are proposed to replace current regime. The core spirit of the proportionate approach will be clarified first. Then it will proceed to detailed analysis of the proportionate approach adopted by the ICA 1984 in Australian law and the new regime proposed under the Insurance Act 2015. A method of comparison will be adopted to find a proper alternative approach to introduce the notion of proportionality into the regime of remedies. However difficulties will arise in drawing a hypothetic picture of what the contract would have been, and what the hypothetic ultimate position the reinsurance parties would have been in. A question must be answered to define the scope of the parties’ contractual obligations and duties first, namely what contractual terms the parties should perform. Shall the law keep digging in pursuit of the hypothesis of ultimate position where the parties would have been in? Is it possible to pursue the hypothetic position in practice? Or should the law just focus on the insurer’s response to the disclosure of the true information, had the duty of utmost good faith been performed successfully? Even the above problem can be solved; it will still cause practical problems in applying the proportionate remedy approach in reinsurance context. Difficulties will arise in referring and proving a hypothesis of what the reinsurers would have been done had all material information been truly represented. It is not easy to resolve the issue of the difference between what the reinsurers would have done had it made a fair presentation and what actually occurred should be found out. In addition such
potential difficulties will even become more complicated in applying the new regime in specialist or complex reinsurance contract. Better solution will be suggested to the make up the deficiencies of the proposed proportionate approach at last, by analysing whether the effect of proportionate remedies on reinsurance can be left to freedom of contract.

4. Outcomes

As a result of the research the following points will be made clear:

• What is reinsurance

• Summary of the framework of the doctrine utmost good faith in evolution

• The role of the reinsurance brokers in performing the duty of disclosure in the placing process

• Modification of the duty of utmost good faith in reinsurance placing process in subscription market

• Material facts need to be disclosed in reinsurance context

• Applicability and duration of the duty of utmost good faith in various reinsurance contracts

• Modification of the duty of utmost good faith by the principles of waiver

• Deficiencies of current regime of remedies and potential problems of the new proportionate regime of remedies applying in reinsurance context
Part I BASIC CONCEPTS OF REINSURANCE AND FRAMEWORK OF THE
DOCTRINE OF UTMOST GOOD FAITH

Chapter 1 Types and Classes of Reinsurance Agreement

1.1 Introduction of reinsurance

1.1.1 What is reinsurance?

Reinsurance, as defined as the insurance of insurers, is basically a contract of or for insurance under which the insurers seek cover for their exposure to claims liability occurred under the direct insurance policy. Therefore reinsurance agreement is regarded as species of insurance. In essence, it is a contract of indemnity between insurers under which the reinsured, i.e. the insurer in the original policy, lays off part or all of a particular risk or a number of risks falling with the contract scope to the reinsurer.

The appearance of reinsurance dates back to the 14th century. From simple contract covering an individual case transacted through ‘chambers or exchanges of insurance’ to complex reinsurance arrangements transacted in Lloyd’s marketplace which has been existing for 300 years, reinsurance develops into a complex domain and functions as essential approach to spread risk. London plays a central role in the worldwide market for reinsurance as all manner of international risks are ultimately partially or completely reinsured in London.

Reinsured and reinsurer are the generic term of two parties of a reinsurance contract. In the treaty arrangements which are the most commonly used type of reinsurance contract, the cedant is often interchangeable with the reinsured, and the transfer of

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10 Edwin W. Eopt, Notes on origin and development of reinsurance, p.5. http://casualtyactuarialsoociety.net/pubs/proceed/proceed29/29022.pdf. The earliest reinsurances first appeared in transport, especially marine insurance, at a comparatively late date 14th centuries. The first recorded reinsurance contract was agreed in 1370 between the Mediterranean merchants Guiliano Grillo and Goffredo Benaira and Martino Sacco to reinsure a ship on a voyage form Genoa to the Burges harbor.
11 Ibid. p5.
risk is often described as cession. Where the reinsurer seeks cover for all or part of his liability in the retrocession, he becomes the retrocedant and who plays the insurer role under such contract is called retrocessionaire.

Reinsurance and direct insurance are tied up tightly in practice that neither of them will perform well without each other. As reinsurance serves as a protection for insurers’ exposure to the original risks and effective means to balance insurers’ profitability and solvency, it is the prior concern and common practice of original insurers to find enough reinsurance protection before they accepted the inwards risks. The availability of reinsurance and its cost determines both the types and size of inwards business which an underwriter can accept. However, before deciding placing method by which the reinsurance is arranged, size and types of risks contained in his inwards portfolio of business requiring reinsurance cover will be brought up to the original insurer’s concern first, although those are not whole intricate factors related to decide what reinsurance to purchase.

Although there is a close tie between the direct insurance and reinsurance as shown above, they are absolutely separate contracts. Each party has separate rights and obligations under individual contracts. Although there are indeed some authorities stating that reinsurance performs as a further insurance on the subject-matter of the direct policy, it is not a partnership or agency between the reinsured and reinsurers but a reinsurance relationship. Such reinsurance relationship brought about by the reinsurance agreement is only between the reinsured and reinsurer. It is mutually independent from the relationship between the insurer and the insured under the original cover. Even in the facultative reinsurance contract which contains a ‘full reinsurance clause’, the coverage terms are incorporated into the reinsurance contract in most cases, these two contracts are still separate normally with different premium, duration and claims provisions. Reinsurance is not an assignment of the direct policy by the reinsured to reinsurers, neither has the assured under the original cover any legal interest in the reinsurance contract.

Based on the distinct nature of reinsurance cover analysed above, there is actually no contract privity between the assureds and reinsurers. It suggests that the liability

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13 RE Norwich Equitable Fire (1887) 57 LT 241.
14 Re Lancashire Plate Glass Fire and Burglary Insurance Co Ltd [1912] 1 Ch 35.
of reinsurer under reinsurance contract is sole to the reinsured, while the insurer retains all the liability encountered under the original cover to the assured. From the reinsurer’s point of view, the reinsurance contract creates new liabilities and obligations of the reinsurer to insure the reinsured’s liability encountered under the original policy. It is not a simple ‘share’ of the reinsured’s existing obligations and liabilities under the original policy. Although the underlying contract terms may be incorporated into the reinsurance contract, there is no contractual relationship between the reinsurer and original insured, therefore the two parties have no obligations or rights against each other. Such character of reinsurance contract is well enunciated by Court of Appeal in Meadows Indemnity Co Ltd v, The Insurance Corporation of Ireland plc and International Commercial Bank plc where May LJ rejected the reinsurer’s declaration that insurer was entitled to avoid the original insurance contract by the reason that “These two parties [the reinsurer and the original insured] have no rights or obligations against or to each other; they are not in a contractual relationship. Although there is of course a connection between the contracts of insurance on the one hand and of reinsurance on the other, [the reinsurer’s] rights are in no way involved in the existing dispute between [the insurer] and [the original assured]…Insofar as [the reinsurer] is concerned, any liability on their part will depend upon the contract of reinsurance and the factual situation which existed between them when this was entered into…”. As a result, reinsurance is distinguished from co-insurance, insurance arranged in layers and double insurance, where the assured has a separate contract of insurance with each underwriter.

1.1.2 The function of reinsurance agreement

Mance J has once enunciated the basic function of reinsurance in Charter Reinsurance Co Ltd v. Fagan as follows: “In insurance, the matching of exposure and protection to assure both solvency and profitability is absolutely fundamental.

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15 Marine Insurance Act 1906, s 9(2); Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd [1985] 2 Lloyd’s REP 599 AT 614, per Hobhouse J: “The relationship of a reinsured and a reinsurer is not that of agent and principal; it is one as between principals. The reinsurer is in no sense a party to the contract of original insurance and has no rights under it.”


17 Ibid.


Reinsurance—of what type—is a principal means to this end.” As stated above, spreading of risks by means of reinsurance arrangements functions principally in two folds, i.e. protecting exposure against liability and making business advantages.

The primary function of reinsurance is to protect the direct insurers against his liability to the assured incurred under the original policy. The reinsurers share the risks and premium in various methods, thus spread the risk in whole market. Consequently, the reinsureds need not sustain whole losses on their own.

Reinsurance not only serves protective functions, but also brings business advantages, such as promote financial stability. The original insurer is unable to predict which policy he underwrites will prospectively make profit and which one will result in unexpected accumulated losses or catastrophic losses during the cover period. Reinsurance can be used to balance such solvency and profitability by smoothing the peaks and troughs then promote stabilisation of profit.  

Moreover, reinsurance can also enlarge the direct insurer’s capacity to absorb larger risks worldwide which would have not been underwritten in absence of the reinsurance cover. Simultaneously, reinsurance can release part of the direct insurer’s capital which would otherwise have been reserved to cover potential losses to fulfill the ‘solvency margin’ requirements for regulation purposes. Thus reinsurance can increase the original insurer’s capacity and strengthen its solvency ratio.  

Furthermore, by the ‘fronting’ practice, worldwide reinsurers are able to participate in insurance business in certain areas where reinsurers are not allowed to insure such business directly due to some local restrictions or regulations. At the same time, the fronting insurers who themselves lack the expertise, resources and sophistication in such business can underwrite the risks and then cede them to reinsurers with no or

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20 Ibid.
22 Under the Insurance Companies Act 1982, the insurer must operate a ‘solvency margin’ generally expressed as the excess of the value of its assets over the amount of its liabilities. The insurers are not allowed to operate once its solvency margin is below the minimum margins or ratios of the regulatory body. However, the 1982 Act was repealed by FSMA 2000. The solvency rules are now found in the Prudential Sourcebook under FSMA 2000.
few retention. As a result, the fronting practice can bring both parties business advantages.

1.1.3 Main types of reinsurance contracts

This chapter will focus on the traditional forms of reinsurance contracts which are commonly employed in the London market. Basically speaking, there are two general types of reinsurance agreement, facultative contracts and treaty arrangements. The distinction between these two main types is that facultative contacts are on a one-off basis on a particular risk. While the treaty is the continuing arrangements under which risks of a type or certain types or whole book of reinsured’s business is transferred to the reinsurers. Treaty mechanisms are normally placed in three methods, namely obligatory treaty, facultative-obligatory treaty and facultative treaty or non-obligatory treaty. Each of them has different nature in placing progress.

As to cessions under the reinsurance contracts, various forms have been developed to reflect different underwriting requirements in practice. Those forms can be divided into two classes, proportional and non-proportional. The difference between the proportional and non-proportional reinsurance is how ceding of risks is defined under the reinsurance contracts. Under a proportional contract, the reinsured and reinsurer share the risk and premium in proportion, whereas under a non-proportional contract the reinsurer accepts liability in excess of the reinsured's deductible up to a given maximum sum. It suffices to say that the proportional reinsurance contract is risk based while the non-proportional contract is claim based.

The principal arrangement forms of reinsurance, namely facultative cover and treaties are based on either proportional or non-proportional basis. Facultative reinsurance is in most cases proportional. In respect of treaty framework, current proportional treaty arrangements can be divided into quota share and surplus cover; as well as combined quota share and surplus cover. Non-proportional treaty agreements can be divided into excess of loss treaty and stop loss treaty. Each of those forms will be described in detail in the following sections.

1.2 Facultative reinsurance
1.2.1 What is facultative reinsurance?

Facultative reinsurance is a method of placing whole or part of a particular single risk. Each risk is considered individually and the terms and conditions of the contract are specifically concluded for the very occasion. In most cases, facultative reinsurance is concluded in proportional form under which the reinsured retained small or even none proportion of the original risks and cede the balance to the reinsurer. It may be controversial whether such reinsurance can be regarded as a form of insurance in some jurisdictions. However, it has been a long-standing theory supported by many early authorities\(^{24}\) that facultative reinsurance is a contract of insurance; whereas other types of reinsurance, i.e. the treaties or stop loss contracts, are treated in some other ways.\(^{25}\) As a result, most of the basic legal doctrines and regulations of insurance apply to facultative reinsurance.

1.2.2 Characteristics of facultative insurance

1.2.2.1 Separate contract

As a basic type of reinsurance agreement, facultative reinsurance has all the nature of reinsurance. Although there is an orthodox opinion that reinsurance is a further insurance on the subject-matter in the original agreement\(^{26}\), the direct insurance and facultative reinsurance are absolutely separate contracts independent from each other. Even if the slip cover incorporates the terms of direct policy into it by a wording of “as original” in a version of the “full reinsurance clause”, these two presumed “back-to-back” policies are still separate contracts. It is a long-standing theory that there is no privity of contract between the facultative reinsurer and the original assured\(^{27}\). Therefore, the original assured are not entitled to bring an action against


\(^{25}\) R. Merkin, (Eds), what is Reinsurance? (1998 edn) LLP, p.11 states “…whether reinsurance is treated in the same way as insurance and in some jurisdictions it may be the case that particular types of reinsurance are regarded as ordinary insurance contracts (e.g. facultative reinsurance), whereas others (e.g. treaty reinsurance, stop loss contracts) are treated in some other way…”


\(^{27}\) Delver v Barnes (1807) 1 Taunt 48.
the reinsurer\textsuperscript{28} or to add reinsurers as parties to an action against direct underwriters\textsuperscript{29}, even that the direct insurer becomes insolvent.\textsuperscript{30}

1.2.2.2 Facultative feature

‘Facultative’, which derives from the word ‘faculty’,\textsuperscript{31} is the most significant distinguishing feature of facultative reinsurance which makes it different from the obligatory treaty or facultative obligatory treaty. Both parties have the option as to whether to enter into a contract in respect of each individual risk. There is neither obligation on the reinsured to cede, nor automatic acceptance of reinsurer. Whether the contract can be concluded depends on both parties’ discretion.

1.2.2.3 Presumption of back-to-back

In the London market, it is a common practice to place traditional facultative reinsurance contract in a simple method of appending a slip cover to the direct policy. Such simple slip normally contains a version of “full reinsurance clause” which is typically formulated as ‘Being a reinsurance of… subject to the same terms of conditions as original and follow the settlements of the Company’. It contains two parts, i.e. “as original” and “follow the settlements” It purports to incorporate the terms of the underlying policy by a brief wording of ‘as original’ and indicate the reinsurer’s intention to follow suit and make an indemnity to the reinsured when the parties of underlying policy enter into a settlement in the brief wording of “follow the settlements”. As a result, these two policies are presumed to be construed on a “back-to-back” basis.\textsuperscript{32}

As the indication of ‘as original’, it is the general notion that the terms of direct policy are incorporated into the reinsurance and take effect as a part of the facultative reinsurance.\textsuperscript{33} When some differences on its face exists in the wording or construction of terms of the reinsurance, there is a presumption that the two polices

\textsuperscript{28} Nelson v. Empress Assurance Corp Ltd [1905] 2 KB 281.
\textsuperscript{30} There may be a ‘cut-through clause’ in the contract, allowing the reinsurer to participate in the action against original insurers. See Grecoair V. Tilling [2005] Lloyd’s Rep IR 151.
\textsuperscript{31} Longmore LJ in Wasa v Lexington said that it derived from the Latin meaning “one-off”.
\textsuperscript{32} Arnould, J., Arnould’s law of Marine Insurance and Average, 18\textsuperscript{th} edn, 2008, para 33-02.
\textsuperscript{33} Ozlem Gurses, Rob Merkin; Facultative reinsurance and the full reinsurance clause, LLMCQ, [2008] 366-388.
are intended to be construed in a consistent fashion on a ‘back-to back’ basis\textsuperscript{34}, subject to some limitation where express provisions in the facultative reinsurance policy overrides the presumption or there are no equivalent provisions between the policies.\textsuperscript{35}

By contrast to application of such presumption to proportional reinsurance contracts under which the parities share the risk and premium according to their proportionate undertaking, it is not the case of the presumption to be applicable to non-proportional ones under which reinsurers employ quite different means of calculation of premium and have distinct strategy and considerations during placing of the reinsurance. This point is well explained by Lord Mustill in Axa Reinsurance v Field\textsuperscript{36}, although it is not a case of facultative reinsurance but an excess of loss treaty. Consequently, where there is a different wording in a non-proportional reinsurance contract, it is to be assumed that the parties intend a different interpretation from the underlying policy.

\textbf{1.2.2.4 Case-by-case transactions}

Known from treaty which is a pre-arranged framework facility to protect the underlying insurer against risks of certain types or to provide an embracing cover for insurer’s entire book of business, facultative reinsurance is just an insurance of a specific single risk or each underlying insurance policy in each one-off transaction. The parties to a facultative reinsurance have to deal with placement case-by-case. Each risk is considered and negotiated individually and the reinsured is obliged to provide full placing information at the inception and renewal on every occasion. As a result the reinsured has to pay high administrative cost. By contrast, the reinsurers’ administrative costs and commission rates for reinsurance placed on a facultative


\textsuperscript{35} Aegis Electrical and Gas International Services Co Ltd v. Continental Casualty Co [2007] EWHC 1763 (Comm); [2008] Lloyd’s Rep IR 17 is an example. Here there were clear differences between the scope of the insurance and the scope of the reinsurance.

\textsuperscript{36} [1996] C.L.C.1169.
basis become lower, even if generally a no-profit commission is operated.\textsuperscript{37}

\section*{1.2.3 Types of facultative reinsurance}

Facultative reinsurance contracts are in most cases written on a proportional basis. The parties will share the risk and underlying premium proportionately. Under such contract, the reinsured will generally retain a proportion of the direct risk for its own account and cede the balance to the reinsurer. The size of the reinsured’s retention varies from case to case and it is material to the reinsurer when placing the reinsurance. And the reinsurer will be paid a share of the underlying premium proportionate to his share of the direct risk less a deduction of ceding commission for the reinsured due to the expenses incurred in operating the direct policy, such as business acquisition, survey and claims investigation expenses.

Although comparatively unusual, some facultative reinsurance contracts are indeed placed in non-proportional form, excess of loss facultative reinsurance. Under such contract, the reinsurer only assumes liability when the loss under the underlying policy reaches a certain level which is pre-agreed in the reinsurance contract. As a result, the share of risk under the non-proportional facultative reinsurance does not depend upon each party’s undertaking proportion. The reinsured will retain the loss until it reaches the agreed level and cede the excess part to the reinsurer. Distinct from the proportional facultative reinsurance, reinsurers under non-proportional facultative reinsurance will determine the premium in every respect of the specific circumstance, such as the whole loss frequency and reinsured’s capacity etc, without automatic reference to the underlying premium. Furthermore, very significantly, there is no presumption of ‘back-to-back’ principle in a non-proportional facultative reinsurance.

\section*{1.2.4 Why facultative reinsurance is purchased}

Although facultative reinsurance, which is a method of laying off individual risks on one-off basis, is gradually taken over by treaty reinsurance, such facultative operation remains an essential means of spreading risk in practice. This mode which used to be the predominant fashion of reinsurance in 19th century still plays a

\textsuperscript{37} R. Carter, L. Lucas & N. Ralph, Reinsurance, Reaction Publishing Group, 2000, p.320.
significant role in placing specific risks in the following circumstances.

First, when there is no available or sufficient cover under the treaty arrangement, direct insurer will seek facultative reinsurance cover as supplements to the treaty arrangement. For instance, direct insurers may expose to risks when there is some special limits of their existing treaty arrangement, such as limits of amount, geographical areas etc. Also, when there are exclusion provisions in the treaty cover, a facultative reinsurance contract is an effective method to provide extra protection for such additional risks.

Moreover, facultative reinsurance contract can protect the insurer against major losses of a particular high-risk when the insurer has no automatic obligatory reinsurance cover for such risks. For example when there is difficult to find a common, mature and experienced automatic mechanism to cede a particular new or high risk, the reinsurer will prefer to accept such risks on a facultative basis.

Furthermore, facultative reinsurance cover can be set up for some poor quality or unstable risk which the insurers are unwilling to cede via their existing treaties in order to avoid any effects on the overall achievements of reinsurance treaties.\footnote{Chao-Chih Lin, “The Development from Traditional Reinsurance to Alternative Risk Transfer in Current Law”, March 2007, p12.}

\subsection*{1.2.5 Fronting Arrangements}

It is a common practice that facultative reinsurance is placed to bring in overseas risks which cannot be insured directly. For instance, it is commonly used where the reinsurers are restricted to write direct insurance business in their local countries, or there are some local licensing or exchange control requirements for regulatory purposes. As a result, reinsurers have to conceal their unlicensed or unacceptable security behind an acceptable fronting insurer.\footnote{Barlow Lyde & Gilbert’s, Reinsurance Practice and the Law, LLP, 2004.} When the overseas reinsurer concludes an agreement to reinsure a risk with an individual or business, it needs to capture a local insurance company to underwrite the risks. The Local insurers will underwrite the direct risks first and then cede the entire or most risks to them in a facultative reinsurance cover. Acting as a ‘fronting’ insurer, the reinsured will cede most or all of the underwritten risks to foreign reinsurers with only small or none...
proportion of retention.\textsuperscript{40} Such fronting practice may turn out to reverse the traditional insurance business procedure, as reinsurance comes into existence before the direct insurance. Alternatively, the fronting facultative arrangements can enable the local market, which may not have had sufficient expertise or capacity to assume considerable risks, to underwrite the business. After issuing the direct policy, retaining a ceding commission, they can cede whole or vast majority of the risk to a fronted reinsurer which specialized in that type of business.\textsuperscript{41}

In most cases, such fronting arrangement contains a co-operation clause and a claim-control clause, which enable the reinsurer take control of the underwriting direct risks, loss adjustment, and negotiation of any direct claims handling with the assured. The reinsured even lacks the capacity of a full-fledged insurer both in terms of human resources and administrative systems.\textsuperscript{42} The relationship between the reinsurer and reinsured is more like an agency or partnership other than reinsurance agreement parties. Even though the reinsurers act in effect as the insurers in reality, it is nature of reinsurance that reinsurers neither undertake the direct liabilities in law; nor take over the reinsureds’ legal positions. The direct insurer is the only party who takes all the responsibilities for the insured’s claims. Disputes may arise here, particularly when the direct insurers are insolvent and gone into liquidation. But the assured does not have a cause of action against the reinsurer, as there is no contract privity between them.\textsuperscript{43}

\textbf{1.2.6 Facultative reinsurance after WASA}

\textbf{1.2.6.1 WASA facts}

Lexington was one of various insurers which had provided liability or all risks property insurance to cover physical loss and damage to property at Aluminum Company of America (Alcoa)’s sites during the period 1946-1985. On 1 July 1977 Lexington issued to Alcoa a three-year all risks property damage and business

\textsuperscript{40} See Sirius International Insurance Co (Publ) v FAI General Insurance Ltd [2005] Lloyd’s Rep. I.R. 294. It is noticeable that, although fronting is almost always recognized as one kind of facultative reinsurance, it is not inclusively limited to facultative, and it can appear in some treaty arrangements.

\textsuperscript{41} Ibid.


\textsuperscript{43} Subject to any ‘cut-through clause’ in the policy if there is any. See, Grecoair V. Tilling [2005] Lloyd’s Rep IR 151.
interruption insurance policy which contained an insuring clause stating “all physical loss of, or damage to, the insured property ...” and a standard US “Service of Suit” clause. Then Lexington reinsured the original risk through London insurance brokers in the London market in 1977 under one-page slip policy, described itself as a ‘contributing facultative reinsurance’ covering 2.5% of the original risks. The period was stated to be for 36 months at date 1.7.77... and / or pro rata to expiry of original. The reinsurer WASA, AGF, on conditions of “Full R/I Clause No.1 amended”, undertook to cover “All Risks of Physical Loss or Damage excluding Fire and Allied Perils &or as original”. Although the “Full R/I Clause No.1 amended” referred to conditions had not been identified, it was common ground that the reinsurers agreed to follow the settlements of the reinsured retained during the currency of the policy. However no formal policy was issued.44

On 2 December 1992 Alcoa began proceedings in the Supreme Court of the State of Washington against his insurers who had provided cover during the period 1946-1985 including Lexington. On 4 May 2000 the Supreme Court handed down its judgment, relying on a series of asbestos cases dating from 1983, held that insurers including Lexington, on risk at any time during the period of damage, were jointly and severally liable to Alcoa for all property damage during the period 1946-1985. Therefore, Lexington was not only barred to rely upon his suit limitation provision in the underlying policy but also jointly and severally liable to Alcoa for all property damage before, during and after the inception of its policy. On 4 November 2003 Lexington entered a settlement with Alcoa indisputably acting in a bona fide and businesslike fashion. On 30 January 2004 Lexington notified the successors to the former placing brokers that they had settled with assured and had incurred and paid legal costs in defending Alcoa’s claims and sought their indemnification under reinsurance contract. Following this, WASA and AGF began a proceeding seeking declarations that they were not liable under the reinsurance contract.

44 The slip referred to a choice of form J1 or NMA 1779. It reflected an administrative practice in the London market for the issue of formal policy documentation. As no formal policy was issued, it was not clear which form was actually used. The J1 form contains the words: ‘Being a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the [reassured].’ Whereas, the NMA 1779 form differs in wording that ‘...to pay or to make good to the Reinsured all such Loss as aforesaid as may happen to the subject matter of this Reinsurance, or any part thereof during the continuance of this Policy’. Although the NMA 1779 form does not contains a follow settlements clause, the wording imposed the reinsurer an obligation to pay the reinsured if they made a settlement with the assured within the reinsurance cover. Therefore, which front sheet had been adopted by the brokers is of no significance in essence. The Court of Appeal refused to consider that the outcome of the case could depend upon which front sheet had been used.
1.2.7.2 Issues in WASA

At first instance, the principal issue was whether the reinsurance contract requires WASA and AGF to indemnify Lexington in respect of the settlement with Alcoa. In particular, whether the reinsurance contract provides a cover for an indemnity in respect of the remedial costs sustained in cleaning up the damage which occurred during the three-year-period specified in the reinsurance or which occurred prior, during and after the three-year-period? Simon J finally granted the claimant, reinsurers, the declarations they sought. The learned judge also expressed their view that reinsurance contract is a further insurance on the subject-matter under underlying policy rather than the insurance of liability of reinsured occurred in the original policy.

After Simon J granted the claimants a declaration that, as a matter of English law, reinsurers were not liable to indemnify the defendant for damage at all, Lexington appealed. In the Court of appeal, the judges treated the principal issue as a construction of contract. Rather than focusing on whether the reinsurance was intended to be back-to-back, they switched to define the intention of the parties. Therefore, the question to be asked is whether the parities intended, to the extent that they used the same or equivalent wording in the reinsurance contract as the underlying policy, the wording to have the same meaning in both contract, i.e. whether the period of cover was effectively identical under both contracts. Although, the court did not reach their decision relying upon the presumption of back-to-back cover, they were strongly in favor of Lexington’s general approach. As regards question of interpretation, the court was unanimous that the parties intended the period clauses in both policies to bear the same construction. Therefore, the judges reversed every aspect of Simon J’s decision. They regarded the reinsurance as one

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46 Although he held that the reinsurance contract was non-proportional, the judge opined that the insurance and reinsurance were written on a back-to-back basis. This was a decision inconsistent with the nature of non-proportional facultative insurance. Inconsistent with the nature of back-to-back presumption, the learned judge stated that the reinsurance was to be construed under its own governing law as covering only those losses and damage occurring during the 36-month period of coverage, rather than being construed by the approach under underlying policy. There were three reasons held by Simon J to reach that conclusion. First, the judge considered the duration clause of reinsurance agreement as of fundamental importance and to be construed according to its terms under its own governing law, irrespective of the meaning of that in underlying policy. Secondly, the meaning of the underlying period clause was uncertain in 1977, it is inappropriate to regard the reinsurer to undertake the risk that they will offer a cover on a back-to-back basis for whatever the interpretation will be put on the wording by a US court at later time. Moreover, the reinsurers were entitled to a benefit of their understanding due to the unexpected interpretation given to the underlying policy.
against liability and not against direct losses of and damage to the subject-matter in underlying policy. Moreover, Lexington’s reinsurance cover was proportional and fully back-to-back. The duration clause itself was nothing special. Furthermore, the wording of underlying policy was not necessary to be clear from the outset to make the two contracts back-to-back.

After the Court of Appeal decided that the parties truly intended the period clause to bear the same construction, therefore fully back-to-back, the reinsurer appealed against the decision. Finally, the House of Lords reversed the Court of Appeal’s decision and restored Simon J’s judgment, although on different grounding. Their Lordships rejected the argument advanced by Sedley L.J. in the Court of Appeal and ruled that reinsurance, even a facultative reinsurance on back-to-back terms, is not equivalent to liability insurance in which the reinsurer undertook to indemnify the reinsured against any liability which it had properly incurred under the insurance. Therefore, the mere proof of liability established under the underlying policy does not create an automatic link to reinsurer’s liability to indemnify the reinsured. A reinsurer could not be held liable unless the loss fell within the risk assumed under the reinsurance cover as well. Moreover, what fell within the cover of reinsurance is not necessarily presumed to be co-extensive with the underlying cover. It is a matter of construction. The reinsurers are entitled to rely upon their own applicable law to construe the policy wording. The general “full reinsurance” clauses and “follow the settlements” clauses do not extend the scope of reinsurance coverage clearly worded in the policy. In the present case, at the time of conclusion of the reinsurance contract, there was no identifiable system of law applicable to the insurance contract which could provide a basis for construing the reinsurance contract in a manner different from his ordinary meaning under English law. Consequently, despite the strength of the presumption of back-to-back, the reinsurer did not intend to provide a

51 The scope of the reinsurance coverage might not be co-extensive with that of the primary coverage in the case where the wording of both policies would be given different constructions according to their own applicable law, even if similar wording has been used to describe the extent of the coverage in the two policies. In the present case, Lord Mance considered the reinsurance as a proportional facultative reinsurance contract even if he thought the policy was not that perfectly proportional because the part of the premium was returned to the reinsured as commission. But it is standard practice in facultative transactions to pay the reinsured a small “finder’s fee” commission and it can not disturb the proportional nature. Their Lordships admitted that, in principle, the relevant terms in a proportional facultative reinsurance, particularly those terms relating to risk, should be construed as to consistent with the terms of the underlying policy. This arises from the essence of the proportional facultative reinsurance contract that the reinsurer took a proportion of the premium in return for a share of the risk. It is the commercial intention of the parties that the two policies should be back-to-back.

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cover to respond to all claims irrespective of when the damage occurred and irrespective of the period to which the losses related; so they were entitled to restrict their liability to damage occurring in the 36-month period of cover.

1.2.7.3 The issue as to nature of reinsurance contract

There has been a long standing division as to the nature of reinsurance, i.e. whether reinsurance is a form of liability insurance providing indemnity for the reinsured where he is liable to pay under underlying policy, or reinsurance is a further insurance on the direct subject-matter. The issue matters in two respects. One is for regulation purpose. It determines whether the reinsurer has to be authorised to participate the business on a one-class basis, i.e. liability insurance or a class-by-class basis. On the other hand, the nature of reinsurance contract determines what test has to be satisfied to trigger the reinsurer's liability to pay.

Previous authorities are not easy to reconcile on this point. In Wasa v Lexington, their lordships unanimously agree to follow the English orthodox theory, by rejecting the suggestion that reinsurance is a form of liability insurance, and preferring the view that reinsurance is an independent further insurance on the original subject-matter. Lord Mance hold that reinsurance is a separate contract which contains its own independent terms requiring to be satisfied before insurers

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53 Defining reinsurance contract as a form of liability insurance creates an automatic link to reinsurer’s duty to pay once the reinsured can establish and quantify his liability to pay under the underlying policy. Whereas treating reinsurance as a further insurance on the original subject-matter makes the claims against the reinsurer a matter of law within the scope of the reinsurance cover. It is possible for the reinsurer relying on the reinsurance wording to argue that reinsured’s liability to pay does not fall within the scope of reinsurance cover.
56 In Court of Appeal, Sedley L.J has clearly expressed the view that reinsurance is a form of liability insurance. And the fiction that reinsurance is an additional insurance on the direct insurance subject matter due to his illegality till 1864 is out of date and better be abandoned. However, the House of Lords found Sedley L.J’s view contrary to long standing theory.
can claim indemnity under it and even a perfectly proportional reinsurance is not an insurance against liability, still less against any liability which the reinsured may be held to incur under the insurance. In his opinion, the subject matter reinsured is the original subject matter and the insurable interest which entitles the insurer to reinsure in respect of that subject matter is the insurer’s exposure under the original insurance. Therefore, the principle of indemnity limits any recover from reinsurers to the amount paid in respect of that insurable interest. 57 However, Lord Mance’s approach is not perfectly beyond question. There are still contrary comments welcoming Sedley L.J’s view. 58 Lord Mance’s argument was commented as a curious one for three reasons. 59 First of all, the first limb to trigger reinsurer’s liability is that the reinsured’s liability under underlying policy has been established and quantified, rather than that a insured peril has occurred causing the subject matter lost or damaged. Secondly, the amount of the reinsured’s indemnity is limited to his exposure of liability under the underlying policy, rather than all the damage and loss suffered by the insured subject matter. Furthermore, it is hard to see what the reinsured’s insurable interest might be if the reinsurance is an additional insurance on the original subject-matter. It would be problematic and inconsistent to independent nature of reinsurance which bars the assured to make a direct claim against the reinsurers. 60

However, it is suggested that the traditional theory is more attractive, although not perfect. The reinsurance contract is in essence an agreement under which the reinsurers share, proportionally or non-proportionally, part of insured perils and risks on the original subject matter with the reinsured and earn premium in return. Once the original insured subject matter suffered a loss or damage caused by insured perils or risks within the scope of original cover, the reinsured will incur liability to indemnify the assured. Naturally he will be prejudiced by the subject matter’s damage, loss or liability incurred thereof. It is opined that the reinsured has obtained his own insurable interest on the original subject matter by sharing the risk, 61 which may prejudice the assured’s interest; rather than obtain the insurable interest by his

57 [2009] UKHL 40, para 32, 33 per Lord Mance.
60 Ibid.
61 The risk here is not the risk or peril which may cause loss or damage to the insured subject matter. It means the assured’s exposure of being prejudiced by a loss, damage to insured subject matter.
exposure of liability. However, he could only be indemnified by the reinsurer for the amount he has been suffered under underlying policy, if he can satisfy the two limbs test established in Insurance Co of Africa v Scor (UK) Reinsurance Co Ltd.\textsuperscript{62} Even in reinsurance against liability, the reinsurer’s indemnity is still subject to the specific reinsurance terms which have to be satisfied. Although the direct trigger to reinsurer’s liability is the establishment and quantification of the reinsured’s liability to indemnify the assured, the fundamental reason is that the reinsured is prejudiced by the loss or damage to the original subject matter. The reason why the reinsured could only recover the amount calculated based upon his exposure of liability is the principle of indemnity. This is irrelevant of the source from which the reinsured gained his insurable interest. Moreover, it is not inconsistent with the independent nature of reinsurance because the reinsurers share with reinsured the risk that exposes the reinsured of being prejudiced by the loss or damage to the original subject matter, rather than share with the assured. There is no contract privity between the reinsurer and the assured. Furthermore, this is consistent with the current regulatory system whereby reinsurance business activities are authorised on a class-by-class basis rather than by a single liability insurance class basis.

Actually, the reinsurers are free to draft his intention whether he wants the contract to be a further insurance on the originally insured subject matter or a form of liability insurance by using very clear wording. Indeed, in Feasey v. Sun Life Assurance Co of Canada,\textsuperscript{63} the reinsurance of an employers’ liability policy was expressed to be one which responded to injuries suffered by the victims of negligence rather than the reinsured’s liability to indemnify the insured employers. However, it is still problematic how clearly the wording should be drafted. In Wasa their Lordships found Lexington failed to do that and indeed that it would have been difficult to define what more could have been done.\textsuperscript{64}

1.2.7.4 The issue of construction of contractual terms under the effect of full reinsurance clause

It is a common ground that in order to recover under a facultative reinsurance

\textsuperscript{63} [2003] Lloyd’s Rep IR 637.
contract, the reinsured must prove that the loss falls under both the insurance and reinsurance contracts. The two-limb-test derived from the classic judgment of Robert Goff in *Insurance of Africa v. Scor (UK) Reinsurance*. In accordance with the Scor case, the first limb is that the reinsured must establish his own legal liability to the assured. If the reinsured entered into a settlement with the assured, the settlement is binding on the reinsurers only if the reinsured can prove that he would have been held to be liable for the assured at least the amount agreed in the settlement, had the matter proceeded to trial or arbitration. The second limb is a question of construction, i.e., the reinsured is required to prove the loss falls within the scope of the reinsurance cover as a matter of law.

In practice, most facultative proportional reinsurance contracts, including the one in WASA, contain a full reinsurance clause, which is worded as “as original” and “follow the settlements”. Under the Scor case, it is further decided that with the follow the settlements clause, the reinsurer agrees to indemnify the reinsured where the reinsured enters into a settlement with the assured. Therefore, the two-limb-test is affected by the “full reinsurance clause”. As to the first limb, the reinsured is exempted from establishing his legal liability to indemnify the assured under direct policy unless the reinsurers can prove that the settlement is not reached in a bona fide and businesslike manner. As a result, the effect of first limb is ousted by the follow the settlements clause. As regards the second limb, the requirement should be considered together with the back-to-back presumption that the insurance and reinsurance contract should be interpreted in a consistent fashion as the coverage terms of the original policy are intended to be incorporated into reinsurance by the wording “as original”. Even if the insurance and reinsurance are governed by different applicable laws which deliver different construction of the common terms,

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66 Commercial Union Assurance Co. v NRG Victory Reinsurance Ltd [1998] Lloyd’s Rep IR 439. It can be proved by being sued to judgment, or by means of obtaining an arbitration award. However, it is possible for reinsurer to argue that the foreign court was not a competent jurisdiction, the judgment was obtained in the foreign court in breach of an exclusive jurisdiction clause, the judgment was manifestly perverse, or the reinsured failed to take proper defences.
68 Assicurazioni Generali v CGU International Ins plc [2003] 2 CLC 852 per Mr Kealy QC at para. 36.
the scope of reinsurance cover is still presumed to be co-extensive with those of the underlying insurance.

Previous authority gave powerful support to such back-to-back presumption. The leading case is the House of Lords’ decision in Forsakringsaktieselskapet Vesta v Butcher. A proportional facultative reinsurance of a Norwegian insurance company was placed in London market. The reinsurance policy was governed by English law whereas the original policy was subject to Norwegian law. Both of the policies contain a 24-hour watch warranty which expressly provided that failure to comply with any warranty was to ‘render the policy null and void’. Despite those express words, under Norwegian law there is a causation requirement between the loss and breach of warranty which is right opposite to English law. The House of Lords held that, by virtue of the ‘back to back’ nature of the reinsurance, the warranty was to be construed in the English law reinsurance as having the same meaning as it had in Norwegian law. The different interpretation, flowing from the different applicable laws was to be disregarded. Similarly, in Groupama Navigation et Transports v. Catatumbo CA Seguros, a different interpretation of a classification warranty arose between the Venezuelan law which governed the original policy and the English law which governed reinsurance contract. Again, the Court of Appeal held that the presumption of back to back applied so the reinsurers were liable and barred from relying upon the English law interpretation.

Although House of Lords in WASA has affirmed the affect of the back to back presumption, it is decided here not be an absolute rule of law. There are indeed authorities showing that the second limb of the Scor test is still alive, rather than automatically satisfied by the follow the settlements clause and the back-to-back presumption. In Hiscox v Outhwaite (No.3), Evans J pointed out that the reinsurers are always entitled to raise issues as to the scope of the reinsurance even if where the risks are co-extensive in both policies and there is a follow the settlement clause. Such analysis was relied upon with approval in Assicurazioni Generali SpA v CGU

International Insurance Plc, it was held that where the original insurance and reinsurance are back-to-back and there is a full reinsurance clause in reinsurance, the reinsurers are not dictated to indemnify the reinsured for a settlement made in a bona fide and businesslike fashion. It remained necessary for the loss to fall within the scope of the reinsurance or at least “arguably so”. Moreover, in Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd Hobhouse LJ stated that ‘It is wrong in principle to distort or disregard the terms of the reinsurance contracts in order to make them fit in with what may be a different position under the original cover. The words “conditions as underlying” cannot contradict either the period or limit provisions of the individual reinsurance contracts.’ Therefore, it can be said that the back-to-back presumption is not an inflexible rule of law. Even if there is a full reinsurance clause in reinsurance contract, the reinsurers are always entitled to raise issues to the scope of the reinsurance cover and rely on the defences provided by the reinsurance terms. The presumption may be ousted if the reinsurance contains clear contradictory wording or the words of the insurance and reinsurance are quite different and there is no equivalence between them. It is always necessary for the reinsured to satisfy the second limb of the Scor test in order to recover under the reinsurance contract.

In WASA, neither was there any argument about the competence of the jurisdiction in the original insurance or any assertion that the decision had been perverse, nor arose any challenges about the reinsured’s manner of the settlement with the assured. Therefore, it can be said that the reinsured had successfully established his liability to indemnify the assured under the original insurance. Therefore, the only issue was that whether the reinsured’s liability fell within the reinsurance cover. As to this point, House of Lords in WASA finally found that the Vesta and Groupama cases were distinguished and re-affirmed the analysis in the Generali case. As a result, the reinsurers’ liability did not automatically arise because of the full reinsurance clause, whether the reinsured’s liability fell within the reinsurance cover as a matter of law was a question of construction.

In fact, in both Court of Appeal and House of Lords, the issue of interpretation of the

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74 [2003]2 CLC 852, 871-872, per Gavin Kealey QC.
76 [1998] CLC 957 at p. 968 per Hobhouse LJ.
period clause is relied upon construction of the parties’ intentions rather than the presumption of back-to-back basis. Therefore, the question to be answered is whether the effect of terms in a reinsurance contract governed by English law should be interpreted to be in accordance with the meaning in direct insurance contract governed by foreign law. Between the two distinct analyses adopted in first instance\textsuperscript{77} and court of appeal,\textsuperscript{78} their Lordships thought distinguished features of WASA make the analysis of ‘reinsurance must respond what direct insurance covers’ reflected in the Vesta and Groupama cases not applicable. The most important distinguished feature of WASA in their reasoning was the unpredictability and uncertainty created by the Service of Suit clause in the original policy. Distinguished from the Vesta and Groupama cases where at the time of concluding the reinsurance it was certain for the reinsurer that Norwegian and Venezuelan law would apply, it was impossible for reinsurers in WASA case to identify which foreign law would apply to the original policy.\textsuperscript{79} Therefore the reinsurers should not be expected to undertake to indemnify the reinsured whatever his liabilities were, in a circumstance that it was not clear which law should govern those liabilities. However, it could not be right to say that WASA has established a rule of law that, in order to apply the presumption of back to back in the Vesta and Groupama cases, the requirement of certain and identifiable applicable law must be satisfied. In other word, certain and identifiable applicable law to insurance contract is not a necessary requirement to trigger the back-to-back presumption. It was the House of Lords’ decision of construction on a particular issue based upon particular facts of WASA. Therefore, from the reinsured’s point of view, it is not safe enough for them to simply insert a full reinsurance clause in the MRC in order to get a back-to-back cover. It is suggested that the reinsured should ensure that the original policy contains identifiable applicable law in order to preclude the reinsurer from arguing that they did not intend

\textsuperscript{77} Simon J found that the WASA case should be distinguished from the Vesta and Groupama case, not only because the meaning of the underlying period clause was uncertain in 1977, but also due to the unexpected interpretation given to the underlying policy wording. Therefore it was inappropriate to regard the reinsurers having undertaken the risk that they would offer a cover on back-to-back basis for whatever the interpretation will be put on the original wording by a US court at later time. They were entitled to their own interpretation of the period clause under English law.

\textsuperscript{78} Their reasoning was quite straightforward that insurance and reinsurance contracts which had identical or equivalent wording should be given the same meaning, despite different applicable law; unless there were clear indications to the contrary in the reinsurance contract. Therefore, the period clause of cover, although expressed in slightly different words, was effectively identical under both contracts. No particular significance is regarded as to the period clause.

\textsuperscript{79} It should be noted that the House of Lords’ reasoning is different from Simon J’s approach in first instance. What is considered critical in HL was the uncertainty of what the applicable law should be rather than the unpredictability of the interpretation of clauses in the direct policy by the Washington Supreme Court in 1977.
to provide a cover by reference to the situations in direct insurance under whatever an applicable law would be ascertained later.

1.2.7.5 Conclusion

WASA, as a leading case regarding proportional facultative reinsurance, has discussed many important issues of reinsurance contracts, especially the nature of reinsurance contract and interpretation of facultative reinsurance contracts which contains a full reinsurance clause.

First, as to the nature of reinsurance contract, their Lordships rejected Sedley L.J’s suggestion and reaffirmed the orthodox view in common law that reinsurance contract is further insurance on the original subject matter.

Secondly, regarding the interpretation of proportional facultative reinsurance contract, WASA as an exceptional example reaffirms that the back-to-back presumption, although has strong authority supporting, is still not an inflexible rule of law but subject to some limits. The reinsurance terms should not be interpreted co-extensively with the terms in original policy if it is inconsistent with the parties’ intention even if the two contracts contain identical or equivalent wording. The reinsurers are always entitled to rely upon any defence provided in the reinsurance contracts if the reinsurer clearly drafts the reinsurance policy to the contrary or there is no equivalence between two obviously different wording. From the reinsured’s point of view, in order to make the reinsurance cover having the same meaning as the direct insurance therefore provide identical cover, the reinsured at least need to draft the full reinsurance clause clearly to that exact intention.

Thirdly, both CA and HL steered clear of the pricket presumption of back-to-back, but focused on the issue of construction of the reinsurance contract as whole. The court searched for clues in parties’ intention at time of conclusion, to decide whether they should grant the same interpretation of the two policy terms subject to different applicable laws, rather than simply decided whether the two contracts should be presumed back-to-back. Although the result in WASA is considered inconsistent with the commercial purposes of proportional facultative reinsurance, it is clearly showed that construction is the key to resolve the problem.
Fourthly, it is suggested that their Lordship’s reasoning why WASA was distinguished from the Vesta and Groupama is neither convincing nor commercially reasonable; furthermore, to some extent, lessens commercial certainty in proportional facultative reinsurance market. It is hardly correct to say that WASA established a rule that an identifiable applicable law should be ascertained in direct insurance contract for reinsurance cover to be presumed back-to-back. It was just a decision on particular facts of WASA. However, their Lordships recognised that their decision was inconsistent with commercial purposes of proportional facultative reinsurance contract. They proposed the parties some approaches to avoid such uncommercial result, i.e. by making both insurance and reinsurance contracts governed by the same applicable law,\(^{80}\) or concluding the reinsurance contract as a liability cover etc. However, it might become impossible or unpractical to reconcile two policies subject to same governing law or where multiple assured located in different jurisdictions leaving the direct insurer exposed to uncertain underlying applicable laws. Particular difficulties may arise from similar facts in WASA where direct insurance covering US-wide risks contains a US Service of Suit clause rather than express choice of law. Therefore, although the final decision in HL was welcomed by the English reinsurance market, it was still worried that such commercial uncertainty would make the English proportional facultative reinsurance market less attractive. However, as WASA reflects, after all it is construction of terms, the magic bean, which matters in deciding the scope of the reinsurance cover. The clearer the parties draft the terms of their contracts to reflect their intention, the easier will they win the battle once disputes arise.

1.3 Treaty reinsurance

1.3.1 What is treaty reinsurance?

As the word “treaty” implies, treaty insurance is an agreement under which the reinsured cedes to the reinsurer a part or all of risks of a certain type or types falling within its scope, and in return the reinsured pays the reinsurer a sum of premium

agreed in advance. In contrast to the facultative placement of individual risks, treaty reinsurance protects the ceding primary insurer against a number of losses under a book of business.\textsuperscript{81} The two methods of reinsurance can be linked to “wholesale” versus “retail”. \textsuperscript{82} Treaty reinsurance is in essence a pre-arranged framework for future cessions of risks. Before placing the treaty, risks which may fall within the scope of the potential treaty are reviewed in detail by the reinsurer taking every specific aspect of the cedant into consideration, such as the general background, historic underwriting record, expertise on claim control etc. The general terms as to the mode of treaty, scope of coverage, limits and exclusions, calculating of premium, reinsurance and profit commissions, statement of account, bordereaux submitting, currency and exchange rate etc. are negotiated and concluded in advance. Thus, future cessions will be made under the framework efficiently during the continuing cover period.

1.3.2 Methods of placing reinsurance treaties

Normally, methods of placing reinsurance treaties can be categorised into three classes: obligatory treaty, non-obligatory treaty, and facultative obligatory treaty. All of them possess the common characters of treaty reinsurance, whereas each has its own specific nature. This matters as it will affect the applicability of doctrine of utmost good faith to the treaty which will be discussed in later chapter.

1.3.2.1 Obligatory treaty

As the predominating method of placing treaty reinsurance, obligatory treaty has a distinctive feature that all the risks falling within the scope of the cover, no matter that the risk is profitable or inclined to incur losses, are automatically ceded to the reinsurer. Neither party has discretion as to the cession, i.e. the reinsurer is bound to accept the risks and the reinsured is obliged to cede risks no matter it is beneficial for him to reserve or not. Although risks are automatically attached, the reinsured is normally obligated to inform the reinsurer his cession of risks by means of regular...

\textsuperscript{81} Dating back to earlier days of development of reinsurance enterprise, facultative reinsurance predominated in the domain of reinsurance. However, it has declined due to its high administrative costs and inconvenience because each risk is considered individually in a case-by-case transaction. Treaty reinsurance has gradually taken over and make up the deficiencies of facultative reinsurance, then has replaced facultative reinsurance as the dominating method of placing reinsurance contracts.

\textsuperscript{82} George J. Biehl, “Reinsurance : a petri dish for disputes”, The RHA review volume 9, (4\textsuperscript{th} Quarter 2002), p.1.
‘bordereaux’ as for information purposes. However, these documents do nothing with the effect of cessions. Failure of declaration will not vitiate the automatic attachment of risks, even if notification is not made until after the loss has occurred.

Obligatory treaty is in essence a pre-arranged framework facility under which contracts of insurance are automatically concluded without individual presentations. Each declaration makes a contract of insurance. As the reinsurer is automatically bound to accept the risks which the reinsured is exposed to, the very nature of obligatory treaty makes it controversial that whether the obligatory treaty is a contract for reinsurance or a contract of reinsurance.

1.3.2.2 Non-obligatory treaties

Treaty reinsurance can be placed by a non-obligatory method. Non-obligatory declaration policy is in essence an agreed framework facility under which insurance covers are provided by subsequent declarations. Such a treaty serves to establish a mechanism for the presentation of proposals by the reinsured and acceptance of risks by the reinsurer. Under non-obligatory treaty, all risks are presented and accepted on a mutual facultative basis. The reinsurer is not bound to accept every declaration the reinsured make but has discretion in accepting or refusing the cessions. Equally, the reinsured also has the option of ceding the risk or retaining it. Once the reinsured has decided to cede the risk, there is a duty of notification on the reinsured. Such declaration of risks serves different purpose from the informational one in obligatory treaty. The declaration fulfills the function as an offer of the reinsured to present the risk. Once the declaration is accepted by the reinsurer, a contract of insurance is created.

As a result, such non-obligatory treaty is entirely a mechanism under which contracts of insurance are concluded. It does not operate as insurance cover by itself but a contract for insurance in nature.

1.3.2.3 Facultative obligatory treaty

88 In Glencore International AG v Ryan, the Beursgracht (No 1) [2002] 1 Lloyd's Rep. 574, Tuckey J states: “The declaration, however, is an essential part of the contractual machinery since it informs the underwriter of what risks have attached to the cover and enables him to calculate as necessary and collect the premium due.”
Facultative obligatory treaty\(^90\) is a hybrid of facultative reinsurance and obligatory treaty under which the reinsurer is obliged to accept all the risks which the reinsured selects to cede. It confers the reinsured an option whether to utilize the facility or not. By contrast, the reinsurer does not have discretion to refuse the reinsured’s subsequent declarations of risks which fall within the terms of treaty. Once the reinsured makes a decision to cede the risks to the reinsurer, he is imposed an obligation to notify the reinsurer what have been ceded by means of regular bordereaux. A declaration is so fatal to the cover that the risk will not attach until such requirement of notification is satisfied. Also it is settled law that the reinsured are not allowed to make a declaration after he has become aware of a loss.\(^91\) It is the opinion of the Court of Appeal in *Citadel Insurance Co. v. Atlantic Union Insurance Co. S.A.*\(^92\) that a fac/oblig treaty is no more than a standing offer. A facultative obligatory treaty does not provide insurance cover to any risks on its own. Individual contract of insurance is created by the subsequent declaration under the facility. As a result, it is a contract for insurance in nature rather than a contract of insurance.

From the reinsured’s point of view, the fac/oblig treaty arrangement acquire benefits in two aspects. First is that the reinsured can not only have a pre-arranged programme providing cover for a specific accumulated risk from a particular loss for certain duration,\(^93\) which saves him from individual presentations, but also have the option to cede the risk or not like in a facultative contract. Secondly, the reinsured can benefit from a profit commission and ceding commissions which is higher than that if the risk is placed individually on facultative basis. As to the reinsurer, the fac/obligate treaty can bring business convenience to accept large numbers of risks potentially falling within the scope of the treaty, and also reduce the underwriting expenses. However, it is potentially disadvantageous for the reinsurer that it involves a risk of anti-selection. Once a fac/oblig treaty is concluded separately from an underlying or associated obligatory treaty applicable to the cedant’s entire portfolio risks,\(^94\) the reinsurer neither has any information or supervisory control over the cession under the fac/oblig treaty, nor has any discretion in respect of acceptance of

\(^90\) It will be abbreviated as fac/oblig in what follows.
\(^94\) Barlow Lyde & Gilbert’s, Reinsurance Practice and the Law, LLP, 2004.
the ceded risks, it may adversely impact the reinsurer when the reinsured cedes the risks which are selected as having a higher chance of loss contemplated by the applicable insurance rate, namely the bad non-profitable risks. As a result, such method of placing reinsurance is only appropriate when there is trust between the treaty parties and the reinsured is able to act in good faith or the cedant retains a proper proportion of the underlying risks for its own net account in an associated obligatory treaty. In practice it is often utilised in the circumstances that the reinsurer has already subscribed to a quota share or surplus treaty with the cedant’s but is willing to provide the cedant with additional automatic capacity on certain selected risks when the treaty is exhausted.

1.3.3. Types of treaty reinsurance

One of the most significant parts in the treaty mechanism is about how the cession of risks is defined under individual declarations. This determines the form of the treaty and the specific feature of the parties' duties and obligations. Various types of cessions under treaty mechanisms have been developed to meet the need of reinsurance commercial practice. Those forms can be divided into two classes, proportional and non-proportional. That is to say the most outstanding distinctive feature between the proportional and non-proportional reinsurance is how the cession of risks is defined under the treaty framework. It suffices to say that the proportional reinsurance contract is risk-based whereas the non-proportional reinsurance is loss-based. Under proportional treaty, a post-transfer relationship is maintained by the parties and all the subscribers of the risks are required to assess all the risks and use the risks to prorate the proportion of premiums, expenses and losses. Under non-proportional treaty, cession of risks is based on loss retention. The reinsured agrees to accept all losses up to a pre-determined level, and get reimbursed by the reinsurer for the losses above the predetermined level up to a limit.

95 Phoenix General Insurance Company of Greece SA v. Halvanon Insurance Co Ltd [1985] 2 Lloyd's Rep 599 (QB Com Ct). It was accepted by counsel for both parties and by the judge that the reinsured under a facultative obligatory agreement was under an implied duty to exercise appropriate care and skill in the conduct of the business. This general obligation encompassed specific duties, inter alia, to keep full records of risks accepted and claims made; to investigate the risks offered prior to acceptance as well as any claims subsequently arising on those risks; to keep accurate accounts; to make collections and payments promptly and to retain all records and make them reasonably available to reinsurers for inspection. In Bonner v. Cox Delicated Corporate Member Ltd [2005] EWCA Civ 1512, Although Phoenix v. Halvanon probably remains good law so far as facultative obligatory (or other proportional) contracts are concerned, it should be noted that the Court of Appeal has held that a reinsured owes no such implied duty of care to a reinsurer in excess of loss business

provided for in the treaty.99

1.3.3.1 Proportional treaty

Proportional treaty is a reinsurance agreement under which the cedant transfers to a fixed proportion of each individual risks within the limits in direct ratio to the premium paid to the reinsurer. The most distinguishing feature of proportional treaty is that the share of risks and premium between the cedant and reinsurer is on a pro rata basis. The underlying insurer agrees to cede the proportion of all the inward portfolio within the treaty limits, and also the reinsurer agrees to accept the share and collect the same portion of inward premium in return subject to some deduction. Absolute majority of proportional treaties are obligatory mechanism in nature. Therefore, once the treaty is agreed, the risks are automatic attached when they fall within the scope of treaty. The underlying insurer is obliged to cede and the reinsurer is bound to accept all risks with neither party having the discretion in the matter.

The primary function of such a treaty is to increase the reinsured’s underwriting capacity. By ceding a large portion of underlying risks, the insurer can accept high value risks which cannot be underwritten without reinsurance protection. Moreover, the primary insurer can reduce the exposure to catastrophic events by spreading risks with other insurers under such exchanging participations in other insurers’ business.

Quota share treaty and surplus treaty are two commonest forms of proportional treaty. Different from the fixed percentage stipulated in a quota share treaty, under a surplus treaty only the liability above the cedant’s retention on a particular risk within the limits of treaty is ceded to the reinsurer as a multiple of the sum retained by the cedant.

The most distinguished feature of a quota share treaty is that like proportional facultative reinsurance construed on a back-to-back basis, the reinsured and the


100 It is a common practice for reinsurers to set a limit of the amount which they will pay with regard to each risk ceded protecting reinsurers from exposure to unacceptable large risks. See, Barlow Lyde & Gilbert’s, Reinsurance Practice and the Law, LLP, 2004. The limits of the treaty can be in relation to the type of risk, the amount of risk, the area for which the risk is provided, for example, only certain countries).
reinsurer share the risk and premium on identical terms and conditions. Such principle is applied in Allianz Via Assurance & Others v. Merchant & Other where the reinsurer were entitled to avoid the contract because the broker had made a misrepresentation of the nature of the reinsurance arrangements by use of the word “quota share”. The judge held that the words “quota share” indicated that a fixed proportion of all risks which fell within the treaty would be ceded in return for the same proportion of original premium. When the broker used “quota share”, he had indicated that the reinsurer and the Lloyd’s syndicates would share the risks and premiums in the same agreed proportion.

With a fixed proportional share in every risk and premium agreed in advance, administrative simplicity is the most advantageous quality of quota share treaties. The reinsured need not devote any more effort to arrange reinsurance cover or negotiate the premium and claims. Therefore, such simple treaty is suitable for small scale insurance company or providing underwriting capacity for a large book of small premium business, or arrangements for simple exchange of participation in each other’s national business. However, as the percentage of every risk within the cover is fixed in advance, neither party has the power to increase or reduce the retention or amount ceded when particular risks are unprofitable or fruitful. In contrast to quota share treaty which stipulates a fixed percentage share on every risk throughout the portfolios, the surplus treaty is much flexible for the reinsured. The cedant is permitted to decide the monetary sum of his retention up to the line on each risk. For a particularly poor risk within the categories covered, the cedant may chose to retain a sum less than the line. Such flexibility in picking out small and profitable risk benefits the reinsured more than the quota share treaty does, although the administrative cost is higher. Although it may be unappealing for the reinsurer in this point, the surplus treaty is a properly comprehensive mechanism under which various categories of insurance business having different loss ratio can be

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101 It is with the exception of profit commissions and reinsurance overrides.
102 (1997) 2 IRLN 61.
103 Barlow Lyde & Gilbert’s, Reinsurance Practice and the Law, LLP, 2004.
105 Therefore, a quota share treaty is frequently used combined with other forms of treaties on the reinsurance market. Such as quota share/ surplus, quota share/ excess of loss and excess of loss/quota share treaty.
106 Such monetary sum of the cedant’s retention varies in individual cessions under the treaty. It depends on the size and nature of each risk.
1.3.3.2 **Non-proportional treaty**

Non-proportional treaty is a mechanism by which the reinsurer assumes liability for the amount, up to an agreed maximum limit, of a loss or aggregated losses from one event or series of events in the portfolio above the cedant’s retention in return for an agreed premium. Under a non-proportional treaty, only the fact that the amount of all losses in the portfolio exceeds the excess point agreed in advance will trigger the reinsurer’s liability. The parties in a non-proportional treaty do not share the risks proportionately but share the potential claims by layers.\(^{110}\) What the reinsurer really cares about is not individual attachment of risk to the treaty because he does not have a proportional interest in each original risk. He concerns about the loss frequency and severity across a certain class or group of risks\(^ {111}\) during the treaty period as he is not interested in any loss until the excess point is reached. Therefore, there is not presumption of back-to-back in non-proportional treaty.\(^ {112}\) Due to such loss based nature, administration of non-proportional treaty is cheaper and easier compared to the risk based proportional treaty. The main function of non-proportional treaty is to protect the reinsured against large catastrophic loss or substantial aggregate losses from a particular event or occurrence.

Excess of loss treaty and aggregate stop loss treaty are two commonest forms in placing non-proportional treaty. Excess of loss treaty can be subdivided into two types by the basis on which the losses are calculated, i.e. excess of loss treaty per risk basis\(^ {115}\) and excess of loss treaty per occurrence or event basis.\(^ {116}\) The ceding company may risk exposure to “attritional losses” within its retention. In such circumstance, an aggregate stop loss treaty can supply a higher level protection to fill the gap, where a reinsured is unable to aggregate such losses on a particular event or occurrence, excess of loss treaty can not avail the reinsured. Aggregated

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110 Barlow Lyde & Gillbert’s, Reinsurance Practice and the Law, LLP, 2004.
111 In Axa Reinsurance v. Field, the reinsured under an excess of loss treaty unsuccessfully argued that aggregation clauses which were differently worded in the insurance and in the reinsurance should be construed back-to-back so as to allow the reinsured to recover on the same basis that it had paid out.
112 Such simple mode can be used to protect direct insurer against working cover in a particular location, fire cover, marine cargo cover, third party cover in motor insurance, and medical cover during a certain period for a single person etc. small size claims in liability insurance in general.
115 Such comprehensive cover is desirable when the reinsured risks a considerable number of exposure units in a catastrophic event.
stop loss treaty can be subdivided into two main forms\textsuperscript{117}, namely aggregate excess of loss and excess of loss ratio, depending on how the excess point is defined.

\textsuperscript{117} Sometimes there is also an amalgamation of the two. One often finds hybrid stop loss policies being effected in which the ratio and specific sums are both included, with the reinsurance cover provided expressed to be a maximum of one or the other. Where the amounts at stake are large, a combination of the various forms of reinsurance may be used. In particular there may be a number of different excess layers of reinsurance.
Chapter 2 Utmost Good Faith—the Doctrine in Evolution

2.1 Introduction

In Carter v Boehm,\(^{120}\) the Lord Chief Justice Mansfield expressed his view on principle of good faith which in his opinion should apply to “all contracts and dealings”.\(^{121}\) His judgment in Carter v Boehm becomes the headspring of various and distinct submissions, arguments, pleadings and decisions which have aimed to apply the principle, extend or reduce the ambit of the duty of good faith. Hundreds of years passing by, the principle of misrepresentation has remained\(^{122}\) and universally applies to all contracts in English law, whereas the duty of non-disclosure does not survive in all types of contracts.\(^{123}\) Nowadays the English contract law cannot police the fairness of every commercial contract by reference to moral principles or undertake the reopening of commercial transactions in order to adjust any injustice with hindsight. Neither does the law require the parties of a commercial transaction to volunteer information positively to each other as a general duty no matter how relevant the information is to conclude the deal on whatever terms.\(^{124}\)

However, in contrast to general rules applying to ordinary commercial contracts, there exists a doctrine of utmost good faith in contracts which can be categorised as *uberrimae fidei* partially or as a whole, with contract of insurance established as a classic example. Although the origin of the doctrine can trace back to hundreds years ago, it still remains difficult to define such emotional and moral duty in a legal sense. Since Lord Mansfield’s judgment in *Cater v Boehm* is codified by *MIA 1906*, the courts have taken many opportunities to structure the doctrine, establish rules of the two-limb test and set up regime of remedies for qualifying breach. Under current English law, the duty of utmost good faith requires both parties to exercise their best effort and endeavor to help each other to make an informed decision and perform

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\(^{120}\) (1766) 3 Burr 1905, 1910.

\(^{121}\) Ibid. He identified two basic aspects of the principle that a party of a contract should not induce the other party into commercial transactions by making false representations or concealing information which may be relevant to decide whether to enter the contract or not and on what terms.

\(^{122}\) The law will assist the party who is induced into a contract by the other’s misrepresentation. Such contract may be voidable, i.e. be set aside retrospectively, restoring the deceived or misled party to the position where they are at the beginning of the negotiation.

\(^{123}\) English contract law introduces an adversarial model in contractual negotiations that parties should enter the contract and stipulate their rights and duties on a completely free basis, behave and take responsibility for each own interests. The principle of caveat emptor reflects the universal legal spirit in contract law.

\(^{124}\) Banque Financiere de la Cite v Westgate Insurance Co Ltd (sub nom Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd [1989] 2 All ER 953, 1013 per Slade, LJ.
the contract concluded thereon without any dishonesty or deceit. The two commonest aspects in Lord Mansfield’s judgment, i.e. duty not to make misrepresentation nor concealment of information is reaffirmed as the most important but not inclusive elements of the doctrine, requiring both parties mutually and positively volunteer information and passively refrain from misrepresentation. Specificities of duty of utmost good faith at pre-contractual stage will be described briefly. Moreover, breach of such draconian duties brings in harsh result which affords the innocent party an option to retrospectively avoid the contract without any other remedy, like damages. Such complex doctrine, especially the harsh regime of remedy received much criticism all the time. After abolished in consumer insurance context, the legislation currently governing operation of the doctrine in reinsurance context, which can be regarded as a typical type of non-consumer insurance, is to be reformed by Insurance Act 2015. Once the act comes into effect the duty of utmost good faith in reinsurance context will shrink into a duty of fair presentation the details and ambit of that will be discussed in the following chapter. Furthermore, there recently emerges a trend to extend the duty to post-contractual stage. But it is controversial and arguable whether there is a continuing duty of utmost good faith during performance of the contract. So applicability of the duty at the post-contract stage remains to be defined and scrutinised.

2.2 The doctrine of utmost good faith at the pre-contractual stage

2.2.1 Source of the doctrine of utmost good faith

Since the 1906 Act partially codifies the common law, the duty of utmost good faith has a statutory source. However, the origin of the doctrine is arguable all the time. The origin of the doctrine is of significance to reveal its nature and application in practice, particularly the remedy available for qualified breach of the duty.

From the long abandoned ‘actual fraud’ or ‘willful intention to deceive’ analysis in early cases, to “the implied contingent condition of the contract” analysis adopted

128 See MacDowell v Fraser (1779) 1 Dougl. 260; Fillis v Brutton (1782) 1 Park, Ins. 414; Fitzherbert v Mather (1785) 1 T.R. 12; Feise v Parkinson (1812) 4 Taunt. 640; Dennistoun v Lillie (1821) 3 Bligh 202; per Lord Abinger in Cornfoot v Fowke (1840) 6 M. & W. at 378. per Willes J.: “There is no doubt that a material (mis-)representation, though perfectly honest at the time, made with the intent that it should be acted on by the insurer, and which has led to the policy being granted, will defeat the policy.” Anderson v Pacific Fire and Mar Ins Co (1872) L.T. 7 C.P. 65 at 68. See the dicta of Lord Mansfield in Pawson v Watson (1778) 2 Cowp. 785; Bize v
in Blackburn v Vigors, in which the Court of Appeal adopted an equity origin of the duty of utmost good faith rather than the contractual origin, this controversial issue is finally arguably determined by the House of Lords in the Star Sea. It is endorsed that the duty of utmost good faith derives from a separate rule of law before a contract comes into existing. There are no general duties under common law imposed on the parties engaging in commerce to volunteer information. Therefore, there is no liability for non-feasance or inaction, requiring parities to look after their own interests in an adversarial mode. However parties are at their liberty to imposes such a duty by expressly or impliedly agreed terms of contract, but breach of such duty entitles the innocent party only contractual remedies.

There are some types of contract uberrimae fidei constituting an exception to the general rules under common law. Those contracts are based upon a doctrine of utmost good faith, requiring each party to open their mind positively and pay close attention to the other’s interests to the furthest extent. In the notable insurance case Carter v Boehm, Lord Mansfield said that: “The governing principle is applicable to all contracts and dealings. Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.” Although Carter v. Boehm was not the first case trying to define a duty of good faith, neither did it succeed in introducing a doctrine of good faith into general common law; it is still considered as the foundation of the notion of utmost good faith in insurance context despite in obiter dicta.

Since the Marine Insurance Act 1906, the doctrine of utmost good faith governing insurance context finally has a statutory footing. However, the current common law

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Footnotes:

132 Fletcher (1779) 1 Doug. 12 n; the dictum of Lord Tenterden in Flinn v Tobin (1829) Moody & Malk. 367. Current doctrine established an absolute duty to disclose material facts and avoid misrepresentation so the parties’ state of mind is irrelevant. Therefore, the ‘actual fraud’ or ‘willful intention to deceive’ analysis is only of historical relevance now.
133 (1886) 17 Q.B.D. 533, 562, 583; 12 App. Cas. 539; 1 Phillips, Ins., s.537.
134 (1766) 3 Burr 1905, 1910.
135 Ibid.
136 The statutory source of notion of utmost good faith is ss.17-20 under the part heading ‘disclosure and representations’ in Marine Insurance Act 1906.
decisions and insurance market practice have clearly shown that the legislation governing the insurance contract area is in many aspects outdated, uncommercial and divorced from realities of 21st century business practice. Insurance law reform has been on the agenda in the UK for over 50 years.\textsuperscript{137} Since 2006 the Law Commission of England and Wales and the Scottish Law Commission have started a joint project to reform the insurance law by publishing a series of issues papers, consultation papers and reports. The reform programme has been divided into two parts in relation to consumer insurance and business insurance. The \textit{Consumer Insurance (Disclosure and Representation) Act 2012} was born first and then abolished applicability of the doctrine of utmost good faith in consumer insurance area.\textsuperscript{138} In July 2014, a new draft bill in non-consumer insurance context has been published,\textsuperscript{139} and becomes a parliament law, i.e. Insurance Act 2015. Accordingly, the doctrine of utmost good faith is recast into a new regime, and modern principles for pre-contract presentation are adopted,\textsuperscript{140} but in non-consumer insurance context only, and then has a new legal root.\textsuperscript{141}

\subsection*{2.2.2 Framework of the doctrine of utmost good faith}

\subsubsection*{2.2.2.1 Statutory principles codified in \textit{Marine Insurance Act 1906}}

\textit{MIA 1906} partially codified the current doctrine of utmost good faith by ss.17-20. S.17 presents a general enunciation of the duty, with following s.s 18-20 providing particular details, content and scope of the duty of disclosure and avoiding misrepresentation which are two most significant but non-exhaustive manifestations of the notion, i.e. duty of disclosure on the assured in s.18, duty of disclosure on the broker in s 19 and duty not make misrepresentation in s 20. In practice, s.18 often subsumes s.20 as misrepresentation can often be treated as non-disclosure of true information. It seems a usual practice of the insurer to plead both defenses if possible. s. 17, though attracting less attention in common law than ss.18-20 which

\begin{footnotesize}
\textsuperscript{137} Rob Merkin and Ozlem Gurses, the insurance act 2015: rebalancing the interests of insurer and assured, unpublished yet.
\textsuperscript{138} The duty of disclosure was replaced by a duty of the insured to take reasonable care to avoid misrepresentation. Therefore the insured needs not to volunteer any information but leaving the insurer to ask questions.
\textsuperscript{139} Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment Law Commission Report Nos 353 (England) and 238 (Scotland): Cm 8898.
\textsuperscript{140} Rob Merkin and Ozlem Gurses, The insurance act 2015: rebalancing the interests of insurer and assured, unpublished yet.
\textsuperscript{141} Insurance Act 2015, part 2, part 5 and Schedule 1.
\end{footnotesize}
define detailed pre-formation duty, is recognised as presenting an overriding duty of utmost good faith which umbrellas following sections.\textsuperscript{142} Therefore, s.17 can play a supplementary role where there is a genuine bad faith not falling accurately within the scope of ss.18-20. However section 17 is silent on its application in post-contractual stage, which makes the post-contractual duty a controversial issue.

The rationale behind the duty of disclosure is that the assured is normally in a much better position than the underwriters to possess considerable information about the insured subject-matter. In order to balance the informational asymmetry so that the insurer can make informed underwriting decisions on whether to accept the risk and on what terms if risk is accepted, the assured and his broker are required, separately by s.s18 and 19, to volunteer all material information about the risk presented for insurance. According to s.18 (1), such disclosure of information is not only relevance of the assured’s actual knowledge, but also extends to those facts deemed known by the assured in his ordinary course of business. The assured is only required to disclose material information before the contract is concluded under s.18(2).

As to duty not to make misrepresentation, actually it is not a special rule applicable to insurance context only, even not to general contractual law context only. Section 20 of \textit{the MIA 1906} requires that the proposer should not only make substantially correct representations of existing and past material facts, but also true statement of his belief and expectation before the contract is concluded.

\textbf{2.2.2.2 The duty of fair presentation under the Insurance Act 2015}

After governing the insurance contact area for longer than 100 years, the 1906 Act has been pleaded unable to reflect the commercial realities of the practice any more. The Law Commission, that has been working on reforming the law in this area over eight years, identified several problems with the current doctrine, including that the legislation of the duty of disclosure is not explanatory and poorly understood; the stakeholders, particularly large companies, feel difficult to know how to comply with the duty; the current doctrine encourages data dumping by business in the disclosure process and it also encourages underwriting assessment made at claims

\textsuperscript{142} The CTI case is the first modern authority which attaches s.17. Kerr L.J. referred to the duty of disclosure, as defined or circumscribed by s.s 18 and 19, as “one aspect of the overriding duty of the utmost good faith mentioned in section 17”.


stage etc. Then a number of important practical difficulties has been identified due to specific feature of the MIA 1906. First, the current materiality test appears on its face to require the assured to predict what a prudent insurer might find interest to know. Secondly, the current remedies regime appears too harsh being frequently disproportionate to the degree of the breach. Thirdly, difficulties exist in operation of the separate duty of disclosure imposed on the agent to insure. Fourthly, there is no clear statement of exactly requisite knowledge possessed by both parties. Consequently, the law commissions make significant changes to current positions in non-consumer insurance contracts, by proposing a duty of fair presentation to recast the duty of utmost good faith and introducing a new regime of remedies based upon the recent development in modern common law authorities, but re-enacting other parts of the current positions.

According to Part 2 of the Insurance Act 2015, a new duty named ‘the duty of fair presentation’ is introduced to replace the current two elements of the duty of utmost good faith codified in ss.18 to 20 of the MIA 1906, but in non-consumer insurance context only. Significant changes have been made to the duty of disclosure, while the duty not to make misrepresentation is more or less untouched. Accordingly, the Act repeats the earlier principle in s.7 (5) so that every material representation as to a matter of expectation or belief must be made in good faith and every material representation as to a matter of fact must be substantially correct and material representation is substantially correct if a prudent insurer would not consider the difference between what is represented and what is actually correct to be material. Consequently, according to s.21 (2), the ss.18 to 20 of the MIA 1906 are repealed. In addition, to replace the current harsh remedies stipulated in s.17 of the MIA 1906, s. 8 of part 2 of the Insurance Act 2015 introduces a new regime of proportionate remedies for qualifying breach based on what the insurer would have made if all the true information had been revealed by a fair presentation of the

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144 Rob Merkin and Ozlem Gurses, The Insurance Act 2015: Rebalancing the interests of insurer and assured, not published yet.
145 S. 2 to s. 8 in Part 2 The duty of fair presentation in Insurance Act 2015.
146 S.3, part 2 The duty of fair presentation in Insurance Act 2015.
147 Rob Merkin and Ozlem Gurses, The Insurance Act 2015: Rebalancing the interests of insurer and assured, not published yet.
149 Insurance is uberrimæ fidei. A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.
This new regime of remedies is proposed in Schedule 1 of the Act. However, as stipulated in s. 2(1) of the Act, this also applies to non-consumer insurance contracts only.

According to the s. 14 in Part 5 of the Act 2015 states, s.17 of the MIA 1906 is reformed by removing the remedy of avoidance for qualifying breaches of the duty, so in s. 17 of the MIA 1906, the words from “, and” to the end are omitted. In fact, in the MIA 1906, the broad wording of s.17 introduces an overriding mutually and only mutually duty of utmost good faith. Moreover it goes further beyond than the following ss.18-20, which illustrates circumscribes and defines the detailed duties, by providing consequence of qualified breach. Fulfillment of requirements of disclosing material information and avoiding misrepresentation is only two non-exhaustive aspects of the general principle in s.17. The assured is also required to provide any information fairly which is considered interesting or relevant by the insurer and draw the insurer’s attention to any mistaken information during the contractual negotiation. Meanwhile, the insurer is required to observe the duty and exercise his right to avoid the contract fairly rather than using avoidance of contract a means to escape from liabilities. Therefore, under s.17, the insurer is also required to disclose all material circumstances to the assured and not to make any material misrepresentation. Such disclosure is not limited to all facts about the nature of the risk sought to be

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150 S. 8 Remedies for breach
(1) The insurer has a remedy against the insured for a breach of the duty of fair presentation only if the insurer shows that, but for the breach, the insurer—
   (a) would not have entered into the contract of insurance at all, or
   (b) would have done so only on different terms.
(2) The remedies are set out in Schedule 1.
(3) A breach for which the insurer has a remedy against the insured is referred to in this Act as a “qualifying breach”.
(4) A qualifying breach is either—
   (a) deliberate or reckless, or
   (b) neither deliberate nor reckless.
(5) A qualifying breach is deliberate or reckless if the insured—
   (a) knew that it was in breach of the duty of fair presentation, or
   (b) did not care whether or not it was in breach of that duty.
(6) It is for the insurer to show that a qualifying breach was deliberate or reckless.

151 Insurance Act 2015, Schedule 1 Part 1 General section 1: This Part of this Schedule applies to qualifying breaches of the duty of fair presentation in relation to non-consumer insurance contracts (for variations to them, see Part 2).

152 Part 5 Good Faith and Contracting Out, section 14 Good faith
(3) Accordingly—(a) in section 17 of the Marine Insurance Act 1906 (marine insurance contracts are contracts of the utmost good faith), the words from “, and” to the end are omitted. So the section 17 in MIA 1906 will be that ‘A contract of marine insurance is a contract based upon the utmost good faith.’

153 Although the duties imposed by the doctrine of utmost good faith are in most cases owed by the assured to the insurer, s.17 in MIA 1906 clearly states that doctrine of utmost good faith is bilateral. It illustrates the reciprocal nature of the duty so that the insurer and the assured owe the duty to observe good faith to each other mutually.

covered by the policy, but also extends to any material information relating to the recoverability of a claim which a prudent assured would like to consider when making a decision whether or not to place the risk. If the insurer has realised that any information is misunderstood by the assured, he is obliged to disclose it to the assured as well. However by the variation made by the Insurance Act 2015, this bilateral duty is replaced by a duty of fair presentation placed only on the insured.\textsuperscript{155} Therefore there is no duty like fair presentation on the insurer anymore which used to be almost only relevance of theoretical level, as there are few circumstances where the assured would plead insurer’s breach of duty in practice.\textsuperscript{156}

Moreover, the duty of disclosure has been changed significantly by the duty of fair presentation. According to s.7 (3), the test of materiality remains untouched by the Act 2015. But the level of strictness of the current absolute duty has been reduced by introducing a notion of fairness. Consequently the insured is still required to disclose to the insurer ‘every material circumstances which the insured knows or ought to know’ that would ‘influence the judgment of a prudent insurer’ in assessing the risks. However, a disclosure in a reasonably clear and accessible manner will be enough to fulfill the requirement,\textsuperscript{157} as the insurer is encouraged to play a more active role in the negotiation process to make the material information disclosed. In a word, in contrast to the current strict duty of disclosure, the insured will still be able to discharge the duty of fair presentation, if the disclosure gives the insurer sufficient information to put a prudent insurer on notice that it need to make further enquiries to reveal material circumstances stipulated in s.3. and its supplementary explanation under s. 7.

To explain the knowledge of the insured and of the insurer, ss. 4 to 6 make further provisions and set out detailed rules concerning attribution of knowledge, particularly to non-natural persons such as insurance companies.\textsuperscript{158} Those sections can be said

\textsuperscript{155} Part 5 Good faith and contracting out, section 14 (1) Any rule of law permitting a party to a contract of insurance to avoid the contract on the ground that the utmost good faith has not been observed by the other party is abolished.

\textsuperscript{156} In fact, avoidance of policy ab. initio, which is the only available remedy for breach of duty, hardly affords the assured benefit since the loss or damage has already caused to the insured subject-matter. It is always the case that the assured would prefer to recover the loss from the insurance protection rather than avoid the policy and get premium paid back.

\textsuperscript{157} It is argued that this will discourage “data dumping”, bombarding the insurer with vast swathes of material whether relevant or not. What should policyholders know about the UK Insurance Act 2015? http://www.strategic-risk-global.com/what-should-policyholders-know-about-the-uk-insurance-act-2015/1411886.article

\textsuperscript{158} An insurer will be presumed to know things that are common knowledge or that an insurer offering insurance
to embody most obvious changes to current positions of legislation.\textsuperscript{159} Apparently different from current position in law, the insured will also be required to carry out reasonable research for information, as he ought to know such information which is available to him revealed by a reasonable search, no matter by making enquiries or by any other means.\textsuperscript{160} However, the Act 2015 does not continues to define the scope of such reasonable research that should be carried out by the insured, but just assists to explain the information subject to such research in s.4(7).\textsuperscript{161} It can be predicted that such ambiguous scope of the duty will almost certain to be a focus of contradiction before the courts. Especially for a big multinational enterprise entity, that needs large and complex insurance cover not only for itself but also needs to pursue cover for its subsidiaries, associates, directors and officers etc., difficulties will arise in practice as to how far the insured needs to make research to dig material information that might be known by so many relevant agents involved in the business to satisfy the requirement of reasonability.\textsuperscript{162} In addition, the act for the first time provides illustrations of material facts in s.7(4), although there is much complex authority on the classes of fact that are likely to be material, namely: special or unusual facts relating to the risk; any particular concerns which led the assured to seek insurance cover for the risk; and anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question.\textsuperscript{163} As to the insurer’s knowledge, it is relevant to the issue of fair presentation, as the disclosure of material information within the reinsurer’s knowledge is expressly waived by the Act 2015 in s.3 (5). Therefore s. 5 explains the scope of the knowledge of insurer, including the actual knowledge, blind eye knowledge, presumed knowledge and imputed knowledge.

\subsection*{2.2.3 Establishing qualifying breach of the duty}

of the class in question to the insured in the field of activity in question would be expected to know in the ordinary course of business. The knowledge of an insured company will be what is known to its senior management or those responsible for the company’s insurance. http://lawcommission.justice.gov.uk/publications/insurance-contract-law.htm.

\textsuperscript{159} Rob Merkin, Ozlem Gurses, Insurance Act 2015: Rebalancing the interests of insurer and assured, not published yet.

\textsuperscript{160} S.4 (6) of the Insurance Act 2015.

\textsuperscript{161} S.4(7) of the Insurance Act 2015: In subsection (6) “information” includes information held within the insured’s organisation or by any other person (such as the insured’s agent or a person for whom cover is provided by the contract of insurance).

\textsuperscript{162} Rob Merkin, Ozlem Gurses, Insurance Act 2015: Rebalancing the interests of insurer and assured, not published yet.

\textsuperscript{163} Ibid.
Although the duty of utmost good faith is long recognised as a draconian duty and breach of it can bring harsh consequence, namely avoidable ab. initio, the test of breach of duty is not clear and finally settled until House of Lords’ decision in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*. After *Pan Atlantic*, the test of breach comprises two limbs, i.e. an objective test of materiality and subjective requirement of inducement. A policy is only avoidable if both of the two aspect of requirement is satisfied.

### 2.2.3.1 Limb 1: test of materiality

Although the doctrine requires the highest degree of positive good faith, the proposer need not disclose all the information within his knowledge throughout the whole life of policy. As codified in s.18 and s. 20, the duty of disclosure and avoiding misrepresentation is qualified by a delimiting factor, i.e. materiality. That is to say only concealment or misrepresentation of material information may make the policy avoidable. The test of materiality comprises two significant aspects, namely what degree of importance must the circumstances assume in appreciation of the risk, and at what time is the materiality assessed.

#### 2.2.3.1.1 What fact can be considered material?

S.18 (2) and s.20(2) of the MIA 1906 clearly declares a formula that every circumstances is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk. A ‘prudent insurer’ rather than ‘actual insurer’ criteria embodies the objective assessment of risk proposed for insurance, reflecting reasonable underwriting practice. However, the unqualified word ‘influenced’ does not reveal what degree of importance the concealment or misrepresentation needs to assume in the hypothetical prudent underwriter’s mind in order to satisfy the test of materiality. Such test is not settled until comparatively recently by House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*. In *Pan Atlantic*, their Lordships upheld the former CTI case in confirming the rejection of ‘the decisive influence’ test or ‘different decision test’. Moreover, the House went further to conclude that a circumstance is material, if

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it clear denotes an effect on the thought process of the insurer in weighing up the risk. Therefore, in order to satisfy the test of materiality, the insurer just needs to prove that the concealed or misrepresented circumstance is relevant to an appreciation of the risk so that the prudent insurer would like to take it into account. There is no need to prove that different decision would have been concluded if the circumstances were disclosed or accurately represented.

The ‘prudent insurer’ approach under the MIA 1906 receives widespread criticism during the consultation process, as it on its face value requires the insured to know what a prudent insurer is interest to know. Although the Insurance Act 2015 bring significant changes to the duty under the MIA 1906 based on modern common law principles, the test of materiality is retained by the Act 2015. The reasoning of the law commissions is that the overwhelming majority of commercial risks are placed by brokers who are equally cognisant with insurers as to what facts are material, so that the test is unlikely to be damaging in practice. Consequently under the duty of fair presentation, the insured is still obliged to disclose every material matter of fact substantially correct and represent every material matter of expectation or belief within the his actual knowledge and constructive knowledge in good faith in a reasonably clear and accessible way to a prudent insurer.

2.2.3.1.2 When is the materiality assessed?

As codified in s. 18 (1) and s. 20(1), materiality is assessed during the negotiation for the contracts. That is to say the duty of disclosure and duty not to make misrepresentation attaches only in the pre-contractual stage. Any information which comes into the proposer’s knowledge after the contract’s conclusion is irrelevant for assessment of risk therefore not material anymore, so that the two duties terminate operation. This point remains untouched under the Insurance Act 2015.

2.2.3.2 Limb 2: requirement of Inducement

2.2.3.2.1 Establishing an requirement of inducement

166 S.7(3) of the Insurance Act 2015.
168 Part 2, section 3 The duty of fair presentation
(1) Before a contract of insurance is entered into, the insured must make to the insurer a fair presentation of the risk.
Conclusion of an insurance contract may be erased if the duty of utmost good faith is not observed in the negotiation of the contract. However, it would only be fair if there is a causal link between the proposer’s breach and representee’s entrance into the policy. In other words, remedy of avoidance would only be grounded in the case that the material misrepresentation and non-disclosure is relied upon by the actual insurer. It is the very position in general contract law that a subjective ‘inducement’ is required to establish the right of rescission for misrepresentation, notwithstanding there is no duty of disclosure in general contract law. Although there is no mention of such subjective element to qualify the remedy in the MIA 1906, it is confirmed by House of Lords in Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd,169 which reversed CTI v Oceanus on this point, that breach of utmost good faith by material misrepresentation or non-disclosure is only actionable if it actually induces the actual underwriter into conclusion of the contract.170 Therefore, it is a firmly determined matter that actual underwriter’s subjective inducement is a necessary requirement in addition to materiality in order to make a breach of duty actionable, no matter by misrepresentation or non-disclosure. It suffices to say here that the inducement test became the dominant issue in the vast majority of cases.171

The Insurance Act 2015 takes the same attitude as to the inducement test and officially codifies the common law position, so that the subjective inducement test will have a statutory foot, once the Act comes into force.172 Generally, it is the insurer who is burdened the onus to establish not only materiality but also his actual inducement.

2.2.3.2.2. Test of inducement

It is a controversial matter what precise motivating impact on the actual underwriter's

170 [1973] 2 Lloyd’s Rep 442, 550 per Lord Mustill, ‘if the misrepresentation or non-disclosure of a material fact did not in fact induce the contract (in the sense in which that expression is used in the general law of misrepresentation) the underwriter is not entitled to rely on it as a ground for avoiding the contract’. 171 Rob Merkin, and Ozlem Gurses, Insurance Act 2015: Rebalancing the interests of insurer and assured, not published yet, Sea Glory Maritime Co, Swedish Management Co SA v AL Sagr National Insurance Co [2013] EWHC 2116 (Comm); Lewis v Norwich Union Healthcare Ltd [2010] Lloyd’s Rep IR 198; Drake Insurance plc v Provident Insurance plc [2004] 1 Lloyd’s Rep 268.
172 Section 8 Remedies for breach
(1) The insurer has a remedy against the insured for a breach of the duty of fair presentation only if the insurer shows that, but for the breach, the insurer—
(a) would not have entered into the contract of insurance at all, or
(b) would have done so only on different terms.
state of mind the material misstatement or non-disclosure must assume in the negotiation of the policy. Analogous to the test of materiality, there have been two main approaches to define inducement. One is ‘substantial influence test’ that the non-disclosure or misrepresentation should play ‘a real and substantial part, though not by itself a decisive part, in inducing the contract; and the necessary inducement would be present if the representee was motivated or influenced …to any substantial extent’. On the other hand, a comparatively higher threshold, namely ‘a decisive influence’ test, is suggested that the actual underwriter need to show that he would have acted differently, either by refusal to enter the contract or underwriting it on different terms; had the material circumstances been disclosed or represented accurately.

The Court of Appeal has made a significant progress to define inducement in *Drake Insurance Plc v Provident Insurance Plc.* Referring to the insurer’s underwriting evidence of their office practice and underwriting guidelines, the court seems to be entitled to speculate what would have happened between the insurer and assured; and ultimately whether the insurer will enter into the contract on the same premium and on the same terms. It is now considered to be even harder for insurers to discharge the burden of proof of actual inducement by being asked the question whether the insurers would have acted differently had the circumstances been disclosed or stated truly. The alleged low threshold of materiality is balanced by such higher requirement of proof of actual inducement. Apparently the new test under the Act 2015 which only applies to non-consumer insurance contract adopts the higher threshold. To prove a qualifying breach, first of all the insurer needs to prove that he would not have entered into the contract of insurance at all, or would have done so only on different terms.

### 2.2.3.2.3. Proof of inducement

The legal burden of proving subjective inducement rests upon the party who alleges his being induced into conclusion of contract, which is almost invariably the insurer in

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practice.  

2.2.3.2.3.1 Presumption of inducement

Although it is still controversial what exact motivating impact on the innocent party’s state of mind should be fulfilled to satisfy the requirement of inducement, the alleging party should at least prove that there exists a causal link between the misrepresentation or non-disclosure and the formation of a marine insurance contract. But there exists a theoretical presumption of inducement in favour of proving a causative effect. The presumption was first introduced by Lord Mustill in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*,\(^{177}\) and re-affirmed in *St. Paul Fire & Marine Insurance Co UK Ltd v McDowell Constructors Ltd.*\(^{178}\) It is presumed that the withholding or misrepresentation of material information unlikely makes no difference. It is a matter of common sense that satisfactory proof of misrepresentation or non-disclosure of material facts will favour a presumption of inducement at face value.\(^{179}\)

2.2.3.2.3.2 No such legal presumption of inducement

There is no such formal presumption as a rule of law.\(^{180}\) As a result, once the insurer has proved materiality, there is no automatic inference of inducement. Although the more material the concealed or misstated information is, the more likely the insurer will be induced into formation of the contract; the fact that a prudent underwriter would consider a fact relevant to access the risk does not necessarily result in that an actual underwriter would decline such risk or underwrite on different terms if the material information is concealed or misstated.\(^{181}\) Evidence of materiality would only play an indirect and circumstantial role in assisting the alleging party to discharge

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\(^{177}\) [1995] 1 AC 501. In Lord Mustill’s opinion, the absence of any reference of a causal link between misrepresentation or non-disclosure and contractual formation in MIA 1906 is deliberate and reflecting a disciplinary distinction in marine insurance contract law area. The existing rules, coupled with a presumption of inducement are already harsh enough.


\(^{180}\) *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, 570 PER Lord Lloyd.

burden of proof of inducement on a balance of probabilities.\textsuperscript{182} There may be some circumstances where inference of inducement from materiality is reasonable and feasible, for example where the actual underwriter in question cannot give evidence for a good reason and other underwriters have given satisfactory evidence of inducement. However, if there is good reason or the actual underwriter does appear in court to testify, the insurer has to proceed to proof his inducement into contractual formation after proof of materiality.\textsuperscript{183} As the Insurance Act 2015 clearly codifies the test of inducement, there apparently needs a requirement of proof of inducement. So no such legal presumption of inducement is settled in law.

\textbf{2.2.4 Regime of remedies}

\textbf{2.2.4.1 Current regime of remedies under the MIA 1906}

Section 17 of the MIA 1906 declares without uncertainty that the contract may be avoided by the innocent party if the duty is not observed by either party. Moreover, section 18(1) and 20(1) emphasises the right of avoidance again in case of material non-disclosure and misrepresentation. It is a well established principle under common law that the innocent party is entitled to go back to the position where he would have been had the duty been performed. In insurance context, as to the breach occurs before the formation of the policy, the remedy has retrospective effect of avoiding the whole policy ab. initio so as to make the parties back to the position, i.e. before conclusion of the contract. It is a draconian consequence for the assured that he is deprived from all cover whereas the insurer discharges all liability under the policy and any loss paid already is recoverable. However, the wording ‘may be avoided’ in s.17 reveals that avoidance does not happens automatically, neither is a judicial intervention required. The insurer has an election to avoid the contract or confirm it. Moreover, avoidance of the contract is the only available remedy. Damages cannot be claimed if the innocent party chooses to avoid the contract, unless any contractual or tortuous obligations can arise.\textsuperscript{184}

\textbf{2.2.4.2 The new proportionate remedies regime proposed by the Insurance Act}

\\textsuperscript{182} Insurance Corp of the Channel Islands v Royal Hotel Ltd [1998] Lloyd’s Rep IR 151, 158; Assicurazioni Generali SpA v Arab Insurance Group ( BSC) [2002] EWCA Civ 1642, [2003] 1 WLR 577, para 61.62
\textsuperscript{183} Ibid.
\textsuperscript{184} Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd [1990] 1 QB 665.
To replace the harsh remedy stipulated in s.17 of the MIA 1906, the Act 2015 introduces a new regime of proportionate remedies for qualifying breach based on what the insurer would have made if all the true information had been revealed by a fair presentation of the insured in s.8 of part 2 'the duty of fair representation'. And then the Act explains the proportionate regime in details in its Schedule 1. The state of mind of the party when committing the breach of the duty is introduced into the regime as significant criteria which divides the remedies for disclosure failures into two camps: one for dishonest conduct and the other for non-dishonest failures to make a fair presentation of the risk. According to the Paragraph 2 of the Schedule 1, where the qualifying breach is deliberate or reckless, the insurer is entitled to avoid the contract as the current remedy regime, refusing all the claims under the contract and still keep the premium. Besides the remedies for deliberate or reckless breaches, all other breaches fall into the non-dishonest failures to make a fair presentation of the risk and then lead to a proportionate remedy. Paragraphs 4 to 6 set out a new proportionate approach to provide remedies for a qualifying breach which was neither deliberate nor reckless. Accordingly, the new range of proportionate remedies will only apply to non-dishonest behaviours which are neither deliberate nor reckless, depending what the insurer would have done had all the true material facts been fairly presented. If the insurer can show that it would have not entered into the contract at all, he will be entitled to avoid the contract and return the premium. If the insurer can prove that the contract would have been concluded on

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185 Paragraph 2 Deliberate or reckless breaches
If a qualifying breach was deliberate or reckless, the insurer—
(a) may avoid the contract and refuse all claims, and
(b) need not return any of the premiums paid

186 Paragraphs 4 to 6 of the Schedule 1 of the Insurance Business Bill:
4 If, in the absence of the qualifying breach, the insurer would not have entered into the contract on any terms, the insurer may avoid the contract and refuse all claims, but must in that event return the premiums paid.
5 If the insurer would have entered into the contract, but on different terms (other than terms relating to the premium), the contract is to be treated as if it had been entered into on those different terms if the insurer so requires.
6 (1) In addition, if the insurer would have entered into the contract (whether the terms relating to matters other than the premium would have been the same or different), but would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim.
   (2) In sub-paragraph (1), “reduce proportionately” means that the insurer need pay on the claim only X% of what it would otherwise have been under an obligation to pay under the terms of the contract (or, if applicable, under the different terms provided for by virtue of paragraph 5), where—
   Premium actually charged
   $X = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100$
different terms, then such terms can be treated as having been included into the agreements. If the reinsurer can prove that a higher premium would have been charged, and then the amount of claims will be reduced proportionately.

2.2.5 Summary of pre-contractual duty of utmost good faith

Contract of insurance as a contract uberrimae fidei attracts a duty of utmost good faith which burdens both parties to mutually volunteer information and avoid misrepresentation. Breaching of such draconian duty brings harsh consequence, especially for the assured who inevitably takes the prominent burden. Since the duty is codified in the MIA 1906, it takes the court a long time to finally establish the two limb test of breach. The assured is required to disclosure and accurately represent all information that a prudent insurer may feel interested to know in decision making process at the pre-contractual stage. However, it is argued that it is unfair for the assured to disclose what a prudent underwriter would like to know. The court has make efforts to balance the threshold by introducing a subjective element of inducement. In order to prove inducement, the actual underwriter is required to show what would have been done or have not been done, had the assured disclosed the material information, although the final decision is the court’s call based upon pure speculation. Once the actual underwriter in question is actually induced by assured’s material non-disclosure or misrepresentation, it is up to the insurer’s decision whether to avoid the policy.

Nowadays, there emerges more and more voices proposing reform of the controversial frame of law which has been regarded as unfair to burden the assured such heavy duties. It finally results in the Insurance Act 2015 reforming the duty of utmost good faith in non-consumer insurance context. S.17 of the MIA 1906 will be read as ‘marine insurance contracts are contracts of the utmost good faith’, removing the remedy of avoidance for qualifying breaches.\(^\text{187}\) In addition, according to Part 2 of the Insurance Act 2015, a new duty named ‘the duty of fair presentation is introduced to replace the broad duty of utmost good faith described by the unlimited wording in s.17. Accordingly current absolute duty of disclosure to the insurer ‘every

\(^\text{187}\) PART 5 GOOD FAITH AND CONTRACTING OUT, Clause 14 Good faith
(3) Accordingly— (a) in section 17 of the Marine Insurance Act 1906 (marine insurance contracts are contracts of the utmost good faith), the words from ", and" to the end are omitted. So the section 17 in MIA 1906 will be that ‘A contract of marine insurance is a contract based upon the utmost good faith.’
material circumstances’ which would ‘influence the judgment of a prudent insurer’ in assessing the risks will be tailed into a duty of fair presentation of ‘every material circumstance which the insured knows or ought to know’, or failing that, making a disclosure ‘which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances’. The spirit reflects in the Insurance Act 2015 encourages the insurer to act more active in disclosure of material information once he is put on notice of further material information, so that an informed underwriting decision can be made by both parties’ effort. In addition, a new proportionate regime of remedies is introduced to replace the current harsh all or nothing regime that will be discussed in details in chapter 8.

2.3 Post-contractual stage—a continuing duty?

Before the MIA 1906, there are actually a number of cases confirming the existence of the pre-contractual duty of utmost good faith. As a partial codification of existing law, the MIA 1906 only expressly enunciates applicability of the duty to pre-contractual stage, but is silent about applicability of the duty after formation of the contract. It is not clear whether the unlimited wording in s.17 extends the scope of the duty to post-contractual stage. It is fair to say that the duty of utmost good faith at post-contractual stage is one of the most controversial issues with more than a century history, although it has not come into focus until the recent two decades. And it is worthy investigation if there does exist one, how it operates after contractual conclusion; what is the scope, duration, rules of test and remedy for qualified breach. Analysis of development of the law on post-contractual duty of utmost good faith will come first in chronological order, from cases prior to the MIA 1906 to modern authorities beginning with The Lition Pride. Then the present status of post-contractual duty of utmost good faith will be under scrutiny in following sections by considering each practical situation which is proposed to attract a post-contractual duty.

2.3.1 Development of the law on continuing duty of utmost good faith

188 Carter v Boehm (1766) 3 Burr 1905, 1910; Pawson v Watson (1778) 2 Cowp. 785; Bize v Fletcher (1779) 1 Dougl. 12 n; MacDowell v Fraser (1779) 1 Dougl. 260; Fillis v Brutton (1782) 1 Park, Ins. 414; Fitzherbert v Mather (1785) 1 T.R. 12; Blackburn v Vigors (1886) 17 Q.B.D. 533, 562, 583.

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2.3.1.1 Position of the law before the MIA 1906

Since the 1906 Act is a codification of the status of law before the act, the authorities on post-contractual duty before the 1906 Act are notable. In an early case, *Shepherd v Chewter*\(^\text{189}\)*, an adjustment agreed without disclosure of deviation prior to the casualty was held not binding, therefore the underwriter was entitled to discharge his liability relied upon the deviation. However, it is not clear whether the decision can be treated as authority on the proposition that breach of continuing duty of disclosure renders the policy avoidable because later cases decided that an adjustment would not prevent policy defenses ever. \(^\text{190}\)

Moreover, in *Britton v Royal Insurance Co*\(^\text{191}\)*, which is considered as the main authority on existence of continuing duty of utmost good faith at the claim stage before the act, it is established that an assured who asserts a fraudulent claim cannot recover it at all. \(^\text{192}\) However, it is treated as a common law principle on fraudulent claims issue rather than rules specify the scope of any continuing duty of utmost good faith in post-contractual period. Although the phrase ‘good faith’ was employed in the judgment, the case attempted nothing to define the scope or duration of the post-contractual duty.

Furthermore, prior to the 1906 Act, there are also cases establishing that the assured is under no continuing duty to disclose information about the insured risk coming into his attention after conclusion of the contract, \(^\text{193}\) and innocent misrepresentation about the insured risk after the formation of the contract cannot be relied upon by the insurer to avoid the policy. \(^\text{194}\)

2.3.1.2 Continuing duty introduced by the broad wording of s.17 of the MIA 1906?

\(^{189}\) (1808) 1 Camp. 274.
\(^{190}\) Luckie v Bushby (1853) 13 C.B. 864.
\(^{191}\) (1866) 4 F. & F. 905 at 909.
\(^{192}\) (1866) 4 F. & F. 905 at 909. “The law is that a person who has made… 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 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; and there was such a condition in the present case. Such a condition is only in accordance with legal principle and sound policy.” It is followed by Black King Shipping Corp v Massie (The Litsion Pride)[1985] 1 Lloyd’s Rep. 437; Orakpo v Barclays Insurance Services Co Ltd [1995] L.R.L.R. 443; Diggens v Sun Alliance and London Ins Ptc [1994] C.L.C.1146.
\(^{193}\) Cory v PATTON (1872) L.R. 7 Q.B. 304;(1874) L.R.9 Q.B. 577; Lishman v Northern Maritime Ins Co (1873) L.R. 8 C.P. 216; (1875) L.R. 10 C.P. 179.
\(^{194}\) Ionides v Pacific Fire and Marine Ins (1871) L.R. 6 Q.B. 674; (1872) L.R. 7 Q.B. 517.
It is suggested that although s.18 confines duty of disclosure and materiality to the pre-contractual period, the notion that attempts to import a continuing duty of utmost good faith into the post contractual stage by the broader and unlimited wordings of s. 17 is not convincing and should not be supported.

First of all, based on the earlier common law cases, it can be said that there are no precise authorities supporting existence of general continuing duty of utmost good faith after formation of the contract before the 1906 Act. At least, if there does exist any as some arguments suggest, the post-contractual duty does not have the same scope and operation as the pre-contractual one has. This is the status of law which the 1906 Act codifies.

Secondly, the rationale behind the doctrine of utmost good faith is to balance the informational asymmetry between the parties and make sure that the insurer can know all the material information and circumstances before he made an informed decision. Materiality is irrelevant after formation of the contract because insurers have already assessed the risk and made their decisions whether to underwrite the risk and at what premium.

Moreover, it is a well-established common law rule that the assured is perfectly free to increase the risk under the policy, while subject to certain limitations. The insurer is not entitled to reconsider terms of the policy or take advantage of any changes of circumstances after making his underwriting decisions. So it is not surprising that the duty of disclosure and duty not to make misrepresentation comes to an end when the insurance contract is concluded. It does not have any application in the post-contractual stage. It is against the original rationale and the background to say that a general continuing duty of utmost good faith is enacted in s.17 of the 1906 Act.

2.3.1.3 Modern authorities

195 For instance, subject to some express conditions in the policy which either prohibit an increasing of risk or require the assured to notify the insurer of any such increase, it is a common rule that a fundamental change to the nature of the insured risk will discharge the underwriter from all liability under the policy as the risk being run is not the same one which is described in the policy; moreover, in marine voyage policy, it is a common rule that the policy terminates automatically if there is deviation, delay or change of voyage.
Beginning with *The Litsion Pride*,\(^\text{196}\) successive modern authorities emerge aiming to specify some particular situations which may attract post-contractual duty of utmost good faith.

In *The Litsion Pride*,\(^\text{197}\) the vessel which was sent into an additional premium war zone without prompt notice to insurer became destroyed by a missile. The underwriters refused the claim upon the owner’s breach of duty of utmost good faith in deliberately failing to notify an additional risk and slip the vessel through a war zone without paying any additional premium. Hirst J. concluded that there was a general continuing duty of utmost good faith derived from the implied contractual terms after the conclusion of the contract. So the assured was decided to be required to disclose all material information and avoid misrepresentation of material facts about increased risk in respect of giving notice, paying additional premium, insurer’s decision as to his reinsurance, insurer’s exercising a right of cancellation etc. As to the remedy, the assured’ breach of the duty affords the insurer a choice to avoid the policy ab. initio or alternatively discharge from liability under any vitiated claims. *The Litsion Pride* which defined a broad scope of post-contractually continuing duty and extended it to culpable non-disclosure was criticised and not followed by a series of first instances cases\(^\text{198}\), and finally overruled by House of Lords in *The Star Sea*.\(^\text{199}\)

In *the Star Sea*\(^\text{200}\) the underwriters rejected the ship owner’s claim on the owner’s breach of continuing duty of utmost good faith at claim stage by non-disclosure of reports on the vessel’s deficiencies which caused her constructive total loss in a fire. A letter from the owner’s broker in negotiating a settlement was also alleged to be misleading relating to an earlier casualty suffered by owners’ another vessel. Their Lordship unanimously decided that the insurer was not entitled to reject the claims because fraud was required to prove breach of continuing duty of utmost good faith.

\(^\text{196}\) Black King Shipping Corp v Massie [1985] 2 Lloyd's Rep. 437.
\(^\text{197}\) Ibid.
\(^\text{198}\) In Iron Trades Mutual Insurance Co v Companhia de Seguros Imperio Hobhouse J. rejected the idea that the duty of disclosure continued after the contract was entered into. In *The Star Sea* at first instance Tuckey J. held that duty of good faith in relation to a claim ended when the claim was rejected and so found that the defence on that ground failed as a matter of law (as well as on the facts). In Royal Boskalis v Mountain Rix J. was inclined to limit the post-contractual duty of utmost good faith to an obligation no to tell material lies. “Material lies” in this sense where lies which went to a defence to the claim, such that the lie would only be material if the truth would have afforded the insurer a defence.
\(^\text{199}\) Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd [2001] UKHL 1.
\(^\text{200}\) Ibid.
in respect of a claim; and the continuing duty of utmost good faith come to an end at the beginning of litigation in which disclosure of information was governed by the procedural rules of court. However, the House of Lords did not go further to define the scope of such continuing duty except affirming that the continuing duty did not extend to post-contractual increase of risk. Although the scope of the duty was ‘elusive’ and had been curtailed to very narrow sense in practice, their lordship was reluctant to abolish the continuing duty which, in their lordship’s opinion, was clearly imposed by s.17. As to the remedy for breach of the post-contractual duty, a less intensive form than the pre-contractual one and flexible construction, which was characterised by Lord Hobhouse as ‘fair dealing’, were preferred to avoid the harsh, unjustified and disproportionate result. The insurer is disallowed to use the remedy of avoidance of the policy as an instrument to escape retrospectively from the liabilities which he validly undertaken.

A few months after The Star Sea, the scope of continuing duty of utmost good faith came into focus once again in The Mercandian Continent. 201 The insured fraudulently manufactured a jurisdiction agreement in the course of negotiation with its liability insurers. The insurers sought to avoid the claim and the policy for assured’s breach of the continuing duty of utmost good faith. The Court of Appeal followed House of Lords in The Star Sea affirming that s.17 expressly embodies a continuing duty of utmost good faith at post-contractual stage. However, by analysing various situations which may attract post-contractual duty of utmost good faith, the Court of Appeal went further to conclude that the situations attracting post-contractual duty of utmost good faith were limited.

2.3.1.4 Position of the law in The Insurance Act 2015

Under the Insurance Act 2015 the issue of attachment point and duration of the duty remains the same position as it is in the MIA 1906. The wording of s.3 expressly confines the scope of the duty of fair presentation to pre-contractual stage.202 Therefore, it is suggested that the Insurance Act 2015 will not change the position of

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202 Clause 3 The duty of fair presentation
(1) Before a contract of insurance is entered into, the insured must make to the insurer a fair presentation of the risk.
law stipulated in *the MIA 1906* regarding the scope of the duty; consequently the post-contractual duty will still have no legislative root as it does now.

### 2.3.2 Situations which may attract post-contractual duty of utmost good faith

From the above analysis on development of the law regarding continuing utmost good faith, it can be concluded that, before the emergence of the modern authorities upon post-contractual duty, there is no general continuing duty on the assured to disclose or not to misrepresent the increase of risk or any changes of the circumstances which are irrelevant with the assessment of the risk and premium after formation of the contract. Although there are no authorities supporting existence of a continuing duty after conclusion of a contract, some controversial situations, for instance renewal of a policy, extension of a policy, additional cover under held covered clauses, cancellation clauses, right of inspection, follow the settlement and claims cooperation clauses, and particularly fraud in claims stage etc. are still unclear. Actually those are just the points where the modern authorities of the continuing duty start. It is suggested here, although the courts tried to import and finally accepted a doctrine of utmost good faith at post-contractual stage, the harshness of remedy for breach of such duty make the courts continuously curtail the scope of duty leaving very limited room for application of post-contractual duty of utmost good faith. In practice, those situations which may arguably attract a continuing duty after the conclusion of the contract can be divided into two categories, distinguishing by whether the insurer has further underwriting decisions to make. Each of them is anaylsed below.

#### 2.3.2.1 Where the insurer has further underwriting decisions to make

**2.3.2.1.1 Renewal of the policy**

At the post-contractual stage, renewal of the original policy can be regarded as a typical situation which attracts duty of utmost good faith. Although the renewal brings the original policy which has already expired into reinstatement, it is still a new contract per se which attracts a brand new duty of utmost good faith because the original one has terminated. The assured is required to disclose and make true representation of all material circumstances happened during the currency of the
original contract. However, such duty is in essence pre-contractual duty of utmost good faith.\textsuperscript{203} Therefore, once there is breach of such duty, only the renewal part will be avoidable by the innocent party, leaving the original policy untouched and outstanding claims valid.

\subsection*{2.3.2.1.2 Extension, variation of the policy, held covered clauses}

After formation of the contract, the parties may make some alteration to the policy terms, in order to vary the scope or duration of cover. Also due to occurrence of particular eventualities, the parties would like to exercise their contractual rights to extend the cover when the insured risk increases during currency of the contract so that the assured can be held covered. As an additional consideration the assured is required to give the insurer prompt notice and pay some additional premium.\textsuperscript{204} In such circumstances suffice it to say that the parties of the original policy conclude a new and distinct agreement to vary or extend the original cover. Such endorsement of contract puts the insurer in the position again, to make an underwriting decision by assessing the risk and premium. Therefore the informational asymmetry imposes the assured a new duty of utmost good faith by disclosing all material information and not making any misrepresentation about the extension or variation part. Thus, it is suggested that such duty of utmost good faith is pre-contractual per se governed by \textit{the MIA 1906} ss.18-20 rather than a post-contractual one. Such approach is congruous with the principles existing authorities establish.\textsuperscript{205}

The scope of duty of utmost good faith in extension or variation situations only extends to the requested variation or extension context. Therefore, the assured is only under a duty of disclosure and making accurate representation of circumstances material to the additional reassessment of the premium or terms of cover. However, if the variation or held covered part does not alter the insurer’s contractual rights or is just favourable to him, then no material facts need be disclosed.\textsuperscript{206} Such cases may

\begin{itemize}
\item \textsuperscript{203} K/S Merc-Scandia XXXXII v Certain Lloyd’s Underwriters (The Mercandian Continent) [2001] EWCA Civ 1275, [2001] 2 Lloyd’s Rep 563, para 31.
\item \textsuperscript{204} It is known as ‘held covered’ clauses in marine insurance policies in London market.
\item \textsuperscript{206} Iron Trades Mutual Insurance Co Ltd v Companhia de Seguros Imperio [1991] 1 Re LR 213, 224.
\end{itemize}
happen where the assured is automatic held covered by giving the insurer a prompt notice and paying pro rate premium agreed in advance. As was said by Longmore L.J. in *The Mercandian Continent* any principle that the assured has to make full disclosure on the exercise of rights which he has under the original contract is “somewhat puzzling.”

With respect of remedy for breach of the duty, since *Fraser Shipping Ltd v Colton* it is established that insurers are entitled to “to avoid the policy, as varied by the endorsement” upon the assured’s breach of utmost good faith. Such rules are affirmed by both House of Lords in *The Star Sea* and Court of Appeal in *The Mercandian Continent*. As materiality and inducement is only assessed to the variation, extension or held covered extent, it is absurd to suggest that such breach of assured would entitle the insurer a right to avoid the entire policy. Such a remedy would be disproportionate and unreasonable. Therefore, ranking the duty as pre-contractual one is a reasonable and appropriate solution so that only the endorsement decisions induced by the assured’s breach is avoidable leaving the entire original policy unstained.

### 2.3.2.2 Where there is no further underwriting decisions to make

Outside underwriting decisions, it is ambiguous whether there is any room for a post-contractual duty of utmost good faith.

#### 2.3.2.2.1 Fraudulent claims

Although *The Star Sea* narrowed down the scope and duration of fraudulent claims, their Lordships did not go further to specify whether fraudulent claims is an aspect of post-contractual duty of utmost good faith or what the remedy is where a fraudulent claim is made. By deciding that the post-duty of utmost good faith exists only when the contractual terms impose such an obligation to volunteer information,  

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207 See Institute Time Clauses (01/11/03), clause 12 providing that: “Should the vessel at the expiration of this insurance be at sea and in distress or missing, she shall be held covered until arrival at the next port in good safety, or if in port and in distress until the vessel is made safe, at a pro rata monthly premium, provided that notice be given to the Underwriters as soon as possible.”


210 The Litsion Pride extended post-contractual duty to culpable misrepresentation and nondisclosure even without fraud. However, The Star Sea overruled the decision by concluding that actual fraud by the assured was required in the claim context. Therefore, only actual fraud can give rise to fraudulent claims.
the court affirmed that the post-contractual duty of utmost good faith did not extend to fraudulent claims which should be regarded as an independent common law rule.\(^{211}\) As to the duty, if there exists any, is based on contractual terms, the remedy for breach of such duty should resort to contractual remedies as well. Therefore, immaterial fraud, which does not enable the insurer to repudiate the contract, just like the position in *The Mercandian Continent*, would not be relied upon by the insurer to avoid the policy ab. initio, although damages may be claimable under common law rules. The insurer is not allowed to step aside the contract by resorting to such tricky instrument, namely treating fraudulent claims as an aspect of the post-contractual duty of utmost good faith.

Consequently it can be seen that the court is reluctant to treat fraudulent claims as part of the post-contractual duty of utmost good faith. There is a tendency to remove it from the frame and make it an independent common law rule. Such trend can also be illustrated by the remedy for fraudulent claims. According to s.17 of *the MIA 1906*, the only remedy for breach of duty of utmost good faith is an option of the innocent party to avoid the policy ab. initio. However, since *Britton v Royal Insurance Co*,\(^{212}\) it is a well established common law rule followed by many authorities that the insured who has made a fraudulent claim will not recover the claim at all.\(^{213}\) Moreover, in practice many policies embody such rule by an express clause to the effect that fraud by the assured will forfeit the claim or discharge insurer from liabilities prospectively. Furthermore, in *The Aegeon*,\(^{214}\) Mance L.J. confirmed such principle again by suggesting that assured’s using fraudulent devices or means to prompt a claim would be regarded as a sub-species of fraudulent claim forfeiting the claim itself or discharging the insurer’s liability prospectively. Therefore, it is fair to say that remedy of avoidance ab. initio is not available in fraudulent claims because fraudulent claims do not have a retrospective effect on prior separate valid claims which have already been settled before any fraud occurs. This position is re-affirmed in *the Insurance Act 2015*. In part 4 on fraudulent claims, separate from part 2

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\(^{211}\) The House of Lord in *The Star Sea* took the view that the fraudulent claims principle stems from a rule of law that the person should not benefit from his own wrong. So it can be said that The Lords treated the fraudulent claims principle as an independent common law rule by divorcing it from the doctrine of utmost good faith. Such analysis was accepted by the Court of Appeal in *The Mercandian Continent*.

\(^{212}\) (1866) 4 F. & F. 905.


regulates the duty of fair presentation, remedies for fraudulent claims is expressly
codified and divided into two parts, to the claims taint by the fraud and to the effect of
the contract thereon, leaving the already performed part of contract untouched.\textsuperscript{215}

Therefore, although there is no clear authority on whether fraudulent claims principle
is a part of post-contractual duty of utmost good faith, it is well illustrated that
fraudulent claims principle can live as an independent rule of law. So it is suggested
that placing the fraudulent claims rule into the doctrine of utmost good faith is
superfluous. It is better to stand alone.

\textbf{2.3.2.2.2 The express or implied terms in insurance contract requiring the
assured to provide information}

There is a suggestion that the post-contractual duty of utmost good faith can be
arisen by express or implied terms in policy which impose the parties such a
continuing duty.\textsuperscript{216} Under such an approach, the post-contractual duty of good faith is
aligned with and arisen by contractual terms. Breaching of such obligations brings
contractual remedies rather than remedy of avoidance ab initio like in the pre-
contractual stage.\textsuperscript{217} The entitlement to avoid the entire policy ab initio for qualifying

\begin{footnotesize}
\textsuperscript{215} Insurance Act 2015, part 4 fraudulent claims, section 12 Remedies for fraudulent claims:
(1) If the insured makes a fraudulent claim under a contract of insurance—
(a) the insurer is not liable to pay the claim,
(b) the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim, and
(c) in addition, the insurer may by notice to the insured treat the contract as having been terminated with effect
from the time of the fraudulent act.
(2) If the insurer does treat the contract as having been terminated—
(a) it may refuse all liability to the insured under the contract in respect of a relevant event occurring after the time
of the fraudulent act, and
(b) it need not return any of the premiums paid under the contract.
(3) Treating a contract as having been terminated under this section does not affect the rights and obligations of
the parties to the contract with respect to a relevant event occurring before the time of the fraudulent act.
(4) In subsections (2)(a) and (3), "relevant event" refers to whatever gives rise to the insurer's liability under the
contract (and includes, for example, the occurrence of a loss, the making of a claim, or the notification of a
potential claim, depending on how the contract is written).
\textsuperscript{216} In The Mercandian Continent [2001] EWCA Civ 1275, [2001] 2 Lloyd's Rep 563, para 31., Longmore L.J.
concluded that the only true illustration of post-contractual duty of utmost good faith is where the policy contains
an express or implied term to impose the assured a continuing duty to provide insurer information. And such duty
is not simply triggered by a cancellation clause in the policy.
\textsuperscript{217} According to Longmore L.J’s view, in order to avoid the policy ab initio upon breach of assured’s post-
contractual duty of utmost good faith, four conditions should be fulfilled. First, there should be a contractual
obligation on the assured to provide insurer information after conclusion of the contract. Secondly, the assured
should have committed fraudulent conduct by misrepresentation or concealment of material facts. However, only
facts which have ultimate legal relevance to the insurer’s defense under the policy would be material. Thirdly, the
insurers are induced to act or refrain from acting in a particular way. Fourthly, such breach of contractual
obligation should amount to a repudiation of the contract, effecting insurer's ultimate liability. The insurer is
entitled to avoid the policy ab initio when four conditions are all fulfills; otherwise the only remedy is breach of
contract.
\end{footnotesize}
beach only confines to the situation where the assured’s breach of contractual obligation to provide information repudiates the policy. However, an obligation to provide information is generally an innominate term breaching of which would be very hard to repudiate an entire policy, leaving little room to argue a breach of post-contractual duty of utmost good faith.\textsuperscript{218} Therefore the test set up in \textit{The Mercandian Continent} is very stringent and difficult to satisfy in practice. Even the approach is correct, it has little practical significance.\textsuperscript{219}

Moreover, It is not uncontroversial that post contractual duty of utmost good faith, if does exist, can be arisen on a contractual basis. It is well established that the legal basis of the duty of utmost good faith is derived from common law with equity origins, rather than contractual in origin no matter expressed or implied. It exists as a rule of law before a contract is concluded. If a duty of utmost good faith is still alive at post contractual stage, it should still be a rule of law per se. Although the parties to an insurance contract are free to stipulate obligations to continually provide information after formation, it means neither that there exists a post contractual doctrine of duty of utmost good faith as a rule of law nor that legal basis of the doctrine is changed into contractual origin. The assured is required to provide information by his contractual obligations rather than the doctrine of utmost good faith. Consequently, the remedy, for breach of such contractual obligations, even in bad faith, would only avail the innocent party ordinary contractual remedy proportionate to the gravity of the breach.\textsuperscript{220} Even though the repudiation of contract justified in particular circumstances equals avoidance ab. initio in practical effect, it does not indicate that the remedy for non-performance of insurance contracts has the same genius as the one for breach of duty of utmost good faith.

2.3.2.2.3 Follow the settlement, claim co-operation and claim control clauses in contract which imply the insurer’s performance in good faith

Where a reinsurance contract contains follow the settlement, claim cooperation, and claim control clauses is taken as an instance to define the insurer’s post contractual duty of utmost good faith. Argument that there exists post-contractual duty of utmost good faith.

\textsuperscript{218} Friends Provident Ltd v Sirius International[2005] 2 All ER 145.
\textsuperscript{219} There are no reported cases in which The Mercandian Continent test has been applied.
\textsuperscript{220} Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea) [2001] UKHL 1, [2003] 1 AC 469, para 52. See also Bonner v Cox [2005] EWCA Civ 1512, para 86.
good faith to carry out the contract dates back to enactment of the MIA 1906. In *Boulton v Houlder Bros & Co*,\(^{221}\) it is said that “it is an essential condition of the 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.” In *Eagle Star Insurance Co Ltd v Cresswell and others (Cresswell)*,\(^{222}\) Rix L.J. following *The Mercandian Continent*, decided that as those claim co-operation claims are conditions precedent of the reinsurer’s liability, the reinsurer is under a duty, arising from an implied term, not to exercise their discretion under a claim provision in bad faith, capriciously or arbitrarily. Such implied duty on insurer to act in good faith is affirmed again in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2 & 3)*.\(^{223}\) However, in court of appeal, Mance L.J. expressly disagreed with that the duty from implied term is an expression of the post contractual duty of utmost good faith by saying: “…this conclusion does not involve an inadmissible extension of the duty of utmost good faith in insurance law or of the consequences of breach of any such duty. The qualification… does not arise from any principles or considerations special to the law of insurance. It arises from the nature and purpose of the relevant contractual provisions…”\(^{224}\)

Therefore, it is a purely implied contractual term from which such duty to act in good faith arises rather than the post contractual duty of utmost good faith. The duty here does not possess any nature special to contract uberrimae fidei. It cannot function as a post contractual duty of utmost good faith. Qualified breach only avails the innocent party ordinary contractual remedy, just like the situation aforementioned where the express or implied contractual term requires the assured to provide information after conclusion of contract. Those terms are ordinary contractual terms which should be performed without assistance of doctrine of duty of utmost good faith in interpretation, especially given the modern emphasis on giving regard to the intentions of the parties.\(^{225}\) Therefore, it is suggested that post-contractual duty of utmost good faith in above situations is of little practical importance and should be curtailed with no application hereof.

\(^{221}\) [1904] 1 KB 784.
\(^{222}\) [2004] Lloyd’s Rep IR 557.
\(^{224}\) Ibid, per Mance L.J. at para. 68.
\(^{225}\) Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2 & 3) [2001] Lloyd’s Rep IR 667, para 68.
2.3.3 Conclusion

There is no generally continuing duty of disclosure or duty not to make misrepresentation after conclusion of contract in law. In respect to situations where the insurers have further underwriting decisions to make after conclusion, the parties conclude a fresh policy by renewal or create a fresh agreement to vary, extend the cover of existing policy. It is unequivocal that the duty of utmost good faith does attach herein. However, such duty of utmost good faith is pre-contractual pre se distinguishing from lack of good faith during the performance of the contract. The assured is required to disclose and make accurate representation of all material information relating to the underwriting decisions. Any breach of the duty make the induced decision avoidable leaving the entire original policy untouched. The post-contractual duty of utmost good faith has nothing to do in such situation. Situations where the insurers have no further underwriting decisions to make after conclusion are more complicated and controversial. It should be noticed that doctrine of utmost good faith should be distinguished from lack of good faith in performance of contract. Where a contract contains express or implied contractual terms requiring provision of information and implied contract terms require the parties to act in good faith to each other should be construed as ordinary contractual terms reflecting parties' intentions rather than doctrine of utmost good faith in law pre-existing before the contract. Such contractual terms should be performed without assistance of doctrine of utmost good faith, and breach of such terms brings the innocent parties only ordinary contractual remedies. As to fraudulent claims principle which derives from a common law rule ‘a person should not benefit from his own wrong’, it can live as an independent rule of law. Therefore, it is suggested that placing the fraudulent claims rule into the doctrine of utmost good faith is superfluous. It is better to stand alone. In a conclusion, it is suggested that post-contractual duty of utmost good faith is of little practical importance and should be elimination at all, leaving contractual law and common law rules governing performance of contract.
Part II Broker's Role in Disclosure Process in Placing Reinsurance in subscription market

Chapter 3 Practical Difficulties and Problems in Performing the Duty of Utmost Good Faith by Reinsurance Brokers

3.1 Introduction

It has been discussed in above chapter that the English law has imposed a duty of volunteering information on both parties in order to make an informed underwriting decision. To place a reinsurance contract, besides the reinsured's personal duty imposed by s.18 of the MIA 1906, there is also established an independent duty of disclosure imposed upon the agent who is instructed by the reinsured to effect reinsurance by s.19.\textsuperscript{226} It has been settled that s.19 places a personal duty of disclosure upon the agent to insure separately from the reinsured's duty under s.18, rather than going through the imputation route.\textsuperscript{227} Therefore the broker in the disclosure process is not only required to disclose material facts which his principal is bound to disclose, but also obliged to disclose material circumstances which even neither know nor ought to have known by his principal, but known or deemed to be known by him as provided in s.19 (a).

It is noteworthy that many of the leading authorities clarifying the framework of the duty of utmost good faith, particularly more recent authorities, are in fact reinsurance cases.\textsuperscript{228} The reinsurance placement practice modifies the duty of utmost good faith and frequently arise specific issues which apply particularly in determining disclosure obligations in the reinsurance context. For instance, it is a common practice in the reinsurance market that there is more than one type of agents involved in the placing process. It is only the placing broker who is the last ache of the chain of intermediate

\textsuperscript{226} The MIA 1906 section 19 provides that an agent must disclose to the insurer: (a) Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to have been known by, or to have been communicated to him, and (b) Every material circumstance which the assured is bound to disclose, unless it comes to his knowledge too late, to communicate it to the agent.


agents to deal with the reinsurer directly. As a result, the practice causes a series of problems as to operation of the duty of disclosure upon the agent to insure under s.19. First, the legal basis of the duty for the purpose of s.19 needs to be analysed, as it may cause controversy of applicability of the exception rules to the duty of the agent to insure under s.19. Secondly, it is worthy further discussion as to who of the chain of intermediate agents involving the complex negotiation process of the reinsurance contract qualifies for the agent to insure of the purpose under s.19. It is arguable whether the agent to insure confines only to the placing broker, i.e. whether the duty of disclosure extends to other intermediate agent involving in the middle of the placing chain. If the answer is negative, how the law accommodates the knowledge of other intermediate agents will be analysed in the following. Moreover, the market practice of placing reinsurance contracts create lots of difficulties in defining the scope of the duty of disclosure upon the reinsurance broker under s.19, as the broad wording of the section is still unsettled. In practice the broker may not only play the role of agent to insure but also plays multiple roles in the operation of the business, involving in some other processes with the insurer of direct insurance or the reinsurer, such as concluding an open cover or a binding authority with the reinsurers before any contract of insurance comes into existence, or acting as the underwriting agent in managing an insurance pool and undertaking to reinsure the pool’s liabilities like a dual agent. It is worth discussion how the duty of utmost good faith applies to the broker in a multiple-role circumstance or a dual-agency situation, as it is controversial in conflicting authorities whether the broker needs to disclose any material information known to him in any other capacity. In addition, as to the scope of duty of disclosure on the agent to insure, it is unsettled whether there are any exceptions undermining s.19 except circumstances expressly excluded from duty of disclosure by s.18 (3). Furthermore, in the broker’s placing process in practice, sometimes the broker may do wrongs or even commit fraudulent conduct against the reinsurer or his principal, i.e. the reinsured. It is arguable whether such wrong doings or fraud committed by the broker is a material circumstance to be disclosed to the reinsurers under s.19. If there should exist a fraud exception to the scope of the broker’s duty of disclosure, how should the fraud exception rules be interpreted and how will it affect the reinsured’s right under the reinsurance contract which the broker effects on his behalf? In addition it will be discussed whether there should be a wider exception rule to the application of the broker’s duty of disclosure
beyond fraud, such as any dishonesty lack of fraud or any information which is unreasonable to be inferred into the reinsured’s knowledge.

The following chapter will analyse difficulties and problems relating to operation of the broker’s duty of disclosure in practice in three aspects, the legal basis for the duty, the relevant agents under the duty and the scope of the duty burden upon the agent. Solutions are proposed to resolve the difficulties. In addition, a comparison will be made between the duty of utmost good faith under MIA 1906 and the duty of fair presentation under Insurance Act 2015, to see whether the new insurance act can resolves the existing practical problems.

3.2 Legal basis for the duty of utmost good faith imposed on reinsurance brokers

The relevance of legal basis for the duty of disclosure imposed upon the agent to insure matters, as it will affect the ambit of relevant agents under the duty, the scope of their duty, and then affect the reinsured’s rights under the reinsurance contract. The leading authority on such legal basis is decision of the House of Lords in Blackburn Low &Co v Vigors where raised a divergence of opinions. Majority of the members of the House adopted an imputation of knowledge analysis whereas Lord Macnaghten as minority opined that the placing broker was required to communicate material facts to underwriters because of his capacity as the assured’s agent to effect insurance. If Blackburn v Vigors justifies that the duty is not based on imputation of knowledge, then it could be arguable that fraud exception in Re Hampshire Land case does not apply to the broker’s duty under s. 19. By this token, the relevance of legal basis for the duty of disclosure on agent to insure is of importance and deserves detailed investigation.

3.2.1 Divergence of the views on this issue

In Blackburn Low A & Co v Vigors, a Glasgow firm of brokers which had previously produced reinsurance for the reinsured had been informed that the subject vessel had been lost. However, they did not pass on this information to the reinsured before the placement of reinsurance by another London broker instructed by the reinsured.

229 (1887) 12 App. Cas. 531.  
230 Ibid.
The reinsurer alleged non-disclosure of this material fact. The House of Lords held that the knowledge of the Glasgow broker was not the knowledge of the reinsured; therefore the policy was not voidable. At the same time, their lordships reached the same agreement, although on two different grounds, that if the reinsured’s placing broker had been aware of the relevant facts, the reinsurer would have had a right to avoid the policy for non-disclosure of such facts. Majority of the members of the House of Lords adopted an imputation of knowledge analysis that the broker would communicate facts known to him to the reinsured, therefore the reinsured was deemed to known such facts imputed into his knowledge. By contrast, Lord Macnaghten as a minority expressed the view that the agent of the assured who is employed for the particular purpose of effecting the insurance is required to disclose material facts because he is bound as the principal to communicate to the underwriters all material facts within his knowledge, rather than the knowledge of the agent is to be imputed to the principal. Such opinion is also followed by some later authorities. 231 Although Phillips J. adopted the imputation of knowledge analyses in Deutsche Ruckversicherung Aktiengesellschaft v Walbrook Ins Co Ltd,232 it was not followed in latter cases.233 In both PCW Syndicates v PCW234 and Reinsurers and Group Josi Re v Walbrook Insurance Ltd,235 the Court of Appeal rejected general imputation of knowledge from brokers to reinsureds, and Staughton L.J. expressed that it was clear that s.19 gives effect to Lord Macnaghten’s view. The same view was expressed by Colman J. and the Court of Appeal in Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd.236 In HIH Casualty & General Insurance Company & Others v. Chase Manhattan Bank & Others,237 the judges also accepted that the broker has a separate and independent duty of disclosure to the insurers under s.19.

233 SAIL v Farex (above) at 142-143 (Dillon L.J.), 150 (Hoffmann L.J.); and in PCW Syndicates v PCW Reinsurers (above) at 255 (Staughton L.J.). See also, El Ajou v Dollar Land [1994] 2 All E.R. 685 at 702.
3.2.2 Legal basis for the broker’s duty under s.19 of MIA 1906

As Lord Macnaghten’s view is confirmed by the House of Lord in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*, it is now a finally a settled law that under s. 19 of the *MIA 1906*, imputation of knowledge rule does not apply to agent who is instructed to effect insurance. The relevant point of particular importance in the *HIH* case is that whether a policy term which purported to exclude the assured’s personal duty of disclosure had the same effect to exclude the agent’s duty of disclosure. By holding that such provision would not exclude the agent’s duty of disclosure unless there was express reference to it, their lordships ruled that the agent to insure is under a personal duty of disclosure independent of the assured’s. Accordingly, it is now clearly established that the s.19 of the *MIA 1906* does not operate through the imputation of knowledge route, but imposes brokers who effect reinsurance a distinct duty of disclosure independent of the assured’s. So the reinsurer is entitled to avoid the contract of insurance induced by the broker’s misrepresentation or non-disclosure of material facts, even though the reinsured has performed his duty of disclosure under s.18 perfectly by passing material information to the broker. Information provided by the reinsured to his own broker, that makes the effect like disclosing to himself, is not deemed to have been received by the reinsurers. After all it is the reinsured who takes the risks of non-disclosure or misrepresentation by his own agents under the rules of disclosure.

3.2.3 Legal basis for the broker’s duty under the Insurance Act 2015

As discussed in the above chapter, the new Insurance Act brings significant changes to current legislation applicable to non-consumer insurance context, including the duty of disclosure imposed upon the insured. Although the duty to volunteer information is retained by the act, reflected by a duty of fair presentation inclusive of the current duty of disclosure and making no misrepresentation, it will be solely imposed upon the insured himself. By contrast to current s.19 of the *MIA 1906*, s. 3 (1) of the *Insurance Act 2015* clearly states that the duty of fair presentation is imposed upon the insured. Under such duty, it is the insured that must make

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238 [2003] 2 Lloyd’s Rep 61. Lord Bingham of Cornhill at para. 5; Lord Hobhouse at para. 87.
disclosure of every material circumstance known or ought to be known by him to the insurer, in a reasonably clear and accessible manner to a prudent insurer. The new act does not mention a separate duty imposed upon the agent to insure any more like it does in the MIA 1906. But in s. 4 which defines the knowledge of insured, an insured is regarded to know or ought to know what is known to one or more of the individuals who are responsible for the insured’s insurance. Therefore, even though the broker is not bound to make a fair presentation to the insurer by new insurance contract law, his knowledge is still attributed into his principal’s by an imputation route, falling within the material circumstances disclosable to the insurer under the insured’s personal duty.

3.2.4 Possible practical problems of the imputation approach under Insurance Act 2015 in reinsurance market

It is not an uncommon practice in reinsurance market that more than one intermediate are involved in placing reinsurance. Under certain circumstances the producing broker who is authorised to place an insurance contract by the reinsured will instruct a placing broker who is qualified to access a particular market or has special expertise in certain areas, rather than places the risks personally. It is argued that the current independent duty basis based on s.19 of the MIA 1906 is more plausible and consistent with the reinsurance market practice. The approach under the new insurance act of switching to the imputation route may cause practical difficulties in practice. Under the Insurance Act 2015, the duty of disclosure is solely imposed upon the reinsured. It is the reinsured’s and only his duty to make all the material information fairly disclosed and represented to the reinsurer. Such duty cannot be simply satisfied by the reinsured passing down his knowledge to his brokers, as the contract could be vitiated if the person who is employed specially to effect reinsurance conceals information from the reinsurer. It should not be reinsurers that bear the risk of such knowledge gap between the reinsured and the brokers; after all it is the reinsured that is the primary principal of the brokers. So the existing approach by imposing a distinct duty of disclosure upon the brokers who effect reinsurance directly with reinsurers can be said to be a fair, to make sure the reinsurers could make informed underwriting decisions. To solve this issue, the

240 The test is subject to the qualification under s. 3 (4) (b).
Insurance Act 2015 attributes all the disclosable knowledge of the agent to insure into the reinsured’s. So all material information subject to a separate duty of disclosure on the broker falls within the knowledge that needs to be fairly presented by the reinsured. Accordingly, to fulfill the duty of fair presentation, the reinsured is required to fairly disclose and refrain from misrepresentation of all the material circumstances known to his agent to insure encompassing risks managers and any employee assisting collection of date or negotiation of the contractual terms. In addition, the reinsured is required to make reasonable search of information available to him, in order to reveal material circumstance which ought to be known by him. Actually, in practice, it is harsh to deem the reinsured to know all the material facts possessed by the placing brokers who are at the end of the intermediate chain, as the reinsured may even not know the existence of such agent to insure. Neither is it easy for the reinsured to know or ought to know all the material information processed by the brokers, nor is it practical for the reinsured to make reasonable search to reveal such information. Moreover, attribution of brokers’, at least placing brokers’ knowledge into the reinsured’s inconsistent with current common law rules. In Simner v New India Assurance Co Ltd, and then followed by ERC Frankona Reinsurance v American National Insurance Co, it is held that knowledge of the agent is imputed into the assured’s in two situations, i.e. where the agent would be an ‘agent to know’ or where the agent is in a predominant position in relation to the assured. It is doubted that the agent employed to effect the reinsurance contract falls into either of the two categories. In practice, it is not reasonable to assume that the placing broker will communicate his knowledge to the reinsured so that such knowledge can be treated as what ought to be known by the reinsured in his ordinary

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241 Herbert Smith Freehills Dispute Resolution, Litigation Note, Insurance Act receives royal assent, p.3
242 [1995] L.R.L.R. 240. See also in ERC Frankona Reinsurance v American National Insurance Co, [2005] EWHC 1381 (Comm), where the defendant ANICO, in 1998 underwriting year, participated in a pool which was established by National Accident Insurance Group in 1997. The pool was managed by National Accident Insurance Underwriter (NAIU). NAIU instructed his London brokers Bradstocks to place a quota share reinsurance of Philadelphia Life’s one-third participation in the pool with ERC. ERC subsequently claimed to be entitled to avoid its line on the 1998/99 quota share because NAIU had failed to disclose the criminal record of the Chief Executive Officer of NAIU. Relying upon decision in Simner v New India242, Andrew Simon J defined situations where the reinsured’s agent’ knowledge would be imputed into the reinsured’s, as a result falls within the scope of duty of disclosure under s.18, i.e. the reinsured’s agent to know who is relied upon for information concerning insurance subject matter, and the reinsured’s agent who is in such a predominant position in relation to the reinsured that his knowledge can be regarded as the knowledge of the reinsured. In current case, neither the NAIU was the American National’s agent to know nor was his predominant agent. As a result, the NAIU’s knowledge about Mr. Drobny’s previous criminal record was not imputed into the reinsured’s knowledge; thereby falling within the reinsured’s duty of disclosure under s.18 of MIA 1906.
course of business. As a result, in general situations, broker’s knowledge should not be imputed into the reinsured; neither should the broker’s knowledge fall within the scope of duty of fair presentation upon his principals for the purpose of s. 3.

At a face value, it appears more simplified and clearer in the position of the new Insurance Act that integrates the current two separate duties of disclosure into one. It seems that the new approach technically makes the test rules and scope of duty easier to understand. No matter how many intermediates are involved in the placing process and no matter what their capacities are, all the relevant information material to the prudent insurer’s underwriting decisions are all disclosable by the reinsured for the purpose of the duty of fair presentation. However, the new approach significantly changes the current legislation, and overturns the current common law rules on the attribution of knowledge. The ambit and test of the knowledge of the reinsured which is subject to the duty of fair presentation is still complex, involving new legal and factual test to be established and clarified. It is still unknown whether the new tests can serve the market practice better than the current existing rules. So it can be said that it will be some time and judicial decisions, like the current settled rules, to show whether the prescriptive approach of attribution of knowledge route will successfully eliminate current unfairness or uncertainty in existing legislation and common law cases. Those will be discussed in the following sections.

3.3 Relevant agent under the duty of utmost good faith

As discussed above, it is clearly settled that in the MIA 1906 s.19 (a) imposes on the agent to insure an independent duty of disclosure when effecting the contract. And it is a common market practice that there are more than one agents involved in placing reinsurance. In addition, in practice there are some circumstances where the brokers play multiple roles and function beyond the agent of the reinsured. For instance, brokers may also act as the agent of a coverholder when effecting binding authority on behalf of him. Also it is possible for an open cover or treaty to be concluded before any contract of insurance actually coming into existence. Consequently it

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244 See also in SAIL v Farax [1994] C.L.C.1094, at p. 1111; PCW Syndicates v PCW Reinsurers [1996] 1 Lloyd’s Rep. 241. If principle of imputation is the correct analysis here, then s.19 is too superfluous and no longer needs to exist anymore. So the ss. 18-20 of MIA 1906 is all replaced by the duty of fair presentation in the insurance act 2015.

245 It can be done by effecting a broker’s master cover between the broker and the insurer initially before any risks actually is produced by any of their clients. When an assured agrees to the insurer’s offer brought by the
raises a practical problem who qualifies for the agent to insure of the reinsured for the purpose under s.19. The meaning of this simply phrase ‘agent to insure’ is to some extent ambiguous and needs to be clarified. This section will focus on what types of agents the duty of utmost good faith applying to. It is arguable that whether a coverholder or a broker who also acting as underwriting agent in such cases is an agent to insure who owes a separate duty of disclosure under s.19 of the MIA 1906; also whether all brokers in placing reinsurance are under a duty of disclosure contemplated by s.19; and how the law accommodates their knowledge if s.19 does not apply to them. As the Insurance Act 2015 takes completely different approach from the MIA 1906 in respect of this issue, it will be discussed whether the new Act can resolve such difficulties caused s.19 of the MIA 1906.

3.3.1 Intermediate agents involved in the reinsurance market

There are generally two broad types of intermediate agents involved in the reinsurance market, i.e. brokers and underwriting agency.

Underwriting agency is authorised by the insurer under a binding authority to accept, manage and carry out underwriting business, collect premiums, issue certificates of insurance and service claims on behalf of the insurer within specific limits. The underwriting agent, who can also be called ‘coverholder’, can be regarded as holding the pen of the insurers and exercising underwriting assessment on behalf of the insurer. Therefore, it is basically recognised that underwriting agency is the agent of insurer’s rather than the assured’s, although underwriting agency may also act as an agent to insure when it is managing and carrying out business for an insurance pool. In practice, when a leading underwriter or the following underwriters under a reinsurance contract are mentioned, it is generally used to refer to their underwriting agents to whom the reinsurance broker actually presents risks, and who will accept or decline the risks for the syndicates or insurance companies for which he represents. Such underwriting agent should not fall within the scope of agent to insure for disclosure purpose under s.19. Actually, the binding authority, which is in essence similar to an contract creating agency relationship, is just a contract for insurance in the sense that contract of insurance will be effected by relevant agents broker, then the broker is regarded as acting on behalf of the reinsured thereby constitutes the agent of the reinsured. See General Accident Fire and Life Assurance Corp v Tanter (The Zephyr) [1985] 2 Lloyd’s Rep 529.
based upon those contracts. Consequently it cannot be regarded as an insurance contract or a contract uberrimae fidei to attract the duty of utmost good faith, although it is suggested in obiter dictum that the underwriting agents may owe some personal responsibilities to the reinsurers similar to but not limited to the duty of disclosure.

On the contrary, a broker is instructed to place insurance on behalf of the insured. In practice, it is often implied that the reinsurance broker is authorised by the reinsured to appoint sub-brokers who have expertise in certain areas or be qualified to access a particular market. The reinsurance broker who deals with reinsurers directly is the placing broker, in contrast with the producing broker who is in the middle of the chain. Generally, it is settled that a broker is the agent of the reinsured or would-be reinsured. Normally the agents of the reinsured can be distinguished into two different types, i.e. the agent to know and agent to insure. It is now clearly decided by common law cases that the agent to know and the alter ego of the reinsured fall into the scope of s.18 of the MIA 1906, whereas the agent to insure is covered by s. 19. But it is only a seemingly settled law that s.19 only applies to agents employed to effect the insurance whose knowledge should not be deemed to be that of the insured. It will be discussed in the following section that what types of agent to insure are under a duty of disclosure contemplated by s.19; and how the law accommodates other intermediate agent’s knowledge if s.19 does not apply to them.

3.3.2 The seemingly settled law as to the relevant agent under s.19 of the MIA 1906

In both of Court of Appeal’s cases, *PCW Syndicates v PCW Reinsurance* and *Group Josi Re v Walbrook Insurance* arose one same issue whether the

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249 Bancroft v Heath [1900] 5 Com Cas 110; affirmed [1901] 6 Com Cas 137 (CA); Empress Assurance Corp Ltd v CT Bowring & Co Ltd (1905) 11 Com Cas 107, 112 per Hennedy J; Re Great Western [1999] Lloyd’s Rep IR 377, 386 per Hobhouse L.J.
underwriting agents had to disclose his fraud against the reinsured to the reinsurers under s.19 (a). By rejecting such argument, the Court of Appeal gave ‘agent to insure’ a restricted meaning that the only person who can be agent to insure is the placing broker.

In *PCW Syndicates v PCW Reinsurance*, which can be regarded as the leading authority to define the agent to insure for disclosure purpose, members of 56 syndicates at Lloyd’s employed PCW Underwriting Agencies Ltd to manage its underwriting business between 1967 and 1982. PCW arranged reinsurance of marine and non-marine risks through brokers for them with 24 insurance companies and 62 other Lloyd’s syndicates, i.e. reinsurers. During this period, a number of individuals in PCW underwriting agency misappropriated the premiums received for the benefit of the insurers and applied them for their own purposes. The reinsurer subsequently alleged to avoid the reinsurance contracts on the grounds that such dishonest conduct was a material circumstance which ought to have been disclosed to them. The judge rejected the reinsurer’s argument on the ground that the insurers were not deemed to know such dishonest conduct by s.18 of the *MIA 1906*, neither did the PCW agency fall within the category of ‘agent to insure’ under s.19 (a) of MIA1906. On appeal, the judges dismissed reinsurer’s appeal by holding that the PCW Underwriting Agency Ltd was not ‘agent to insure’ within s.19 (a) of the *MIA1906*, since they had not effected the reinsurance contract themselves directly but had placed the risks through brokers. It had been held that an agent to insure, who is required under an personal duty to disclose not only all material circumstances which the reinsured is bound to disclose but also all material circumstances which ought to be known to him in his ordinary course of business, only applies to the agent who directly places the reinsurance contract with the reinsurer. In current case, the agent to insure was the subsequent broker Kininmonth rather than NAIU. Consequently, the NAIU was not the agent to insure who is under a separate duty of disclosure under s.19. Therefore, if American National had not themselves been aware of Mr. Drobny’s past, their reinsurance would not have been susceptible to avoidance on the basis that NAIU was aware of it.

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The similar issue arose in *ERC Frankona Reinsurance v American National Insurance Co.* the claimant ERC provided a quota share reinsurance cover to the defendant ANICO who participated in a pool established by National Accident Insurance Group (NAIG). The pool was managed by National Accident Insurance Underwriters (NAIU). NAIU instructed London brokers to place a quota share reinsurance of Philadelphia Life’s one-third participation in the pool with ERC. ERC subsequently claimed to be entitled to avoid its line on the 1998/99 quota share because NAIU had failed to disclose the criminal record of the Chief Executive Officer of NAIU. Smith J rejected that argument by following the decision of the majority of the Court of Appeal. It is held that NAIU who is the intermediate agent is not kind of agent to insure whose non-disclosure of material information would render the reinsurance contract avoidable.

In conclusion, based on the Court of Appeal’s decisions, ‘agent to insure’ is given a restricted meaning that the only person who can be agent to insure is the placing broker. In another word, duty of disclosure under s.19 only burdens on the broker who actually deals with the insurer directly and concludes the contract in question. In deciding whether an agent falls within the scope of agent to insure under s.19, three significant elements should be taken into consideration, i.e. whether the agent is relevant of placing business for the reinsured, whether the agent deals with the reinsurers directly in placing procedures and whether the agent functions as effecting the contract of insurance in question.

3.3.3 Problems in practice relating to the relevance of agent to insure for the purpose of duty of utmost good faith

Although it is clearly established that the agent to insure is imposed a separate duty of utmost good faith by s.19 of the *MIA 1906*, it still arises problems in practice. In London subscription market, the procedure is complicated to place a reinsurance contract of complex nature and large size. It is not an uncommon practice to involve a chain of agents in arranging reinsurance covers. Typically the producing broker instructed by the reinsured will often instruct a different placing broker to present the risk to the reinsurers, for geographical reasons or to use the expertise of a broker.

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256 [2005] EWHC 1381 (Comm).
specialising in the particular type of risk in question. It is controversial whether the agent to insure for disclosure purpose confines only to the placing broker, or maybe putting it in this way, whether the duty of disclosure extends to other brokers in the middle of the placing chain.

As discussed above, it is a seemingly settled law that s.19 only applies to agents employed to effect the insurance whose knowledge should not be deemed to be that of the insured.\textsuperscript{258} However, such decision is not incontrovertible. Although following cases found them have to be bound by this decision, opponent opinion was advanced that knowledge possessed by an intermediate agent should be disclosed.\textsuperscript{259} In \textit{ERC Frankona Reinsurance v American National Insurance Co},\textsuperscript{260} although the Andrew Smith J found himself bound to follow the Court of Appeal's decision in the \textit{PCW} and \textit{Group Josi} cases, he still expressed he recognition of potential forceful criticism of such reasoning in \textit{PCW}. It is still arguable whether the placing broker is the only one kind of agent to insure contemplated by s.19. If the answer is affirmative, then how could the duty of disclosure accommodate the knowledge of other kind of intermediate agent appointed by the insured to arrange insurance cover? It is concerned that absence of duty to disclose would make intermediate brokers who is in the middle of the chain withhold or conceal material information simply by appointing a sub-broker to carry out placement no matter he chooses to do so intentionally or is required to do so by market custom. However, it does not reconcile with the market practice to burden a duty of disclosure upon the producing broker or other intermediate agents. How could they disclose the material information if he does not deal with the reinsurer at all? Actually, even if where the information within the producing broker’s knowledge is caught by s.19 (a),\textsuperscript{261} i.e. if the producing broker has any information which ought to be communicated to or ought to be known by the placing broker in the ordinary course of business, it does not matter whether the producing broker are required to disclose it personally to reinsurer or not, because the reinsurer will know it anyway so far as placing broker

\textsuperscript{260} [2005] EWHC 1381 (Comm).
\textsuperscript{261} It provides that an agent must disclose to the insurer every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to have been known by, or to have been communicated to him.
has fulfilled his duty of disclosure. It makes little difference in practice whether the producing broker falls within ambit of agent to insure in s.19 or not. Therefore, it is indicated that even though the agent to insure for the purpose under s. 19 is not confined to placing brokers, they must be the most obvious example of the type of agent contemplated. So where an intermediate agent was obliged to disclose every material circumstance under s.19 it was very likely that it should be made by the agent at the last tache of the chain dealing with the reinsurer directly anyway.

Although it is seemingly decided that the any intermediate agents in the middle of the chain are not required to disclose material information directly to reinsurers, the common law does not intent to make any agent to inform escape from passing on their possessed material information down the chain. In *PCW Syndicates v PCW Reinsurers*, where the issue as to whether an agent to insure was limited to a broker arose, Saville L.J., by relying upon *Blackburn Low & Co. v Vigors*, expressly objected burden of disclosure upon the intermediate agents but emphasised that what an intermediate agent is expected to is to pass on information either to further intermediaries or to those actually dealing directly with insurers. The insurer is entitled to rely upon that the agent to insure who is effecting the insurance has received information from the producing broker in his ordinary course of business. Even though the intermediate agent’s knowledge is not passed on to the broker who actually deals with the reinsurers, such knowledge may be imputed to the reinsured and then subject to a duty of disclosure of the reinsured under s.18 rather than falling within the scope of the placing broker’s duty under s.19.

This is actually the reasoning of ss. 3 and 4 under the *Insurance Act 2015*. Under the new approach, all the information within the knowledge of relevant agent who is responsible for the reinsured’s reinsurance is imputed into the reinsured’s knowledge, consequently subject to a fair presentation to the reinsurer. It means that the reinsured is obliged to disclose not only what he actually knows but also what ought to be known by him, i.e. what is known to the individuals who are responsible for the reinsured’s reinsurance contract. Therefore, it achieves the same effect as a

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265 (1887) 12 App. Cas.531.
combination of s.18 and s.19 under the *MIA 1906*. It doesn’t matter whether such material information is actually known by the agent to insure who deals with the reinsurer directly, or any other intermediate agents in the middle of the chain like producing brokers. As long as it is actually known or ought to be known by the intermediate agents responsible for the reinsured’s reinsurance in his ordinary course of business, it needs to be disclosed to the reinsurer under the reinsured’s duty of fair presentation. The *Insurance Act* defines the relevant person responsible for the insured’s insurance in s. 4(8) (b).\(^{266}\) So any individuals participating on behalf of the reinsured in the process of procuring reinsurance can fall within the scope. Basically they are divided into two campuses, namely the employees of the reinsured himself, and the agent to insure of the reinsured. It is not easy to put forward the exhausted examples of all possible capacities of the reinsured’s agents involved in the placing process. For example it could include the agent of the reinsured responsible for risk management, collecting relevant information of the reinsurance contract, negotiating the contract terms, doing reasonable search of information of material circumstances, passing on placing information to agent responsible for next step, and finding qualified placing broker to deal with the reinsurer etc. Therefore it is suggested that, basically any intermediate agent of the reinsured involved in the placing process and relevant in effecting reinsurance contract for the reinsured can be included into this category for imputation of knowledge purpose under s.4. Consequently this broad ambit of relevant agent to insure may have some impact on the scope of the knowledge of the reinsured; subsequently effect the scope of the duty of fair presentation.

### 3.4 Scope of the knowledge possessed by the agent to insure for the purpose of duty of utmost good faith

Under the *MIA 1906*, s.19 formulates the personal duty of disclosure on the agent to insure in two aspects. s.19 (b) employs a straightforward way by requiring the agent to insure to pass on material information which his principal is bound to disclose,\(^{267}\) whereas the s.19 (a) is more complicated requiring the agent to insure by a broad wording to disclose every material facts within his own knowledge, including both

\(^{266}\) S.4(8)(b) stipulates that an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, as an employee of the insured’s agent or in any other capacity.

actual knowledge and deemed knowledge, no matter his principal knows the information or not. Besides the materiality test, there are only some general exceptions in s.18 (3) and a limit provided in s.19 (b) qualifying the agent’s personal duty of disclosure, so that the scope of the duty is ambiguous. Such broad wording arise two controversial issues in respect of the scope of the placing broker’s duty of disclosure, i.e. whether information acquired and held by the agent to insure exceeding his capacity as broker of the reinsured need to be disclosed to reinsurer and whether s.19 operates subject to the fraud exception established in the Re Hampshire Land case or even wider principle. Consequently, difficulties may arise in practice where the broker who plays the role of agent to insure may also play multiple roles in the operation of the business, involving in some other processes with the reinsurer or the reinsured, such as concluding an open cover or a binding authority with the reinsurers before any contract of insurance comes into existence, or acting as the underwriting agent of the reinsured in managing an insurance pool and undertaking to reinsure the pool’s liabilities like a dual agent. It is worth discussing how the duty of utmost good faith applies to the broker’s knowledge in such circumstances, as it is controversial in conflicting authorities whether the knowledge of any material information acquired by the broker in any other capacity needs to be disclosed to the reinsurer. In addition, as to the scope of knowledge disclosable to the reinsurer by the broker, no matter under his personal duty of disclosure imposed by s. 19 of the MIA 1906 or on behalf of the reinsured under s. 3 of the Insurance Act 2015, it is unsettled whether there are any exceptions undermining the duty besides circumstances expressly excluded from duty of disclosure.268 Those difficulties will be discussed in the following sections.

3.4.1 General exception to the scope of broker’s knowledge for duty of disclosure purpose

S.18 (3) of the MIA 1906 expressly provides some general exceptions to the scope of the assured’s duty of disclosure.269 It can be said that those four circumstances

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268 s.18 (3) of MIA 1906 or s.3(5) of Insurance Act 2015
269 Section 18 (3) of the MIA 1906: In the absence of inquiry the following circumstances need not be disclosed, (a) any circumstance which diminishes the risk; (b) any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know; (c) any circumstance as to which information is waived by the insurer; (d) any circumstance which it is superfluous to disclose by reason of any express or implied warranty.”
set out in the section are either immaterial or material but waived from disclosure to insurers. Although s.19 (a), which is only about the broker’s duty of disclosure, adopts a broad wording requiring every material circumstances to be disclosed to the insurer, it is suggested that s.19 should operate subject to provision s.18 (3). Such reasoning is supported in an authority Societte Anonyme d'Intermediaries Luxembourgeois (SAIL) v Farex Gie.\textsuperscript{270} In SAIL v Farex Gie, Saville L.J. said that why it should be a breach of good faith sufficient to deprive the assured of his contract if the agent fails to disclose something which, had the assured known of it, would not have had to be disclosed by the latter.\textsuperscript{271} Therefore, exceptions provided by s.18 (3) should apply to s.19 too. The agent to insure should not be obligated to disclose facts which the reinsured would not be required to disclose if the reinsured knew them. It is irrelevant whatever the broker’s state of mind is. Applying exceptions in s.18 (3) to s.19 will make those two allied sections function correspondingly. However, in practice if the reinsurer does inquire about the circumstances listed in s.18 (3), it is still the reinsured’s and his broker’s duty to disclose and make a correct representation those information.

Under the Insurance Act 2015, there is no separate duty of utmost good faith imposed on the brokers any more. But the general exception rules set by s.18 (3) is retained by the new act but with some modification.\textsuperscript{272} Compared with s.18 (3), material information which either diminishes the risk, within the insurer’s knowledge, or waived by the insurer is still excluded from the scope of the duty of fair presentation imposed on the insured like before. However, the exception that any circumstances superfluous to disclose by reason of any express or implied warranty is removed by the new act.

Moreover, s.19 (b) of the MIA 1906 expressly provides an exception to the broker’s duty of disclosure that the insurer is not entitled to avoid the contract on the ground of the broker’s non-disclosure, if the material information comes into the assured’s knowledge too late to communicate it to the broker. Therefore, if the reinsured is informed of any information material to the risk, it is the reinsured’s duty to forward

\textsuperscript{270} [1994] CLC 1094.
\textsuperscript{272} In s.3(5) it provides that in the absence of enquiry, subsection (4) does not require the insured to disclose a circumstance if (a) it diminishes the irk; (b) the insurer knows it; (c) the insurer ought to know it; (d) the insurer is presumed to know it; or (e) it is something as to which the insurer waives information.
those material facts with all reasonable diligence to his broker so that the broker can pass on the information before the reinsurance is effected. In 21st century, with modern methods of communication in worldwide use, it becomes more difficult for the reinsured to prove that information reached his knowledge too late to communicate it to its agent. It actually makes little effect in practice, so such exception is also removed from the new act.

3.4.2 Difficulties in practice as to disclosure of the broker's knowledge possessed in other capacity

3.4.2.1 Information possessed and held by the broker in other capacities rather than agent to insure

S.19 (a) provides that an agent must disclose to the insurer every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to have been known by, or to have been communicated to him. The broad wording of s.19 (a) makes ambit of the disclosure controversial. It is unsettled whether brokers are required by s.19 to disclose material information possessed and held in other capacities rather than agent of the assured according the broad meaning of the words in s.19 (a). If the answer is positive, then to what extent, and in what circumstances is the broker obliged to disclose information acquired in this way? Such difficulties might arise particularly in context of reinsurance contract, as the extent of reinsurance broker’s duty to disclose his knowledge of claims may depending upon other reinsurance policies of the same reinsured.273 There are two contrary opinions in this respect of the scope.

3.4.2.1.1 Conflicting authorities

It can be said that the common law authorities governing scope of knowledge of an agent to insure acquired in a different capacity for disclosure purpose is complex and difficult to reconcile. There are two contrary opinions in this respect of the scope of knowledge of the agent to insure.

273 Arnould’s law of Marine Insurance and Average 16th ed. para. 637.
On one hand, it is proposed that material facts disclosable are confined to those the broker possesses and holds in his capacity as the agent of the reinsured. In *PCW Syndicates v PCW Reinsurers*, reinsurers alleged that reinsurance contract should be avoided because the reinsured’s underwriting agent did not disclose that he had defrauded his principal. At first instance, it was decided by Mr. Justice Waller that a broker who had committed a fraud against his principal was not obliged to disclose such fact to the reinsurer as he acquired that knowledge in a capacity other than agent of the reinsured. On appeal, the court upheld the decision but on different grounding. However Staughton L.J. went on further to comment that there were no authorities supporting the broker to disclose information received in capacity other than agent of the reinsured. Therefore the court refused to go further to decide on this point. However, in reliance on the decision in *PCW*, it has been suggested by certain comments that material circumstances known to broker need not to be disclosed, unless such knowledge was acquired in his capacity as agent of the insured under the contract in question. Therefore, in the context of reinsurance, it is held that such knowledge is not disclosable if acquired by the reinsurance broker at a different level in the reinsurance chain.

On the contrary, there are authorities holding the opinion that duty of disclosure under s.19 should have an inclusive ambit as the broad wording presents. It means that, in addition to information acquired in the capacity as the agent of the reinsured, information under the broker’s duty of disclosure extends to all material facts within the broker’s actual or deemed knowledge, no matter acquired as the broker of the reinsured in respect of the reinsurance contract in question or not, even not functioning as his broker at all. The general rules governing whether the knowledge of a broker acquired in other capacity should be disclosed derives primarily from *Blackburn Low & Co v Vigors*. In *Blackburn v Vigors*, a case which the s.19 is founded on, House of Lords rules that the agent to insure is bound to disclose all material facts within his knowledge as his principal. It is the wording of s.19 itself that suggests disclosure of all known material facts subsuming information acquired in other capacities. Such view is supported by following authorities, though in dicta. In

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276 per Staughton L.J. in PCW Syndicates, above at 256-257.
277 (1887) 12 App. Cas. 531 per Lord Halsbury at 539.
El Ajou v Dollar Land Holdings plc,\textsuperscript{278} Hoffmann L.J. held that the broker’s failure to disclose material facts within his knowledge may make the insurance avoidable, even though he did not obtain that fact in his capacity as agent for the insured. The editor of Arnould’s law of Marine Insurance and Average 16\textsuperscript{th} ed. took the view that all information that is or ought to be within the broker’s knowledge must be disclosed. However, he also admitted that “[D]ifficult problems sometimes arise, particularly in reinsurance contracts, concerning, for example, the extent of the broker’s duty to disclose his knowledge of claims pending on other policies of the same reassured.”\textsuperscript{279}

3.4.2.1.2 Proposition relating to scope of the broker’s knowledge for the purpose of disclosure

As it is not easy to reconcile the authorities, the proposition that broker’s knowledge for the purpose of disclosure is merely confined to facts known in capacity of the reinsured’s agent to effect reinsurance contract is still not convincing. Before any suitable case comes to the court, brokers are advised to disclose all the material information within their knowledge to reinsurers, irrespective of the capacity in which the information is acquired or held.

In practice, there are quite complex scenarios where the broker may be involved at different stages in a placement chain of insurance, reinsurance and retrocession covers; or as broker for a different reinsured on other overlapping reinsurances. It is quite far from straightforward to just apply the general principles outlined in Blackburn Low case. Caution should be exercised in relying on those authorities outlining general rules on whether knowledge gained at one level in the reinsurance chain should be disclosed at another level. The principal authority dealing with knowledge gained by a broker in other capacities in acting at different levels in a reinsurance chain is Societe Anonyme d’Intermediaires Luxembourgeois v Farex Gie.\textsuperscript{280} In SAIL v Farex, the broker who is employed to place reinsurance obtained a retrocession cover offer before approaching reinsurers. However, the retrocession was avoided by the retrocessionaires on the ground that their own agent had

\textsuperscript{278} [1994] 2 All. ER.685. 702.
\textsuperscript{279} Arnould’s law of Marine Insurance and Average 16\textsuperscript{th} ed. para. 637.
exceeded his authority. Therefore, the reinsurer alleged that the reinsurance contract should be avoided as the brokers did not disclose his knowledge that the retrocession might not be valid. The court rejected the reinsurer’s argument because of the broker’s unawareness of the authority flaw. However, the court went further to comment that even if the broker had actually possessed such information, the reinsurer, for whom such information is held, would be deemed to waive disclosure of it, since the broker was the agent of the reinsurer when he obtained retrocession cover for the reinsurer and the reinsurer’s knowledge of such information make it immaterial any more. Although the facts in the SAIL v Farex case did not arise on the issue of scope of the broker’s duty of disclosure, it is still considered by Hoffmann L.J that the reinsured and his agent are under a duty to disclose ‘every material circumstance’ of which they have knowledge of, irrespectively of the way in which that knowledge is acquired. Later Hoffmann LJ added that the agent’s duty to disclosure includes all material circumstances known to him in any capacity. Saville L.J. expressed his agreement with above comment that the duty of disclosure should not confine to the knowledge acquired by the agent from the reinsured but extends to knowledge otherwise acquired. Therefore, in the scenario where the broker is involved in more than one stages of placing a chain of insurance, reinsurance and retrocession cover, the broker is still obliged to disclose material information acquired in another levels. But if the broker holds such information for the reinsurer, it can be regarded that the disclosure of such information is waived by the reinsurer, rather than such information is not within the scope of disclosure. However, such situation should be distinguished from the situation of separate divisions of a large broking company placing different reinsurance contracts. The broker is only required to disclose the information actually known or ought to be known by him in his ordinary course of business. It is not necessarily for one division of a large broking company to know information communicated to other different divisions. It is the circumstances in individual case that determines whether an individual broker ought to obtain such material information from his colleagues.

Actually this proposition corresponds with market practice, as it is possible for reinsurance broker to acquire material information entirely unconnected with his

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281 Ibid., at p 149 per Hoffmann L.J.
282 Ibid.
283 Ibid, at p 157 per Saville L.J.
function as the reinsured’s broker, such as refusals by other reinsurers, losses reported to the market or pending claims on other policies not effected by the broker. The reinsurer should be informed of such information within the broker’s knowledge, unless where the broker owes a duty to a third party to keep that information confidential. For instance, in placing direct insurance and reinsurance contracts, a broker may be under the duty of disclosure to disclose some confidential information obtained in his capacity as agent of the underlying insured from a third party. However, it is suggested that normally confidentiality will rarely be an excuse for not producing material information in practice, as it is a general understanding in the insurance market that information used for placing insurance may be disclosed by the reinsureds and their broker for the purpose of placing reinsurance if necessary. To solve this difficulty, the Insurance Act 2015 expressly stipulates that confidential information known by the broker will not be imputed into the insured’s knowledge, if the broker acquires such information through a business relationship with a person who is not connected with the contract of insurance. As such confidential information is not that material information ought to be known by the reinsured in his ordinary course of business, thereon subject to disclosure. Consequently, the broker will not face such dilemma anymore in presenting material information to the reinsurer on behalf of the reinsured.

Moreover, there may be market practices or customs that some broker possesses professional knowledge base and therefore is regarded as a specialist in certain areas. Such information may be mystery to the reinsured or has come into the broker’s knowledge when he is not in capacity of the reinsured’s broker. It is advised that brokers had better to disclose such information to reinsurers, especially when their expertise and reputation are relied upon by the reinsurers.

Furthermore, the Insurance Act 2015 reflecting the latest legal spirit supports such proposition too. Under s. 4(8) (b), it expressly states that an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance whether the individual does so as the

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284 S. 4 (4) (b). Also the Act defines the persons connected with a contract of insurance in s. 4(5): for the purposes of subsection (4) the persons connected with a contract of insurance are—
(a) the insured and any other persons for whom cover is provided by the contract, and
(b) if the contract re-insures risks covered by another contract, the persons who are (by virtue of this subsection) connected with that other contract.
insured’s employee or agent, as an employee of the insured’s agent or in any other capacity. It means when the broker participates in placing reinsurance on behalf of the reinsured in whatever capacities, he falls within the scope of individuals responsible for the reinsured’s reinsurance contract. Consequently his knowledge including that acquired by him in any capacities should be imputed to the reinsured’s, and needs to be presented to the reinsurer fairly.

To sum up, it is suggested that the placing broker should disclose all material information known or ought to be known by him irrespective of where it is acquired and for whom the information is held, i.e. no matter as the broker of the reinsured to effect the reinsurance contract in question at all, even if the broker acquired such information coincidentally.

3.4.2.2 Difficulties arising from the situation of the broker functioning in dual agency situation

Given the proximity and complex nature of the relationship between the participants in the market practice, the broker may find himself in a dual agent role, serving both of the original insured and the original insurer/reinsured, or acting as the agent of the reinsured and the reinsurer in placing reinsurance and retrocession covers. It is not an uncommon practice of a broker acting as agent for two potential or actual opposing parties in the Lloyd’s insurance market. Such dual agency roles of the broker may give rise to potential conflicts of interest, enlarge the ambit of knowledge of the broker accessed in multi capacities, and then affect the operation of the duty of utmost good faith in placing process.

3.4.2.2.1 Importance of the consent of the primary principal

Under common law it is settled that the reinsured is the primary principal of the broker in placing reinsurance so that the reinsured’s interests must be placed first above all other parties.\(^\text{285}\) It is decided that no agent who has accepted an employment from one principal can in law accept an engagement from a second principal inconsistent with his duty to the first principal, unless he makes the fullest

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disclosure of his interest to each principal and obtains their consents to the dual employment. Consequently the broker owes a full rigour of fiduciary duties to the reinsured and the principal’s consent must be obtained by the broker before he can act as underwriting agent for the reinsurers. It is open to the broker’s primary principal, i.e. the reinsured to agree the broker’s conduct. Therefore such conflicting position may not always cause a problem as it is often agreed by the broker and reinsured in advance.

3.4.2.2.2 Practical difficulties for the broker to obtain consent of his primary principal

It is a frequent practice in the business insurance market that a broker acts as agents for two opposing parties, such as a underwriting agent of the reinsurers by concluding an open cover or a binding authority with the reinsurers before any contract of insurance comes into existence; or acting as the underwriting agent in managing an insurance pool and undertaking to reinsure the pool’s liabilities for more than one principal; or starting at the top of the retrocession chain and work backwards, for instance, securing a reinsurance package first before trying to place the insurance itself with no identified insured at all. In such a case the fact that reinsurance is already available is likely to be a material element to influence the underwriting decision. And the broker will have a better prospect of persuading the underwriter to participate in the primary insurance if he is able to offer him reinsurance cover at the same time. In fact, the broker is on his own initiative to approach potential principals to be with an advance agreed binding promise of reinsurance cover, rather than instructed by the primary principle’s instruction. As to the reinsurer, he is bounding by his promise to provide reinsurance cover for whatever reinsured may subsequently write a line on the primary cover and desire to reinsure the whole or part of the line. Such process practice can carry on further up the chain for the broker to approach the retrocessionaire to find retrocession cover for the potential reinsurers.

As the broker is in fact on his own initiative to approach potential principals to be, the so called primary principal has not come into existence then, it is arguable who should be the broker’s principal and whose authority should be obtained in the above discussed dual-agency scenarios. Although the broker becomes the agent of the insurer or reinsurer first in placing reinsurance or retrocession, it is suggested that his primary principal should still be the potential insured or reinsured. As it is already settled that the broker should be agent to insure of the original insured or reinsured in placing insurance covers. The identity of the insured or reinsured will not necessarily be known at the time when reinsurers are approached. Nor will the broker needs to know for certain whether the prospective insurers will even want to purchase the reinsured cover or not. The broker is anyway functioning as the agent to insure of the insured or reinsured to be, with anticipation of the potential principal’s request and stands in the interest of his principal, but just having the intending principal’s identity pending until the contract of insurance is finalised.\(^\text{289}\) Even when the broker offers the firm indication from the proposed reinsurer to his original principal, he is still acting on behalf of his principal, the reinsured. Therefore, the broker should take his intending principal’s interest as priority above all other clients, even though he may not know its identity.

3.4.2.2.3 Managing the conflicts of interests

The issue as to potential conflicts of interest in dual-agency situation was considered by the Court of Appeal in *HIH Casualty & General Insurance Ltd v JLT Risk Solutions Ltd*,\(^\text{290}\) where the broker was involved in the placement of insurance and in arranging reinsurance cover for the reinsured.\(^\text{291}\) Although the decision did not concern conflict of interests issues alone, the existence of such practice in the London Market is recognised by the court. It was held by the court of appeal that the fact that a broker acting for two principals may find himself in a conflict of interest, does not necessarily absolve him of his duties to both principals.\(^\text{292}\) As the broker has assumed duties to both principals, he must properly carryout his duties to both those principals. The fact that the broker did not perform his duty to one principal does not absolve him from

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\(^{289}\) Société Anonyme d’Intermediaries Luxembourgois v Farex Gie & Ors [1995] LRLR 116 at p 122, per Evans J.

\(^{290}\) [2007] EWCA Civ 710.

\(^{291}\) [2007] 2 Lloyd’s Rep 278.

performing his duty to another. If there is information which may potentially put cover at risk, both clients will want to know about it and, in normal circumstances both clients should be informed of the fact. This is consistent with the way in which market practice works. However, in normal circumstances, if the broker failed to disclose to the reinsurer material information passed on by the reinsured, the reinsurer on whose behalf the risks are underwritten by the broker should not be allowed to avoid the contract for non-disclosure.293 It is suggested that such information possessed by the underwriting agent of reinsurers is deemed to be imputed into the reinsurers’ knowledge so that disclosure of such knowledge is waived by the reinsurer, although such knowledge does fall within the scope of disclosure upon the broker.

3.4.3 Fraud exception to the broker’s independent duty under s.19

In practice, there is possibility that the broker may do wrongs or even commit fraud against the reinsurer or his principal, i.e. the reinsured in placing process. It is arguable whether such wrong doings or fraud committed by the broker is a material circumstance to be disclosed to the reinsurers under s.19. If there should exist a fraud exception to the scope of the broker’s duty of disclosure, how the fraud exception rules should be interpreted and how it will affect the reinsured’s right under the reinsurance contract which the broker effects on his behalf? Details will be discussed in following sections.

3.4.3.1 Is fraudulent act included in the broker’s knowledge disclosable to reinsurer?

3.4.3.1.1 The Re Hampshire Land principle

English law has long established a well-recognised exception to the circumstances where agents’ knowledge might be regarded as the principal’s. There will be no imputation of such knowledge into the principal’s if the agent to know has committed a fraud against his principal or be guilty of irregularity.294 As it is against common

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sense that agent will communicate such information to his principal; therefore such fraud is not what the principal will be aware of in his ordinary course of business. Although the actual facts and ruling in *Re Hampshire Land Co. Re*295 does not support this proposition,296 it has now been taken as the authority and applied in number of cases. The phrase ‘Re Hampshire Land’ has been used as the title of the exception to the rule of imputation of knowledge, and recently it is arguably proposed that the principle would be wide enough to protect the principal from his agent’s wrongful acts.297

### 3.4.3.1.2 Difficulties of applying the ‘Re Hampshire Land’ rule to the duty of disclosure

In respect of performing duty of disclosure in effecting reinsurance, it is unsettled that whether the fraud exception can apply to ss.18 and 19 which are a discrete set of rules requiring both the reinsured and its broker to disclose every material information within their knowledge.

Under s.18 the reinsured is required to disclose all material information known and ought to be known in his ordinary course of business, including the knowledge of his agent to know under the imputation rules. As the Re Hampshire Land principle negates imputation of an agent’s fraud into the reinsured’s deemed knowledge, the agent’s dishonesty is not the information which the reinsured needs to disclose to the reinsurer, unless he actually knows it.298

By contrast to s.18, s.19 imposes an independent duty on the agent to insure in effecting reinsurance for his principals. Therefore the relevant knowledge to be

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295 [1896] 2 Ch. 743.
297 *Re Hampshire Land* has been recognised as a common law rule that, under the circumstances where agents’ knowledge might be regarded as the principal’s, there will be no imputation of such knowledge if the agent has committed a fraud against his principal or be guilty of irregularity. However, in recent case *Safeway Stores Ltd v Twigger* [2010] EWCA Civ. 1472, it was arguably proposed that the principle was not only an exception to the general rule of the law of agency that a principal is affected by the agent’s knowledge, but also wide enough to preclude the application of ex turpi causa where it was claimed by the principal that they were the victims of agent’s wrongful acts.
disclosed is the broker’s rather than his principals’, i.e. the reinsured’s. S.19 (a) confines such knowledge to all the material information what ought to be known by or communicated to the placing broker in his ordinary course of business. So the knowledge of the broker for duty of disclosure purpose includes not only what the reinsured is bound to disclose, but also what the broker knows beyond the assured’s knowledge ambit. If the reinsured’s other agent has committed dishonesty, it is apparently not information which ought to be communicated to the agent to insure in his ordinary course of business then falls into the scope of the placing broker’s duty of disclosure. Therefore, unless the placing broker actually possesses information of such fraud, the placing broker is not under a duty to disclose such information to the reinsurer. However, it is problematic whether the agent to insure is required to disclose his own fraud against the reinsured or even against the reinsurer which makes the reinsured secondary victim. 299

It is settled law that s.19 imposes an independent duty of disclosure upon the agent to insure, rather than proceeds through the route of imputing the agent’s knowledge into the assured. Therefore, the Re Hampshire Land principle which is an exception to imputation of knowledge rule is not pertinent to the issue here. Even if the Re Hampshire Land principle could protect the reinsured from losing reinsurance cover due to non-disclosure of its agent’s fraud against himself through the route under s.18, it is still possible for the reinsurer to allege that the reinsurance contract is avoidable due to the placing broker’s breach of the separate duty under s.19 by concealing his fraud against his own principal.

3.4.3.1.3 Justification of applicability of the fraud exception to the broker’s duty of disclosure under s.19

Although the imputation route set up in the Hampshire land principles is closed under the s.19, there are strong authorities supporting applying such fraud exception to s.19. In PCW Syndicates v PCW Insurers 300 and the parallel case Group Josi Re v Walbrook Insurance Co Ltd, 301 the reinsurers alleged to avoid the reinsurance because reinsured’s underwriting agent did not disclose that he defrauded the

reinsured. The court of appeal held that the fraud exception applies to section 19 although on different grounds. It is held by Saville L.J that claims for avoidance should be dismissed because an underwriting agency is not the agent to insure under s.19 (a). By contrast, Staughton L.J. approved such decision on different ground. In his opinion, the duty of disclosure under s.19 arises out of the fact that the agent to insure is acting as an agent of the reinsured. When the agent defrauds the reinsured, he neither acts as the reinsured’ agent nor acquires or possesses such information in the capacity of reinsured’s agent. So the placing broker is not regarded as possessing such information of fraud. Therefore, s.19 does not give the reinsurer a defense to avoid the contract. Although it is still unsettled and controversial whether the agent to insure need to disclose information possessed in the capacity other than the reinsured’s agent, the court of appeal prepares to confirm the application of the fraud exception to s.19. The reasoning in the PCW case is consistent with the one behind Re Hampshire Land principle. An innocent principal should not be harmed by his agent’s fraudulent commission or guilt of irregularity against himself if it is impossible for him to be actually aware of it.

Moreover, it is proposed in Arab Bank Plc v Zurich Insurance Co that an employee is under no duty to disclose his own dereliction of his duty to his employer. In Arab Bank plc v Zurich, the managing director deliberately made a fraudulent valuation on behalf of the insured. The insurer alleged to avoid the insurance cover on the ground of non-disclosure of the agent’s fraud. Although the primary victim of fraud was the lending institute who had been relied upon the fraudulent valuation, Rix J found that the insured was the secondary victim of the agent’s fraud, or at least the insured’s agent had been guilty of dishonesty. It is held by Rix J that an employee is under no duty to disclose his own dereliction of duty to his employer. Therefore analogically, it is absurd to impose a duty upon the agent to insure to disclose his own dishonesty against his principal to reinsurer when effecting reinsurance contract.

Furthermore, if the agent’s dishonesty is not which should be known by the assured in his ordinary course of business under s.18, why should the assured be vitiates by

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302 PCW Syndicates v. PCW Reinsurers, [1996] 1 Lloyd’s Rep. 241, at p.255 per Staughton LJ “If the dishonesty of the agent is not something which in the ordinary course of business ought to be known to the principal (s.18), why should it be held against the principal merely because the agent is an agent to insure (s.19)? It is equally absurd in either case to suppose that the agent will in fact disclose his dishonesty, whether to his principal or to the proposed reinsurer.”

the dishonesty of his agent to insure under s.19? Staughton L.J expressed such
concern in *PCW Syndicates v PCW Reinsurers*. In his opinion, the reinsured that
was protected by Re Hampshire Land Co exception should not be vitiated merely
because the fraudster is agent to insure under s.19. Re Hampshire Land Co principle
should not be confined to cases where the agent’s knowledge is imputed into the
principal or deemed to be the knowledge of the principal. It should extend to any
case where the principal’s rights are affected if the agent does not make disclosure
to a third party. No matter the scope of the Re Hampshire Land Co principle can
be extended or not, the rationale behind is consistent with its original intention. The
principal’s right should not be impaired by his agent’s fraud or dishonesty, even if the
agent is an agent to insure who takes an independent duty of disclosure in effecting
reinsurance. It would be unreasonable to create such remarkable difference between
those two allied sections.

It can be concluded that s.19 operates subject to a fraud exception as well as s.18,
so that the reinsured’s rights will not be impaired by broker’s non-disclosure of fraud
committed at least against himself, although the fraud exception here is not exactly
the same as the Re Hampshire Land principle which negates imputation of such
fraud into the assured’s knowledge under s.18. Such difficulty should eliminate after
the Insurance Act 2015 comes into force. S.3 of Insurance Act 2015 takes the
imputation approach that attributes all the information within the person who is
responsible for the insurance contract into the insured’s knowledge. Consequently
Re Hampshire Land principle can apply to the duty of fair presentation directly. Any
fraud conducted against the reinsured’s interest is not a information that can be
imputed into the reinsured’s knowledge. Therefore the broker is not obliged to
present such information to the reinsurer.

3.4.3.2 A wider principle than the fraud exception applicable to the duty of
disclosure?

Since the reinsured is protected from vitiation by the agent’s fraud against himself, it
is proposed that there may be a wider principle than the fraud exception applicable
to the duty of disclosure so that the exception will extend to circumstances which

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lack actual fraud of the agent against his principal. Although there are some authorities expressing readiness to accept a wider exception rule, it is still open for the court to define the ambit of exception rule.

3.4.3.2.1 Information unreasonable to be inferred into the principal's knowledge

In *Group Josi Re*, Saville L.J was prepared to define the scope of the fraud exception as cases of ‘the agent's or director's fraud or other breach of duty to the company’. In *Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd*, Colman J concluded that, besides the situation where the agent's fraud against its principal is not to be imputed into its principal, there are also circumstances where imputation is negated in absence of actual fraud. It is the type and nature of information in question that makes it unreasonable to infer principal's knowledge in his ordinary course of business. That is to say, no matter the agent has committed any actual fraud against its principal or not; the information will not be imputed into principal's knowledge unless it is a reasonable case to infer that the agent will refer such information to its principal in the ordinary course of business. For instance, it is proposed that an agent will not generally disclose its wrongdoing or non-fraudulent breach of duty to its principal in the ordinary course of business.

3.4.3.2.2 Knowledge of his own dishonesty beyond fraud held by broker

In *Arab Bank plc v Zurich Insurance Co*, Rix J adopted Colman J's analysis and went further to accept that there should be wider exception beyond fraud. In his judgment, Rix J comments that the agent's knowledge of his own dishonesty, even without fraud, will not be transferred to his principal, if it is impossible to infer so in justice and common sense.

However, such decision was doubted by the Court of Appeal in *Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A firm)*, where a company claim against its

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307 [1996] 1 W.L.R. 1152 at p. 1545 per Saville L.J.
308 March 4, 1996.
accountants for not picking up the fraud of the company’s controller directed against third parties to whom the company had become liable. It was held by the Court of Appeal that the fraud committed by the company’s controller was directed against the third parties rather than the company itself. Therefore, the fraud had been imputed into the company’s knowledge so that it cannot be saved by the Re Hampshire Land rule. Although the House of Lords reached the decision on different ground that Re Hampshire Land rule does not applies to one-man company situation where the company and the agent cannot be distinguishable, their lordships still upheld the Court of Appeal’s decision.\textsuperscript{312}

In \textit{ERC Frankona Reinsurance v America National Insurance Co},\textsuperscript{313} reinsured alleged that his agent’s failure to report losses which reflected badly on the agent should not be imputed in to the principal because the agent would not disclose information that reflected badly on it in ordinary course of business. Although Andrew Smith J accepted Colman J’s opinion in Kingscroft v Nissan case, he rejected the reinsured’s argument.

As discussed above, although there are some authorities ready to accept existence of wider exception beyond fraud, none of the allegers succeeded due to the facts in the cases. As a result of current authorities, scope of the exception rule will be regarded open for the Court of Appeal to consider until any suitable case reaches the court.

\textbf{3.4.3.2.3 Proposition for the rules of a wider exception principle}

If there is a wider exception principle beyond fraud protecting the reinsured, it is arguable that whether such wider exception rule would apply analogically to s.19 which burdens the broker a personal duty of disclosure, although not through the imputation route. Provided that there exists a wider exception beyond fraud applicable to s.18, the reason why reinsureds are exempted from disclosing some type of information to reinsurers is that they are deemed to have no knowledge of such non-fraudulent information rather than reinsurers waive disclosure of such information within reinsureds’ knowledge. If the reinsured did actually know such


material information from any possible path, he is still obliged to disclose it. As to broker who effects reinsurance personally under s.19, it is doubtful why he can escape from disclosing such material information if he actually possesses it, even though it may reflect badly on himself to some extent. After all, it is the essence of doctrine of utmost good faith that all material known information should be disclosed precisely so that the insurer could make an informed decision.

Therefore, it is suggested that there should not be any wider exception beyond fraud exempting the broker from disclosing information within his knowledge to the reinsurer. Even if there does exist one, the test should not be easy to satisfy otherwise it would undermine the doctrine of utmost good faith. This proposition corresponds the spirits reflected in the latest insurance legislation. The Insurance Act 2015 is silent on any possible wider exception to the duty of fair presentation. The only qualification to the scope of the knowledge for disclosure purpose is the general exception rules set out in s.3 (5) and the confidential information exception set out in s.4(4) on the insured’s knowledge. The essence of the duty of fair presentation is that both parties should exercise reasonable effect and endeavor to make the risks presented fairly so that an informed underwriting decision can be made by the insurer.

3.5 Summary of the framework of duty of utmost good faith regarding the reinsurance broker’s duty of disclosure

Since House of Lords’ decision in HIH Casualty and General Insurance Ltd v Chase Manhattan Bank,314 it is a settled law that s.19 places a personal duty of disclosure upon the reinsurance broker separately from the reinsured’s duty of disclosure under s.18 rather than going through the imputation route. The broker is not only required to disclose material facts which the reinsured is bound to disclose, but also required to disclose material circumstances as provided in s.19 (a) which the reinsured neither know nor ought to have known. However, this duty is significantly changed by the Insurance Act 2015. Under the new act, broker’s personal duty is eliminated and his knowledge which is material information disclosable to the reinsurer is imputed into the reinsured’s, and then should be fairly presented to the reinsurer.

As to relevant agent under s.19, on the balance of authorities, it is seemingly settled that s. 19 only applies to the agent who is the last tache in the chain to place the risk directly with reinsurer, i.e. the placing brokers. Once any intermediate agents are involved into the negotiation of effecting reinsurance, no matter underwriting agency or appointed sub-brokers dealing with the reinsurer indirectly, they do not fall into the scope of agent to insure for the purpose of s.19. However, the producing brokers are supposed to pass his possessed material information down. The placing broker is deemed to know such information in his ordinary course of business then disclose it to the reinsurer under s.19 (a). Therefore, s.19 (a) can protect insurer from situations where material information does not reach placing broker or the placing broker has received the information but fails to disclose it. The Insurance Act 2015 adopts such reasoning by using the imputation of knowledge route. Therefore it is suggested that, basically any intermediate agent of the reinsured involved in the placing process and relevant in effecting reinsurance contract for the reinsured can be included into this category for imputation of knowledge purpose under s.4 of the Insurance Act 2015.

However, the scope of the broker’s duty of disclosure is still unsettled. By contrast to the broad wording of s.19 requiring disclosure of every material information to the insurer, it is suggested that there are some exceptions apply to the duty of utmost good faith. First, circumstances enumerated in s.18 (3) of the MIA 1906 and s.3(5) of the Insurance Act 2015 are only clearly settled exceptions applying to s.19. The brokers should not be required to disclose what the reinsured are not bound to disclose. Secondly, the duty of utmost good faith operates subject to a fraud exception that brokers are not required to disclose their fraud against their principals, although the reasoning is different from the Re Hampshire Land principle through the imputation of knowledge route. However, it is doubtful whether there exists any wider exception beyond fraud to the broker’s duty of disclosure. Moreover, if the broker plays a dual agency role in the placing process, it is regarded that the insurer should bear the risk. Furthermore, although there are some authorities supporting a gloss on s.19 that brokers are only required to disclose material information known by or ought to have been communicated to them in the capacity of reinsured’s broker, the reasoning is still unconvincing. As a result it is still unsettled and controversial whether the broker is only required to disclose information held and acquired in capacity of the reinsured’s broker. Before a suitable case comes to the court, brokers
are advised to disclose all material information within his knowledge received in all capacities.
Chapter 4 Performance of duty of utmost good faith in broker’s placing process in a subscription market

4.1 Introduction

Reinsurance as an important type of commercial insurance involving large amounts of money and high risks in London market is inevitably underwritten by more than one reinsurers, usually represented by Lloyd’s and some insurance companies outside Lloyd’s market. Lloyd’s, as a representative market whose practice and placement procedure is commonly adopted in London market, is a place where facilities and regulation are provided for his members to conduct business transactions, rather than an insurer who by itself issues commercial insurance covers. Reinsurance brokers have always been relied upon heavily for producing reinsurance business in London market, especially Lloyd’s whose system functions on a broker-orientated basis.

However, such traditional and unique subscription placing process in the market will have some impact upon the formation of the insurance contracts, and then affect the attachment of duty of utmost good faith to the contract. Difficulties may arise because the duty of utmost good faith cannot apply straightforward when reinsurance is effected by a subscription procedure. Therefore it will be discussed in this section how current doctrine of duty of utmost good faith operates in broker’s placing process of reinsurance in the subscription market. The difficulties will be analysed as to when the reinsurance contract is concluded in the subscription procedure, and then attracts the duty of utmost good faith. In addition, problems may arise in performance of the duty of utmost good faith due to the specific characters of the subscription procedure. Solutions will be found to cover the gap in both common law and market practice aspects.

4.2 The placing process of reinsurance contract in the subscription market

4.2.1 The scratching process in the subscription market by use of a slip

Placing of reinsurance contract at Lloyd’s was inevitably using a slip which was also commonly used to effect commercial insurance between insurance companies
outside Lloyd's. After obtaining the quotations from the underwriters, the broker at the beginning of the placing process will approach the leading underwriter with a prepared brief memorandum called the slip, containing details of the intended cover. The slip can be regarded as offer of the reinsurance contract. Normally the leading underwriter will go through the slip with the broker by negotiation of the terms and premium which can be considered as a counter-offer of a reinsurance agreement. Once all the amendment to the broker’s draft is agreed and premium gets fixed, the leading underwriter will initiate the ‘scratching’ process, by stamping and signing the name of his syndicate on the slip and indicating on the slip of the proportion and amount of the risk that he is willing to accept. Subsequently, the broker will take the initialed slip around the market successively among following underwriters until satisfactory level of subscription is received. It is not an uncommon practice for the broker to get oversubscription by continuing presenting the risk in the market after 100% has been achieved, in the purpose of reducing proportionately subscription of each underwriter under the principle of indemnity. After cease of subscription of the risks, the broker may give each subscriber a signing indication which is a statement of the total percentage subscription to the underwriters.

However the subscription procedure by use of a slip raised a number of practical problems as to the uncertainty of the contract and inconsistency between the slip and policy issued later. Therefore since 2000 Lloyd’s initiated a thorough review and reform of the insurance placement procedures in the market. Subsequently a short-lived London Market Principles 2001 was published to clarify the protocols and stands for placing of risks and claim-handling in the London market, by use of a new form of slip and the increasing use of leading underwriting clauses. For mitigating disputes and regulating purpose, in 2001 Xchanging Ins-sure was established to issue a single policy which records the terms and conditions of the contract effected on behalf of all the contributing underwriters in the London market. However, difficulties may still arise in practice where, especially in the reinsurance market, no

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315 Such signing down practice is a widely accepted custom and practice recognised by common law. See General Reinsurance Corporation v Forsikringsaktiebolaget Fennia Patria (Fennia Patria) [1982] 1 Lloyd’s Rep 87 (Comm); [1983] 2 Lloyd’s Rep 287 (CA); General Accident Fire and Life Assurance Corporation v Tanter (The Zephyr) [1984] 1 Lloyd’s Rep. 58.
317 It will be referred as LMP 2001 in this chapter.
318 This can be a market response of s.22 in MIA 1906, which provides that a contract of marine insurance, represented by slip in placing process in London market, is not admissible in evidence unless it is embodied in a marine policy.
A unified formal policy is to be issued. Finally LMP 2001 did not survive the challenge of the insurance regulator, i.e. the FSA, to find a better solution to the problem of inadequate documentation of the contract of insurance.

4.2.2 The scratching process in the subscription market since the MRC stage

To beat the challenge of the FSA, two separate working groups was established by the London insurance market, i.e. the Subscription Market Reform Group to reform the market using slip in placing risks and the Non-subscription Market Reform Group to reform the market which is dealing all other insurance transactions. Code of Practice was issued by the two groups to provide guidance on contract certainty. Finally in 2007 a consolidated code of Practice was successfully issued to enhance the certainty of the insurance contracts and all previous contract certainty guidance was replaced.

According to the principles set out in CCCP, to ensure the certainty of the contract, the insurer/reinsurer and his brokers must, by the time of entering into the contract, ensure that all the terms are clear and unambiguous. Therefore at the time of the offer to enter into a contract of insurance or acceptance of the offer, all the terms must be clearly expressed and includes any conditions or subjectivities. In addition, after the conclusion of the contract of insurance, contract documentation must be provided to the insured/reinsured promptly. If there is any changes to the contract, it need to be certain and documented promptly accordingly. Moreover, the CCCP tried to give guidance on decreasing contract uncertainty caused by the signing down practice and avoiding oversubscription problems. According to the specific nature of the subscription placing procedure, more than one participating insurer/reinsurers will be involved in a contract of insurance. The contract must include an agreed basis on which each subscriber’s final participation will be determined, and their final participation must be provided to each subscriber promptly, so that the oversubscription problem in the signing down practice can be avoided.

To achieve the aim and objectives of such guidance principles, the London Market

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319 In such a case, the slip is referred to as a ‘slip policy’ which is simply a slightly fuller form of the signing slip. Once the slip is signed, a contract is concluded binding both parties even without issuing a policy.

320 In June 2007, a consolidated Code of Practice, i.e. the Contract Certainty Code of Practice (CCCP) was published by the Contract Certainty Steering Committee. This Code successfully consolidated and replaced all previous contract certainty guidance.
Group introduced to the London market a placing standard to provide a standard form of submissions. In 2007 a standardised form of agreement, initially LMP and now MRC (the Market Reform Contract), is used to replace the slip, when a risk is presented by the broker to the market. Annual review of the MRC has been carried out by a cross-market group. Until now several versions of MRC have been published to provide guidance to placing risks in subscription market. Changes have been updated into the MRC, for example in July 2011 changes arose from the non-admitted and Reinsurance Reform Act (NRRA) and was added to surplus lines filing requirements. Consequently, the MRC guidance for binding authorities, lineslips and lineslip declarations has now been updated in line with these changes made in the ‘Open Market’ Guidance version 1.4. Until now the latest version has been published by the group as MRC 1.5.

As stipulated in the MRC guidance, it must contain all the details set out in the guidance, i.e. the risk details, information supporting the assessment of the risk at the time of placement, security details, subscription agreement, fiscal and regulatory, and broker remuneration and deductions. Therefore, when the broker is approaching the subscription market, he will make a presentation consisting of an introductory section including out the most important details of the risks instead of the slip used to be referred in the placing process. In addition to the similar ‘old slip’, a document of schedule consisting of all the terms of the policy

321 London Market Group (LMG) is a senior market wide body with the primary function to act as champion of the modernisation agenda in the London Market. This remit extends to any area of market processes where the actions of one constituent party cannot be viewed in isolation from the effects they might have on any of the other constituents; subject to ensuring that the remit does not infringe any relevant competition law. http://www.londonmarketgroup.co.uk/. Standards for placing documents are agreed with Market Associations and Lloyd’s and published on behalf of the London Market Group (LMG).

322 The guidance was published as follows: Market Reform Contract (Binding Authority) Implementation Guide v 1.4; Market Reform Contract (Lineslip) Implementation Guide v 1.4; Market Reform Contract (Lineslip Declarations) Implementation Guide v 1.4.

323 All MRC publications can be found at www.londonmarketgroup.co.uk.

324 The details consist of any information provided to insurers to support the assessment of the risk at the time of placement, either in full or, if inappropriate, clearly referenced and made available to all subscribing insurers.

325 The information consists of any information provided to insurers to support the assessment of the risk at the time of placement, either in full or, if inappropriate, clearly referenced and made available to all subscribing insurers.

326 The details consist of the subscriptions of subscribing insurers in percentage terms of the financial limits; terms of signing down (so that if a line is written “to stand” it may not be signed down). It is not permitted to include a line condition “wording to be agreed”: all wording must be agreed before the insurer commits to the contract.

327 This establishes the rules to be followed for processing and administration of post-placement amendments and transactions. The name of the slip leader must be clearly identified, any leading underwriter agreement must be specified and the claims agreement procedure is to be specified;

328 Those are issues specific to the insurers involved in the risk must be shown, in particular, taxes which are deducted from the premium retained by the insurer.

329 It is about information relating to brokerage, fees and deductions from premium.
should be attached by the broker. It serves the function of a combination of old slip and policy. When the underwriter scratches the documents, the entire contract can be presented in front of the underwriters. Consequently, it can solve the difficult issue of inconsistency between the slip and policy and deliver the effect requested by the CCCP that all of the documents should be prepared at before conclusion of the contract.

4.3 Difficulties of attachment of the duty to the reinsurance caused by the modification of contractual formation process in subscription market

The presence of the MRC offers a clear structure of the insurance contract and means for the broker in presenting risks in a subscription market, so that an insurance contract can be concluded in a consistent manner. This results in clarity to the negotiation of the terms of the contract and then enhances the efficiency of the placing process. It notably ensures the content of contract of insurance is aligned with the needs of contract certainty. Consequently, the difficult issue of inconsistency between the slip and policy is only historical. It is now easy to answer the questions what has been concluded between the reinsurance parties in the contract. However, difficult issues still exist even though the MRC resolves the problems from the weakness of the previous slip procedures prima facie. Notwithstanding the MRC resolves the difficult issue of inconsistency between the slip and the policy issued later in the previous slip time, some problems due to the subscription procedure still remain. As a result, it modifies the contractual formation process and consequently causes some difficulties in attachment and duration of the duty of utmost good faith to the reinsurance contract. Therefore the most significant issue here is when the reinsurance contract is concluded and how the duty of utmost good faith operates in the negotiation which is modified by the specific contractual formation process. Moreover, particular difficulties may arise in situation where the reinsurer is approached by the broker before existence of any direct insurance. It is arguable whether the reinsurance contract is concluded before the identity of the reinsured, i.e. the original insurer under underlying slip, can be said for certain.
4.3.1 When the duty of utmost good faith is attracted to a contract of reinsurance in subscription market

It may be found sometimes struggling to make the general legal principles of contract law apply to reinsurance contract due to its placing process in London subscription market practice. It is arguable when a binding contract is concluded between the reinsured and the reinsurer in the scratching process. It need to be clarified whether scratching the MRC by an underwriter can be considered as an acceptance of a prospective reinsured’s offer to contract so that a binding contract is concluded between each reinsurer and the reinsured by putting down his line; or the reinsurance contract will remain open to acceptance and finally be concluded until the slip was fully subscribed.

In very early stage, the contractual effect of the slip has been confirmed by Blackburn J. in Ionides v Pacific Fire and Marine Insurance Co. that the slip is a complete and final contract between the parties, fixing the terms of the insurance and the premium. The modern authority supporting the conclusion of a reinsurance contract by a slip is General Reinsurance Corporation v Forsikringsaktiebolaget (Fennia Patria), by rejecting the earlier dicta in Jaglom v Excess Insurance Co Ltd. In Fennia Patria, the reinsured Fennia had reinsured its liability under two facultative reinsurance policies. In a process of reinsured's broker taking an amendment slip around the subscribing underwriters, the loss happened when just two out of twenty-eight of the specific loss underwriters had initialed the slip. Thereupon, the broker was instructed by the reinsured to withdraw the amendment slip. The disputing issue is whether the two reinsurers who had initialed the amendment slip were bound and whether the reinsured was entitled to withdraw a partly subscribed slip. It was decided by Court of Appeal that the slip which is initialed by the reinsurers as acceptance of the broker’s offer is a binding contract between the reinsured and reinsurers. Therefore it is now a settled law that a slip is regarded as containing an offer, acceptance of which gives rise then and there to a separate binding contract between the parties. A party cannot withdraw from the

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332 [1972] 2 QB 250, where it was commented that a slip was not binding until fully subscribed.
agreement even though the slip may be partially subscribed.\textsuperscript{334} Although the slip is no longer used for placing reinsurance contract, MRC which now serves the combined function of the slip and the policy should inherit the role of the slip. So the same principles as to the contractual effect of a slip should apply to MRCs. As a result, the reinsurance underwriter’s unconditional subscription to the MRC creates a binding contract between the parties. Whether the underwriter has subscribed the MRC unconditionally needs to be determined objectively, rather than by reference to his actual belief,\textsuperscript{335} even though the MRC itself says that it is made subject to the qualification ‘to be entered’ or the MRC is scratched in pencil.\textsuperscript{336} It is a question of construction as to whether the subjectivity is a condition precedent to a binding acceptance. However in the situation where the underwriter indeed specially imposes subjectivities which have to be satisfied before the scratching becomes binding upon the contractual parties, provided any such condition is imposed before the scratching is complete,\textsuperscript{337} the parties are not bound by the agreement until the condition is satisfied. Even though the loss has occurred before the MRC has been fully subscribed, each underwriter is bound by his scratching and is liable and only liable for his subscribed proportion of the total amount once the risks has incepted.

As to the contractual privity between the reinsured and all subscribers, it is decided that the slip used to represent a bundle of separate rather than joint and several binding contracts,\textsuperscript{338} even a policy has not been issued. Consequently, it is fair to say that each subscribing reinsurer on scratching the MRC accepts individual underwriting obligations to the reinsured under a separate contract. The MRC will bind the subscriber individually for his own part rather than collectively or jointly and severally. Therefore, according to the general rules of application of the duty of utmost good faith, the duty attaches to the negotiation of contract of insurance and

\textsuperscript{334} General Reinsurance Corporation v Forsikringsaktiebolaget (Fennia Patria) [1982] 1 Lloyd’s Rep 87 (Comm); reversed [1983] 2 Lloyd’s Rep 287 (CA).

\textsuperscript{335} Bonner v Cox Dedicated Corporate Member Ltd [2006] Lloyd’s Rep. I.R. 385.


\textsuperscript{337} Bonner v Cox Dedicated Corporate Member Ltd [2006] Lloyd’s Rep. I.R. 385, where the condition was imposed after scratching.

ceases to exist when the contract is concluded. As a result, the reinsured and broker owes separate duty of disclosure and duty of refraining from misrepresentation in the scratching process to individual reinsurers. Each reinsurer, not only the leader but also the following reinsurers, deserves a full disclosure of all material information concerning the underwritten risks so that an information underwriting decision can be made by him. Once the reinsurer scratches the slip after an underwriting decision is made, a reinsurance contract is concluded. Thus terminates the operation of duty of utmost good faith. No more duty of disclosure of material facts is required by the broker to the reinsurer even if the underwritten risk is not fully subscribed yet. If a loss had occurred between the date which the slip became fully subscribed and the date which the policy is issued, the reinsured would still be covered, as the policy would be merely a formal recording of terms in the contract agreed between the parties. It is suggested that such rules are consistent with current market practice. Each of the reinsurers has an individual contract of reinsurance with the reinsured on the same risk and only liable for his own subscribing proportion of the risks, and each contract of reinsurance attract a separate duty of utmost good faith between the parties involved.

4.3.2 Problems arising in the situation where reinsurance exists before the direct insurance

As discussed above, it is settled that reinsurance contract is concluded when the reinsurer scratches the MRC as an acceptance of the broker's offer on behalf of his principal, i.e. the reinsured. However, difficulties may arise in the situation where the broker places reinsurance cover before he brokes the direct insurance.

At the time when the broker approaches the reinsurer with an offer on behalf of a potential reinsured whose identity may not be known by the broker for certain, the presence of the documentation could not be regarded as an offer to a contract of reinsurance made by the broker on behalf of the reinsured. As the broker does not actually act on behalf of any identifiable principal or can be said to simply give an offer on behalf of himself. It is arguable whether the reinsurance contract is concluded before the identity of the reinsured, i.e. the original insurer under direct insurance, can be said for certain. If the answer is the negative, then further questions need to be asked is when a binding contract of reinsurance is deemed to
be concluded.

In *General Accident Fire and Life Assurance Corporation and Others v Peter William Tanter and Others* ("The Zephyr"), it was found by Hobhouse J that when the reinsurance underwriter put down his line, he was just agreeing to provide cover to any reinsured who subsequently wrote the underlying cover and came within the description of a reinsured under the reinsurance slip. Such opinion was approved by Mustill LJ in the Court of Appeal, although the issue was not the subject of appeal. The issue arose again in *Bonner and Others v Cox Dedicated Corporate Member Ltd.* In *Bonner v Cox*, the broker approached the reinsurance underwriter with the reinsurance slip prior to broking the renewal of an existing open cover. While the brokers were taking the reinsurance slip around the market, a substantial loss occurred to the open cover for the previous year. The issue whether the reinsurance was concluded became vital, as if the brokers had been aware of the loss before the conclusion of the reinsurance contract, such material information should have been disclosed to the reinsurers. Morison J at the first instance adopted the approach in *The Zephyr*. It was recognised that the reinsurers by scratching the reinsurance slip was making an offer to all potential qualifying underwriters of the underlying cover, to provide reinsurance on the terms of the slip. Such opinion gained approval on appeal.

Therefore, it is suggested that initialing the MRC is just functioning as a binding promise to provide reinsurance for whatever person who subsequently write a line on the primary insurance and desire to cede the risks to the reinsurer. As a matter of law, the offer was capable of being accepted by a communication by a qualifying underwriter to the broker to that effect. So once the reinsurance had been accepted by the original underwriter, the reinsurance contract is concluded binding the parties. Even without a communication of that acceptance made to the reinsurers by the broker, a binding contract comes into existence on strict contractual analysis.

As a result, the duty of utmost good faith has attaches the reinsurance contract since the broker starts to approach the reinsurer at the beginning of the scratching process.

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The broker must anticipate the placement request of a potential reinsured in respect of a proper reinsurance protection and then make a full disclosure of all material facts and information concerning the underlying risks and the reinsurance agreement itself to individual proposed reinsurers during the scratching process. The duty of disclosure continues after the reinsurer has put down his line on the MRC. Any material information comes into the broker’s knowledge after the reinsurer has made the scratching must be disclosed by the broker to the proposed reinsurer. As a result, in contrary to normal situation, the broker remains under a duty of disclosure until the underwriter of the underlying cover has accepted the offer to conclude a binding contract.

4.4 Problems in relation to performance of duty of utmost good faith in placing process in the subscription market

As shown in previous section, placing reinsurance in a subscription market to some extent modifies the formation process of a reinsurance contract, and subsequently effects the operation of the doctrine of utmost good faith under the reinsurance contract concluded. As a result broker’s performance of duty of disclosure has been transformed to some extent by the special placing procedure. Difficulties arise in broker’s performance of the duty as a gap is created between the rules of law and the market practice. Relevant solutions in common law and the market practice have been proposed and practiced to cover gap which will be discussed in details in the following sections.

4.4.1 Difficulties created by the gap between the rule of law and the market practice in disclosure process

It is now established that the duty of utmost good faith attaches to the slip which has a legal status as reinsurance contract, so that it may be set aside if the scratch has been induced by misrepresentation or non-disclosure.\(^{343}\) Due to the contractual effect of a slip, it is determined that each of a bundle of contracts concluded by the slip attracts a separate duty of utmost good faith between the parties. There is strict contact privity between the individual reinsurer and individual reinsured, no matter how many reinsurers or reinsured are involved in the subscription of the underwritten

risks. Therefore as required by the duty of utmost good faith, both the reinsured and
his placing broker are under separate duty of disclosure and making no
misrepresentation not only to the leading underwriter but also to all the following
underwriters on the subscription list. It is hardly true that the following underwriters
will care nothing about whether the risk is a good one thereupon waiver the
reinsured and the broker’s duty of disclosure.\(^{344}\)

However according to the market placing procedure illustrated above, rather than
going through the contractual negotiation with the broker, the following underwriters
subscribe the slip simply and largely by considering who the leading underwriter is
and what proportion he has subscribed the risks. The leading underwriter’s skills and
judgment in deciding whether to accept the broker’s offer and to accept it on what
terms and premium is believed and trusted by the following underwriters. It is
assumed by the following underwriters that the leading underwriter has duly
ascertained and weighted all material circumstances and then made an informed
decision after being disclosed and represented all material information accurately.

As a result, in case where a misrepresentation or non-disclosure is made to the
leading underwriter, the gap between the rule of law and the market practice will
cause difficulties as to whether the following underwriters would have the same
defense as the leading underwriter does to avoid their insurance contracts,
especially in absence of a leading underwriter clause in the slip or in any event that
no line slip is used. Also, problems will arise where non-disclosure or
misrepresentation is made to the following market but not to the leading underwriters.
The following sections will focus on the difficulties arising from such transformation
and discuss detail the solutions proposed by the common law and adopted in the
market practice, so that it can show how the common law and market practice react
in order to make the duty of utmost good faith is performed well in the placing
process.

4.4.2 The deemed communication rule

In order to cover the gap between the law and the market practice in performance of
the duty of disclosure, a solution is suggested that there should be a deemed

communication rule. Such deemed communication rule is supposed to grant each underwriter on the subscription list a defence that, when there is a non-disclosure or misrepresentation made to the leading underwriter, such non-disclosure or misrepresentation was deemed to be communicated to the following market as well. Consequently the following underwriters could take advantage of non-disclosure or misrepresentations established in the case of the leading underwriter.  

4.4.2.1 Flaws of the deemed communication rule

Such rule is not flawless, as it has to some extent made violation of the duty of utmost good faith which is crystallised rule of law under ss.18 to 20 in the MIA 1906. The reinsurer is only allowed to avoid the reinsurance contract if he could actually establish that there was a non-disclosure or misrepresentation of material facts to him, and actual inducement requirement need to be satisfied as well.346 The rationale behind the deemed communication rule is to protect the innocent following underwriter who is induced into a contract of insurance without knowing material facts. It should not be used by a following underwriter to get rid of his own contractual liabilities without proof of actual non-disclosure or inducement just because someone he relies upon and trusts in has been induced into another separate contract of insurance.

4.4.2.2 Dissatisfaction of the deemed communication rule shown in authorities

The courts have showed their passive and dissatisfactory attitude by recognising a limited application of the rule. Such dissatisfaction can be smelled in General Accident Fire & Life Assurance Corp v Tanter (The Zephyr),347 although this case did not directly concern the duty of disclosure issue but about signing down indication by analogy.

In The Zephyr, the assured instructed his broker to place suitable insurance cover. The broker first obtained a quote from the leading underwriter, a total loss underwriter, and the leading underwriter singed a line of 10 percent of value at a total

346 It has been a long story about doubts about the deemed communication rule. In Bell v Carstairs, (1810) w Camp 543,544, Lord Ellenborough observed that: “it is difficult to see on what principle of law a representation to the first underwriter is considered as made to all those who afterwards underwrite the policy.”
loss rate of 0.45 percent after having been given a 1/3 signing down indication by the broker. Then the broker confirmed that all the insurance cover required was completed after having proceeded to the following market. 11 days later, the Zephyr stranded and suffered serious damage, and then all risks underwriters gave notice of abandonment on the basis that the Zephyr was a constructive total loss. The reinsurers refused to pay the claim on the basis that the reinsurance broker did not achieve the 1/3 signing down indication. At first instance, Hobhouse J. held that the broker was liable to the leading underwriters in the tort of negligence but not to the other following underwriters. The issue on appeal was the liability of the brokers to pay damages to underwriters for breach of duty. The court of Appeal disapproved the finding of tortious liability based on the signing down indication. It was held that the signing down indication, according to the practice of the market, implied acceptance of a responsibility to use best endeavors to procure the signing down by the date of inception. However, in this case, there was nothing to suggest that a bare optimistic promise given by the broker was not founded upon honest and reasonable belief. As to the broker’s tortious liability to the following underwriters, it was held that the broker was speaking to the leading underwriter about a transaction effected between the broker and the following underwriters was not capable of creating a situation where the broker must do what he conveyed he would do or pay damages in default. Therefore, in absence of an express signing indication, the brokers could not be held liable where nothing was said to the following underwriter.

It can be concluded that the reasoning of the following underwriters’ argument was derived from an analogy with the deemed communication rule. The disapproval of such analogy to some extent, indicated the courts’ dissatisfaction with the deemed communication rule.

4.4.2.3 A solution of effecting a supposed rule

The doubts about the deemed communication rule discussed above does not stand alone. In Bank Leumi Le Israel BM v British National Insurance Co, the assured took action against the insurers who tried to avoid the contract by alleging non-disclosure and misrepresentations by the assured. As the 10th defendants, the
brokers argued that non-disclosure and misrepresentation were made only to the first three insurers not to other following underwriters. Therefore, the following underwriters could not rely upon such defense. Although he found himself not necessary to decide this point, Saville J. gave his comments on the deemed communication rule by expressing his agreement with Mustill L.J. in *The Zephyr*. He went further to find a solution to effect ‘the supposed rule’. In order to make such deemed communication rule valid, it should be established that a custom or usage of such supposed rule can be proven in the particular market, or it imported an implied term into the contracts between the reinsured and the following underwriters, or an implied representation had been made to following underwriters that all material circumstances had been accurately provided to the leading underwriter. Even though the solution suggested by Saville L.J can harmonise the rule of law and the market practice, the proposition is not logically perfect as the mere fact that the leading underwriter may be able to avoid his contract with reinsured does not necessary confer such defense on the following underwriters who have separate contracts and then separate duty of disclosure with reinsured.

4.4.3 Other solutions in common law besides the deemed communication rule

In addition to Saville L.J’s solution, an alternative solution is becoming popular in courts. It suggests that the fact that a misrepresentation or non-disclosure of material fact has been made to the leading underwriter is on its own a material fact which should be disclosed to the following underwriters and non-disclosure of such fact entitles the following underwriters to avoid the insurance policy. However, there are two different grounds supporting such solution. Comparison will be made between the two solutions to find a better way to cover the gap.

4.4.3.1 Two different grounds supporting the solution

In *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins Ltd*, the reinsurer instructed his broker to place retrocession cover for him. During the placing process,
a misrepresentation about the nature of the reinsurance contract was made to the leading retrocessionaire. Arbitration between the reinsurer and retrocessionaire awarded the leading retrocessionaire entitlement to avoid the retrocession due to such misrepresentation. In addition, the arbitrators held that the following market could avoid on the ground that the brokers should have disclosed this failure to make a full and fair presentation to the leader. The brokers tried to argue that they were not liable for the following market due to the misrepresentation as a matter of law, relying upon the dicta doubting the deemed communication rule by Mustill L.J in The Zephyr and Saville J. in Bank Leumi. However, Cresswell J, based on the facts of the particular case, found that the following market had accepted the risk on the basis that a full and fair presentation had been made to the leading retrocessionaire underwriter. Therefore, such misrepresentation made to the leader should have been disclosed to the following underwriters.

Such issue came before the court again in *Brotherton and Others v Aseguradora Colseguros SA and another (No.3)*[^354] where the reinsurer sought to avoid the reinsurance contracts due to the broker’s non-disclosure as to the reinsured’s moral hazard. As to the issue on whether the following reinsurance underwriters would be able to avoid the policy, it was held that the non-disclosure of material facts to the leading underwriter was itself a material fact which should be disclosed to the following underwriter. However, different from Cresswell J relying on the particular facts of Aneco, Morison J focused on the expectation of the following market that a fair presentation had been made to the leading underwriter, if the leading underwriter was entitled to avoid the contract due to non-disclosure or misrepresentation, the following underwriter should be entitled as well. This can be regarded as a diversion from the alleged solution. Such alternative solution is accepted in *Toomey v Banco Vitalicio De Espana Sa De Seguros Y Reaseguros*,[^355] where the reinsurer alleged that the reinsured had made a misrepresentation as to the nature of underlying insurance which was cover for ascertained loss rather than for an agreed value. It was evidenced by one following underwriter that he had limited experience of this type of business and heavily relied upon the leading underwriter, moreover he would

[^355]: [2004] Lloyd’s Rep IR 354 (Comm); [2005] Lloyd’s Rep IR 423 (CA)
not have subscribed the risk if it was not led by the leader.\textsuperscript{356} Andrew Smith J held that each of the underwriters was induced by the misrepresentation including the following underwriters who relied upon the presentation to the leading underwriter and the leader’s judgment in respect of the risk.

\textbf{4.4.3.2 Comparison between the two solutions}

In comparison, the latter of the two solutions is more attractive. First, the fact that the broker has made a non-disclosure to the leading underwriter has not necessarily to be a material fact. In \textit{CTI v Oceanus},\textsuperscript{357} the proposition is that previous non-fraudulent breaches of the duty of utmost good faith are not material facts for the purpose of latter applications. Whether misrepresentation or non-disclosure to the leading underwriter would be considered as a material fact depends upon a prudent underwriters’ judgment. Moreover, the fundamental reason why the broker’s non-disclosure or misrepresentation to the leading underwriter would influence the following market is that the following underwriters have reliance upon the leading underwriter’s expertise and skill in underwriting such particular risk. The following underwriters enter into the contracts with an expectation that the brokers have made a fair and full presentation to the leading underwriter so that he has made an informed decision. Therefore, if a reliance or expectation can be established, the following market should be entitled the same defense as the leading underwriters.

\textbf{4.4.4 The leading underwriter clauses in market practice}

In addition to the common law solutions, the London market has its own practical exercise and reaction to save time and cost, and to avoid disputes. A leading underwriter clause is one of such important devices inserted into the contract to cover the gap between the law and market practice, to make sure the obligations of all subscribers are concurrent. It functions to facilitate the placement, administration and claim handling of a multi-party insurance contract. Such clauses are also widely used in the subscription market in declarations policies such as a line slip, an open cover or treaties. Corresponding to the adoption of the MRC in the subscription

\footnotesize{\textsuperscript{356} [2004] Lloyd’s Rep IR 354 (Comm), 71, 77. \\
\textsuperscript{357} [1982] 2 Lloyd’s Rep 178, 193, 198-200}
market, a General Underwriters Agreement (GUA) is developed.\textsuperscript{358} It sets out the use of leading underwriter clauses with the MRC, especially concerning the amendment and claim-handling process after the placement of the risks. Therefore an agreement is created between the subscribing underwriters on a particular contract for the management of changes.\textsuperscript{359} It clarifies the extent of the authority of the leading underwriter who has been delegated to agree contract alternations and ensures all the following subscribers are notified of alterations.

In most cases, the leading underwriter will usually but not necessarily the first reinsurer on the subscription list. He may, but not always subscribe the largest or one of the largest lines.\textsuperscript{360} It is irrelevant that that underwriter has taken only a small part of the risk in comparison to the following market.\textsuperscript{361} Also there may be more than one leading underwriter involved. For example in a reinsurance treaty which is arranged in layers, there may be one or more leading underwriter on each layer. The leading underwriter may be expressly identified on the slip. However, in the situation where the slip is silent on the identity of the leading underwriter, in the situation where the slip is silent on the identity of the leading underwriter evidence of the parties’ intention will be found by the courts. The courts may take into consideration several matters, such as who was the first reinsurer approached by the broker in the placing process, whether the reinsurer has scratched his line as the leader and any other evidence in the placing document created by the broker for his principal.\textsuperscript{362} Which underwriter to be chosen as a leader is totally up to the broker’s discretion. Choosing a reputed leading underwriter whose judgment is believed and trusted by the following market will make the risk attractive to the following underwriters to be subscribed.\textsuperscript{363}

By inserting such clauses into the contracts between the reinsured and individual

\textsuperscript{358} The version 2.0 of the General Underwriters Agreement (GUA) has now been published and is available on the London Market Group (LMG) website. http://www.marketreform.co.uk/Documents/RD_Doc_Archive/GUA211206.pdf

\textsuperscript{359} As seen above, the MRC requires the terms of any contract to be agreed and presented up-front, so that the leading underwriter clause is concerned not with formation but rather with subsequent amendment and claim-handling.

\textsuperscript{360} Unum Life Insurance Company of America v The Israel Phoenix Assurance Co Ltd [2001] WL 395248.

\textsuperscript{361} Ibid.

\textsuperscript{362} Ibid.

\textsuperscript{363} In a case where underwriters involves both Lloyd’s syndicates and insurance companies outside Lloyd’s, a Lloyd’s leading underwriter and an insurance companies’ leading underwriter are both required. However, according to the London Market Principles 2001, there should be only one leading underwriter for the London market to create clarity and certainty of contract, no matter they are Lloyd’s underwriters or insurance companies.
underwriters, the broker approaches the leading underwriter on behalf of the whole market so that the following market will be bound by the decisions of the leading underwriters in the given circumstances provided by the clauses. Such clause may live throughout the period of contract, giving the leading underwriter the authority to bind all the following subscribers from the stage of contractual formation to claim handling, including negotiation of the terms of the policy,\textsuperscript{364} alteration or amendments to the wording,\textsuperscript{365} waiver of any conditions,\textsuperscript{366} settlements of claims,\textsuperscript{367} resolving disputes by arbitration,\textsuperscript{368} or accept declarations in respect to a declaration policy to which the following underwriters has subscribed, even though they might not become bound until later declarations are made at later stage where the declaration policies are placed in a non-obligatory or facultative obligatory method.\textsuperscript{369}

Due to non-standard wording of the clause and the various characteristics of policies in which the leading underwriter clauses are used,\textsuperscript{370} it is not easy to define the nature and effect of authority given upon the leading underwriter in such leading underwriter clauses. It is a question of fact depending on the specific wording of the clause in individual case. However, the legal effect of the leading underwriter clause is significant to determine the relationship between the leading underwriter and following underwriters. And it may subsequently have some effect on the broker’s performance of the duty of disclosure in formation of reinsurance agreements, especially in declaration policies.\textsuperscript{371}

4.4.4.1 Confusion of the nature of the relationship between the lead and following underwriter

It is not settled what the nature of the relationship between the leading underwriter and the following underwriters is,\textsuperscript{372} i.e. whether the leading underwriter acts as the

\textsuperscript{365} Barlee Marine Corp v Mountain (The Leegas) [1987] 1 Lloyd’s Rep. 471; Inversiones Manria SA v Sphere Drake Insurance Co plc (The Dora) [1989] 1 Lloyd’s Rep. 69
\textsuperscript{367} Roar Marine Ltd v Bimeh Iran Insurance Co [1998] 1 Lloyd’s Rep. 423
\textsuperscript{369} For details, please refer to later chapter.
\textsuperscript{370} The GUA enables each class of business to define their specific requirements/needs within a common framework.
\textsuperscript{371} The applicability and duration of utmost good faith in declaration policies will be discussed in later chapter.
agent of the subscribing underwriters,\textsuperscript{373} or whether the leading underwriter clause is simply a mechanism or trigger whereby the subscribing underwriters become bound to the leader’s decisions made on their behalves.\textsuperscript{374} Although such divergence might affect the leading underwriter’s duties to the following underwriters, it is suggested that the clause satisfies to cover the gap between the market practice and the rule of law regards to application of the duty of utmost good faith in placing reinsurance agreements anyway, no matter which opinion prevails.

4.4.4.2 Where the leader acting as the underwriting agent of the followings

In the case where reinsurance is concluded between the parties immediately once the leading underwriter scratches the MRC, it can be said that the relationship between the leading underwriter and the following subscriber is pretty simple. There is hardly any room for the mechanism or trigger analysis, as each following underwriter is bound under its own individual contract of insurance with the reinsured, as soon as the leading underwriter scratches the MRC on their behalves. There is no more need for any further agreement, amendment of the cover or any settlements with the reinsured to be triggered, as they are already binding upon the following underwriters automatically, provided they are made within the authority. In such circumstances, the leading underwriter clause can be regarded as incorporating an agreement between the reinsurers that the leading underwriter can act as the agent of the following underwriters within the authority prescribed in the clause.\textsuperscript{375} Such authority is analogous to a binding authority between the underwriters and his coverholder who holds the underwriting pen on behalf of the insurer. The leading underwriter can be regarded as the following subscribers’ underwriting agent. This was supported by \textit{Roadworks (1952) Ltd v Charman (Roadworks)},\textsuperscript{376} where the slip contained a leading underwriter clause that provided ‘all alterations, additions, deletions, extensions, agreements, rates and charges in conditions to be agreed by the leading Lloyd’s underwriter, it was held by HHJ Kershaw Q.C. that the new agreement bound both the leading underwriter and the following market as the leading underwriter was the agent of the following market with the authority.

\textsuperscript{372} \textit{Roadworks (1952) Ltd v Charman [1994] 2 Lloyd’s Rep. 99.}
\textsuperscript{374} \textit{The GUA states that the leading underwriter is the “agent” of the following market for the purposes of agreeing variations of the agreement.}
\textsuperscript{375} [1994] 2 Lloyd’s Rep 99.
Consequently, all the leading underwriter’s decisions within the authority are binding upon the following subscribers. For instance, if the following market is required by the clause to follow the settlements of the leading underwriter, the reinsured will only sue the leading underwriter as representative, as long as the settlement falls within the scope of the leading underwriter’s authority.\footnote{Barlee Marine Corporation v Mountain, The Leegas [1987] 1 Lloyd’s Rep 471.} Therefore, the broker can simply fulfill his duty of utmost good faith that is owned to individual underwriters by making no misrepresentation and disclosing material facts to the leading underwriter only. If the leading underwriter has been induced into a contract of insurance by the broker’s non-disclosure or misrepresentation of material facts, the leading underwriter’s option of avoidance or waiver of the remedy will bind the following underwriters as well. Therefore such establishment of agency can make the application of the duty of utmost good faith operate well and consistently with the market practice. In fact, even if no such agency relationship can be established, the clause can still cover the gap between rule of law and market practice just in a slightly different reasoning. Such leading underwriter clauses contained in the MRC constitutes an agreement between the reinsured and individual following underwriters. It gives the effect that the following underwriters will be bound by the leading underwriters’ agreement as to the wording of the contract which spells out the rights and obligations of the underwriters.

However, if reinsurance between the leading underwriter and the reinsured is avoided ab. Initio due to misrepresentation or non-disclosure of material facts, the whole contact including leading underwriter clause is itself null and void, and then there hardly exists any agreement as to the reinsurance contract wording made by the leading underwriters to bind the following underwriters at all.\footnote{Unum Life Insurance Co of America v Israel Phoenix Assurance Co Ltd [2002] Lloyd’s Rep IR 374 (Comm).} Therefore the following underwriters should be able to take advantage of the leading underwriter’s defenses to avoid the agreement induced by the broker’s non-disclosure or misrepresentation.

4.4.4.3 The leading underwriter clause used in declaration polices

Situations may be complicated when the leading underwriter clauses are used in declaration polices such as a line slip, an open cover or a treaty. The facility effected
between the reinsured and the leading underwriter is probably merely a contract for insurance. In that case, contracts of insurance may not come into existence until declarations are made to the leading underwriter at later stage, rather than the time when the declaration policies are placed. The broker still needs to present all the risks which are chosen to be declared to the leading underwriter at the declaration stage. Therefore, the following underwriters do not become bound until the leading underwriter accepts the declarations which generate contracts of insurance then.\textsuperscript{379}

4.4.4.3.1 Nature of the relationship between the leader and the followings created by the clause

It is arguable whether the leading underwriter becomes the agent, thus owes a duty of care to the following underwriters at the stage of formation of the declaration policies. As there are not any contract wording, underwriting, amendment or settlements decisions to be made by the leading underwriter then so that it could bind the following subscribers. There are some authorities, although in obiter dictum, supporting that the leading underwriter clauses in such policies are merely mechanism or trigger by which the following underwriters to be bound by the leading underwriter’s later decisions.\textsuperscript{380}

In \textit{Mander v Commercial Union Assurance (Mander)},\textsuperscript{381} where a broker placed a retrocession subscribed by the defendants for a number of Lloyd’s syndicates by developing an open cover. It provided that declarations be ‘t.b.a (L/U) only’\textsuperscript{382}. The following underwriters who subscribed to the open cover denied their liabilities to indemnify the claimant, by alleging that the leading underwriter had not been authorised to be bound to accept the risk presented by the broker so that no proper declarations were ever made and accepted under the open cover; or alternatively the declaration to the open cover could be avoided if there ever were contracts of reinsurance with the defendants. Rix J, by cited dicta by Steyn J. in \textit{The Tiburon}\textsuperscript{383} suggested that a leading underwriter under an open cover was not constituted the agent of the following market by reason merely of a leading underwriter clause. The

\textsuperscript{381} [1998] Lloyd’s Rep IR 93.
\textsuperscript{382} It refers to ‘to be agreed with leading underwriter only’.
\textsuperscript{383} [1990] 2 Lloyd’s Rep.418.
following market only agreed, by subscribing to the cover, that they would be bound
by a declaration falling within the scope of the cover and accepted by the leading
underwriter. So the agreement of the leading underwriter worked as a “trigger” event
by which the following market themselves came to be bound by the declaration,
rather than as an act of agency. Therefore the leading underwriter did not owe to the
following market a duty of care as distinct from a duty of good faith with respect to
their activities as a leader.

4.4.4.3.2 Effect of the leading underwriter clause in declaration policies

As to the effect of the leading underwriter clauses in declaration policies, it is
suggested that it should be divided into two aspects according to the two-stage
placing process.

At first stage, suffices it here to say that the open over or treaty is only binding at its
highest that the reinsurers offer the potential reinsureds an opportunity to order an
insurance cover in the future. By inserting a leading underwriter clause in such
facility, the following market only undertakes what the leading underwriter undertakes
under the facility. Therefore, the facility could only be regarded as constituting an
offer from the following underwriters that they will be bound by a declaration falling
within the scope of the insurance cover, if the leading underwriter chooses to accept
the risks that the reinsured choose to cede. So it is hard to say whether the
relationship between the leading underwriter and following market is an agency
relationship. At least, the leading underwriter is not acting as an underwriting agent
of the following subscribers at this moment.

At the declaration stage, i.e. when the reinsureds choose to declare the risks to the
cover and the leading underwriter chooses to accept the risks, contract of insurance
is generated through the medium of the framework facility provided that the risks fall
within the insurance cover, consequently there come into existence a bundle of
separate contracts of insurance between the reinsured and individual following
underwriters who subscribe to the open over or reinsurance treaty. Due to the effect
of the leading underwriter clause, as soon as the leader accepts the declarations, the
following underwriters become bound by the leading underwriters’ decisions as to
underwriting agreement, amendment of the cover, drafting the wording of the
contract even coming into settlements with the reinsured, provided that the leading underwriters are acting within the authority given by the clause. At this stage, it would be the same as the situation where a contract of insurance is concluded between the parties immediately once the leading underwriter scratches the slip discussed above. It is suggested that the clause satisfies to cover the gap between the market practice and the rule of law regards to application of the duty of utmost good faith in declaration policies anyway, no matter what the relationship it is between the leading underwriter and the following market. There should be no duty of utmost good faith attaching to the facility, as a contract of insurance is not yet concluded at that stage. Once declarations are made to the cover, generation of contracts of insurance attract the broker’s duty of utmost good faith so that the broker needs to disclose all material facts and make no misrepresentation to the leading underwriter who holds the underwriting pen on behalves of all the following underwriters within the authority given by the clause. Once the leading underwriter is induced by any non-disclosure or misrepresentations of the broker, not only the leading underwriter but also the following market is entitled to avoid the reinsurance. Even if an agency relationship can be established between the leader and the following market, there would have been only nominal damages for the breach of the authority given upon the leading underwriter, as there hardly exist any agreements as to the reinsurance contract made by the leading underwriters to bind the following underwriters and incur their liabilities at all.

4.4.4.4 Conclusion

In conclusion, it suffices to say that the problems caused by the deemed communication rule or other common law solutions can be avoided by the market practice by inserting a leading underwriter clause into the slips so that the leading underwriter can be regarded as the representative on behalf of the following market in respect of any disputes between the parties under a contract of insurance. However, whether the leading underwriter can act on behalf of the following underwriters depends on the scope of the authority given by the leading underwriter clause. It should be noticed that problems may still arise in circumstances where no leading underwriter clauses are used in practice, such as where no such clause is contained in the slip, where the leading underwriter is acting beyond its authorisation,
or where non-disclosure or misrepresentation is made only to the following market rather than the leading underwriters. In those cases the interpretation of the particular facts in the case should be relied upon to find solutions to enable the market practice to operate under rule of law.

384 Once the following market succeeds to avoid their contracts of insurance by reason of the broker’s breach of duty of utmost good faith, the leading underwriter clause which constitutes a contractual term of the contract will also be revoked so that no basis of representative authority can exist. See Unum Life Insurance Co of America v Israel Phoenix Assurance Co Ltd [2002] Lloyd’s Rep. I.R. 374.
Part III Difficult issues arising in the operation of the doctrine of utmost good faith in reinsurance context

Chapter 5 Material Facts in Placing Reinsurance Contracts

5.1 Test of materiality in reinsurance context

Reinsurance which in essence is insurance for insurers can be categorised as contract uberrimae fidei, so the doctrine of utmost good faith is applicable to reinsurance which is a contract of insurance.\(^{386}\) The doctrine of utmost good faith plays significant role in reinsurance context. First, if the direct policy has been avoided due to qualifying breach of the duty, there is no legal liability of the reinsured to pay under the direct policy. As a result, the reinsurers are not liable to make payment to the reinsured under the principle of indemnity. Second, concealment or misrepresentation of the risk may be made simultaneously to the reinsured and the reinsurers, particularly in a fronting practice. Under such circumstances, both contracts are voidable, imposing the reinsurers no obligation to pay. Thirdly, the duty of utmost good faith is not simply satisfied by the reinsured by just passing on material information to the reinsurers. Failing to satisfy this strict duty may render the reinsurance voidable, even though the reinsured may remain liable to the direct assured under the original insurance.

Actually many important aspects of formulation of the duty of disclosure and non-misrepresentation derives from reinsurance disputes, for example when the duty attaches to the contracts, i.e. material misrepresentation and non-disclosure is only actionable if discovered before the contract is conclude;\(^{387}\) test of materiality compromises not only objective test but also subject aspect that underwriters must prove his inducement by the reinsured’s non-disclosure or misrepresentation;\(^{388}\) the requirement of inducement is not to be assumed even the objective test is satisfied; the knowledge of an agent is not necessarily to be imputed to the assured for

\(^{386}\) The duty of utmost good faith only attaches to a reinsurance agreement which of itself a contract of insurance rather than a contract for insurance, such as a facultative contract, an obligatory treaty, or facultative obligatory treaty, and any declaration made under a contract for insurance, i.e. non-obligatory treaty. Details in this respect will be discussed in next chapter.


disclosure purposes;\textsuperscript{389} the duty of disclosure is not waived by a failure to ask questions etc.\textsuperscript{390} Therefore, the application of duty of utmost good faith plays significant role in reinsurance contracts, even if deficiencies and difficulties exist in formulating the duty in reinsurance area due to specific nature of reinsurance contracts.

As to the test of materiality in reinsurance, the general assumption is that reinsurance should be subject to the same test of materiality which is applicable to all forms of insurance.\textsuperscript{391} Under the statutory definition of materiality in s. 18 (2) \textit{MIA 1906}, every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk. Under the \textit{Insurance Act 2015} the absolute duty of disclosure and making no misrepresentation has been reformed into a duty of fair presentation that only requires the reinsured to disclose material information reasonably clear and accessible to a prudent reinsurer. Although the strictness level of the duty has been changed, the test of materiality is not touched. The act enunciated in s.7 (3) that a circumstance or representation is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms. Then s.7 (4) continues to supply non-exhaustive examples of material circumstances.\textsuperscript{392} Therefore, the reinsured is still obliged to fairly present all the information which would influence a prudent reinsurer in underwriting assessment and calculation of the premium.

This is simply the case in facultative agreements in which the reinsurer and reinsured share the risk and premium in an agreed proportion. In \textit{Highlands Insurance Co. v. Continental Insurance Co.}\textsuperscript{393}, the underwriting agents on behalf of the Continental Insurance Co.\textsuperscript{,} which was actually the retrocessionaire treated as the reinsurer as the direct insurance was simply a fronting, avoided its subscription to

\begin{itemize}
  \item \textsuperscript{389} Simner v New India Assurance Co Ltd [1995] L.R.L.R. 240.
  \item \textsuperscript{392} S. 7 (4), Examples of things which may be material circumstances are—
    \begin{itemize}
      \item (a) special or unusual facts relating to the risk,
      \item (b) any particular concerns which led the insured to seek insurance cover for the risk,
      \item (c) anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question.
    \end{itemize}
\end{itemize}
the slip on the ground that the reinsured had made a material misrepresentation as to the insured subject matter.

Under proportional reinsurance treaties, although it had been argued that the test of materiality here might be more complicated as reinsurer’s share of premium may be deducted for payment of commission to the reinsured, it is still fair to say that such particular method of distribution of premium reflects the reinsurer’s assessment of the quality of the risk. While under non-proportional treaties, the reinsurer charges and calculates the reinsurance premium on its own judgment, with no relationship to the premium charged by the reinsured under the original policies, but still based on the information provided by the reinsured. Consequently, it suffices to say that the test of materiality under reinsurance contracts are the same as it applies to all forms of insurance so any information or representation can be material if the reinsurer would like to take it into account and assume the premium upon it during his underwriting assessment.

5.2 Disclosure of material facts in reinsurance market practice

It is a general assumption that reinsurance agreements which attract duty of utmost good faith should be subject to the same materiality test as that applies to all forms of insurance. Actually in business insurance market practice the duty of disclosure under the MIA1906 has become onerous to a certain degree, especially for large size, complicated nature and complex business. As under such large size and complex insurance business, identification, collection and collation of all material information related to the risk can be extreme difficult tasks involving multiple sources of information, proportionate to the size, nature and complexity of the business. To minimise the difficulties and the deficiency of enforcing the law, the reinsurers commonly follow the current business insurance market practice by designing particular standards and procedure of disclosure and inserting a specially draft clause in the reinsurance contracts overriding the current legal regime set out in the MIA 1906, rather than seeking enforcement of the full requirements of the act. Also it should be noticed that, in market practice, the test of materiality that which a prudent insurer would deem to be material to the underwriting of the risk will often be

exercised only after the occurrence of a claim, by contrast to the requirement of being disclosed prior to the inception of the contract established by the legal framework of duty of disclosure. In many cases, claims are often settled rather than avoided, even though the reinsurer may have been able to challenge the completeness and accuracy of the information disclosed.

Unlike small business where the disclosure procedures is simple and merely involve completion of a proposal form, the reinsurer conducting large complex business insurance will require formal disclosure procedures, identify various disclosure roles and allocate responsibilities, draft a unique clause on non-disclosure and misrepresentation into the policy, and identify the nature of the material facts and information. Also in practice, larger business reinsurers may send detailed checklists and questionnaires describing the scope of required information. The reinsurers may give additional support and advice to emphasise the importance of understanding the concept of material facts in order to eliminate subjective interpretation. Therefore, it is crucial for the reinsurer and reinsured in the reinsurance market to work together to develop standards and guidance over what a satisfactory presentation and disclosure of the risk should include, so that such suitable and sufficient disclosure procedure could facilitate full disclosure of material facts and information.

First of all, the key roles and responsibilities of disclosure of material information should be identified. So far as knowledge of material circumstances is concerned, s.18(1) of MIA 1906 states that every material circumstance is required to be disclosed if it is known to the assured, and such knowledge includes not only actual knowledge but also blind eye knowledge. This point stays the same in the Insurance Act 2015. However, in reinsurance market where the reinsured is a corporate entity, it is necessary to clarity whose knowledge is relevant, attributable to both the directing mind and will of the corporate entity and the staff who placed the insurance in question. Although the Insurance Act 2015 adopts complete different approach from the one under the MIA 1906, s.4 of the Insurance Act 2015 still describes the knowledge of insured from two separate campuses, namely the knowledge of the agent to know, and the knowledge of the agent to insure. Therefore it is important for

396 S.6 (1) of the Insurance Act 2015:
For the purposes of sections 3 to 5, references to an individual’s knowledge include not only actual knowledge, but also matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining from confirming them or enquiring about them.
the business participant to allocate in the disclosure procedure, the knowledgeable persons who has or has access to the material information to be disclosed, the responsible persons who have the task of compiling all material information and the authorised person who will sign off the full adequate and accurate information.

Secondly, the nature of the material facts and information needs to be identified, described and defined in a due diligence checklist in advance, in order to achieve full disclosure of material facts for the purpose of reinsurance submission. Although there is no legal definition, a material fact has been defined under decided common law cases as any fact that may influence the judgement of a prudent insurer in deciding whether to accept a risk and on what terms and at what premium. However the elements which would influence a prudent reinsurer’s judgment in subscribing the risk and fixing the premium may differ under various types of reinsurance agreements from the general elements under the direct insurance, reflecting the specific relationship between direct insurance and reinsurance premiums. Rather than focusing on individual risks underwritten, especially in some treaty reinsurance contracts, under which the reinsurance is concluded like a wholesale business, the material information focusing on the general nature of whole portfolio offered by the reinsured in a long term. Therefore under reinsurance contracts, not only the information relating to underlying risks is material, but also facts relating to the reinsurance agreement is of significant concern of the reinsurers. Normally it includes the information of physical risks underwritten, such as processes, products and geographical areas of business activities and sector, increasing of the degree of risks like additional premises, risks insurable items in high risk geographical, geological or metrological areas, higher degree of risks than those in ordinary business course, greater liabilities than normal or expected due to specific contract terms and conditions, restricted rights subrogation associated with claims or loess; moreover, information concerns the financial statues of the reinsured’s business and the manner in which the reinsured runs his business matters as well to the reinsurer as it may affect the profitability of the reinsurer’s business, , for instance, the reinsured’s previous claims history and experience of the business especially in relation to historical, emerging or other unexpected risks, the reinsured’s previous policy cancellation and refusal of insurance, details of the business profitability, financial status of the business etc. In addition, the moral hazard of the reinsured
may be also of the reinsurers’ concern, such as status, reputation, length of services, qualifications and experience of board members, and details of any criminal convictions etc.

Facts which are material in the reinsurer’s underwriting assessment may vary according to the distinct placing methods by which the premium and losses are distributed between the reinsureds and the reinsurers under each individual contract. In the following sections, material facts subject to duty of disclosure in placing facultative reinsurance and treaties will be summarised separately.

5.3 Material Facts in Reinsurance Contracts

Generally speaking, in the context of all forms of contracts of insurance, the material facts which need to be disclosed to the insurer can be separated into the physical hazard relating to the quality of the risk subscribed and the moral hazard relating to the personal characteristics of relevant parties, depending on the subject matter of the insurance, the nature of the insurance contract, the risks insured against, and attitude of a prudent underwriter. From case law, material circumstances can be identifies as including any unusual or special circumstances which increase the insured risk, any particular concerns about the risk which led to the insurance being placed and standard information which market participants generally understand should be disclosed.

However the specific material facts which the reinsurer would take into account will be different from those in direct insurance context aligned with the nature of reinsurance relationship that each reinsurer subscribes part of the risks underwritten like operating in a partnership. Also the elements which would influence the reinsurer’s judgment in subscribing the risk and fixing the premium may differ under various types of reinsurance agreements depending upon the relationship between direct insurance and reinsurance. Therefore, facts which are material in the reinsurer’s underwriting assessment may vary according to the distinct placing methods by which the premium and losses are distributed between the reinsureds and the reinsurers under each individual contract. As a result, it is far from satisfaction of the duty of disclosure of the reinsured by simply passing on the information relating to the underlying risks. Any facts and information relating to the
5.3.1 Material Facts in Facultative Reinsurance

After WASA,\(^{397}\) the leading case which clarified many significant issues of facultative reinsurance, it is reaffirmed that facultative reinsurance is further insurance on the original subject matter rather than a reinsurance of reinsured’s liability under the direct insurance. Even there are still contradictions after WASA, but it does not affect the materiality as to circumstances in respect of the underlying risks, especially under proportional facultative reinsurance. It suffices to say that factors which are material to the underlying risks are also material and need to be disclosed to facultative reinsurers. In most cases, where the reinsured and reinsurer share the risk and premium on an agreed proportion, the terms of reinsurance contract are incorporated from the direct policy by words ‘as original’, and the original insurance and reinsurance contracts are on a back-to-back presumption, subject to some limits. Such closely tied-up relationship between the two contracts results in that circumstances relating to the direct insurance may also affect reinsurers’ underwriting assessment. Therefore, the reinsurers may be interested in anything which affects his obligation to pay, not only information relating to the facultative reinsurance itself but also those relating to the direct policy.

Consequently, material facts that the reinsurer would like to take into account in placing facultative reinsurance fall into two classes. The first class of material facts consists of facts concerning the circumstances relating directly to the underlying risks. Such circumstances in broad terms extends to any fact which increases the reinsured’s liability quantum or the physical hazard against which the subject matter is insured under the direct insurance, and any information concerning the moral hazard of the assured or his agent under the direct insurance. It suffices to say that any information which may affect the reinsured’s obligation to pay the assured is material to the reinsurers. The second class of material facts is facts which

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\(^{397}\) [2008] Lloyd’s Rep IR 510.
specifically affect the reinsurance agreement itself rather than the underlying risks, relating to the manner in which the reinsurance contract has been underwritten.

5.3.2 Material Facts in Reinsurance Treaty

In contrast to a facultative reinsurance, the reinsurer under a treaty is not interested in retails but the wholesale business, focusing on the general nature of whole portfolio offered by the reinsured in a long term rather than concentrating on individual risks. Generally speaking, placing information material to facultative agreement will normally be material the treaties too. In addition to those, other information may also be material to the reinsurer, depending on particular features of the treaty, the method taken by the treaty, and the nature of business in original insurance to be ceded. For instance, as far as facultative obligatory and obligatory treaties concerned, materiality tends to focus on the reinsured’s own experiences in running his book of business, whereas material facts relating to individual declaration under a non-obligatory treaty may be similar to those material to a facultative reinsurance.

It suffices to say that, being different from material facts in direct insurance, material facts to be disclosed in placing reinsurance agreements mainly relate to two aspects, compromising of operation of the treaty itself such as information about previous declarations to the treaty falling outside the treaty scope at renewal of the treaty\(^\text{398}\); and the manner in which the reinsureds run their business under the direct insurance, make underwriting assessment and handle claims, rather than the circumstances relating to the underlying risks. For example, the reinsurers may be interest to know the risk run by the reinsured, existence of other reinsurance and reinsured’s retention level, identity of other co-reinsureds, the reinsured’s loss experience, claims handling by the reinsured, and the premium the reinsured charge etc.

5.4 Material facts concerning reinsurance agreement rather than the underlying risks

Although the first limb of materiality is an objective one, the exact nature of the circumstances that must be disclosed or need not be disclosed by the reinsured will

always depend on the facts and circumstances of the individual cases. The following sections will discuss circumstances which are commonly recognised as material information and particular concerns about the placing risks under contract of reinsurance, besides the general material facts commonly recognised relating to the underlying risks under direct insurance.

5.4.1 Reinsured’s Retention

It is a common practice in reinsurance agreements that the reinsured maintain at least a small part of the risk as retention, although sometimes the reinsured is allowed to cede one hundred percent of the risk where the direct insurance is only a fronting practice for the reinsurance agreement. Normally the amount retained by the reinsured will be clearly stated in the agreement. Such retention can not only help the reinsurer to regulate the numbers of claims received reflecting the proportion that the reinsurer is willing to accept, but also guarantee the quality of the business underwritten by the reinsured so that the reinsured could underwrite good risks and manage his underwriting business prudently. Therefore, the reinsured’s retention cannot be said to be immaterial at all to a reinsurer in placing reinsurance agreement. However, is the reinsured under an obligation to retain a part of the risk by himself when the contract states a clear amount? If not so, can the reinsured cede his retention somewhere else? If the reinsured does reinsure his retention under other reinsurance agreement, does the reinsured need to disclose to his reinsurer such circumstance? The decided cases show that the position as to materiality of the reinsured’s retention does not stay the same. There has been a shift of the attitude towards the obligation of the reinsured to retain his part of risk.

In early times, it was held that misrepresentation made by the reinsured as to his net retention was material so that the reinsurers could avoid the policy. In Trail v Baring,399 the Industrial Life Assurance Society insured the life of Lydia Taylor and reinsured £3,000 with the Provident Mutual Association. Then Provident retroceded £1,000 of the sum to Reliance and represented that it intended to retain £1,000 of the risk by himself. Such representation was true when the reinsurance was placing. However, before conclusion of the contract, Provident retroceded its retention of

£1,000 to the Victoria. As a result, the reinsurers bear no retention at all. Subsequently, the retrocedant refused to pay on the ground that the reinsurer did not disclose such material change of circumstances. The court held that Provident’s failure to disclose the change of circumstances was material to permit Reliance to avoid the policy as Provident’s stated retention was a guarantee of the quality of the risk which induced the Reliance to enter into the agreement without any further investigation. Therefore, it can be said that the level of reinsured’s retention was a material fact that the reinsured could not misrepresent or conceal. Such opinion was shown in Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd (No.2). In Kingscroft v Nissan, Weavers that was managing the business of an underwriting pool, ceded a proportion of the pool’s excess of loss reinsurance business to the defendant Nissan under two facility quota share (‘FQS’) treaties. The treaties provided that fiver per cent of the overriding commission to be retained by Weavers. However, besides the FQS treaties, Weavers had its own excess of loss reinsurance protecting the pool’s casualty account and that reinsurance was within the classes of business ceded under the FQS treaties. When Weaver took proceedings to recover under the FQS treaties, Nissan refused to pay the said sum. One of the grounds is that the treaties are avoided due to Weavers’ misrepresentation and non-disclosure concerning the existence of the pool’s excess of loss reinsurance programme. The defendant claimed that the reinsured was not entitled to enter into excess of loss reinsurance in respect of its retained share of the business ceded under the FQS treaties. The court held that there was no material non-disclosure or misrepresentation in respect of Weaver’s excess of loss reinsurance programme as Nissan was aware of the fact that it covered business which was to be ceded under the FQS treaties and Nissan would still have entered the FQS treaties even if it had even if it had been specially told such information. But the judges still held that it was a common ground that a reinsurer under a quota share treaty invariably wants to know what proportion of the risks being ceded the reinsured intends to retain for his own account because such proportion is of considerable importance reflecting a measure of the reinsured’s confidence in the

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400 [1999] Lloyd's Rep IR 603,629 per Moore-Bick, J.
business underwritten and providing a continuing incentive to underwrite prudently.\textsuperscript{401}

However, \textit{Trail v Baring} was basically a case based on misrepresentation. If the reinsured wanted to say something about the amount, they should not misstate such important information. But it does not necessarily reflect an imposition on a reinsured a duty of disclosure to disclose the amount of his retention. As there is distinct difference between misrepresentation and non-disclosure, it has been held in recent cases that the reinsurer must ask a specific question as to the reinsured’s intention to reinsure somewhere else first, while the reinsured is required not to misrepresent the amount of his retention neither the intention to reinsure elsewhere. Such opinion was stated in \textit{Societe Anonyme d'Intermédiaires Luxembourgeois v Farex Gie},\textsuperscript{402} where the ceding company retained for its own account a very small part of its retention under a non-obligatory open cover agreement, giving the reinsurer a ground to allege non-disclosure of material information concerning the retention. Gatehouse J accepted the cedant’s retention’s significant impact on a prudent reinsurer’s underwriting assessment, but he ruled that a prudent reinsurer could not rely upon any assumption that there was to be a retention when no mention of a retention was made by the reinsured when he declared to the reinsurer under the agreed facility, unless the reinsurer is told or is entitled to assume so from a previous course of dealing. So, it is not a burden on but is up to the reinsurer to make enquiries about the reinsured’s retention. If the reinsured considers the disclosure of the retention significant, he need to ask reinsured such questions. There is no general expectation of the reinsurer that the reinsurance is such a limited book of business so that the retention must be bear on the reinsured, unless the reinsurer is told so or is entitled to assume from a previous course of dealing. If the reinsured’s answer is not full enough, the reinsurer will enquire further. If the reinsurer is totally silent, disclosure is deemed to be waived by the reinsurer.

More recently, there has been a trend comes into the courts, holding that the amount of reinsured’s retention for its own account is not a material fact in any event. Such

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\item \textsuperscript{401} Ibid.
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opinion was expressed in *Great Atlantic Insurance Co v Home Insurance Co.*,\(^\text{403}\) where the defendant reinsurers entered into a quota share reinsurance agreement to provide the claimant reinsured’s portfolio of marine and aviation business. Under the treaty, by the terms “*agree to accept as ‘insurer’ and reinsure 90 per cent quota share hereon*”, the direct insurances issued by the reinsured will be ceded to the reinsurer on a fixed proportion of 90 per cent, leaving 10 per cent retained by the reinsured net for its own account. The reinsurer later sought to avoid the treaty on the ground that the reinsured breached the warranty that he would retain its full 10 per cent by obtaining excess of loss cover for 75 per cent of that figure. The court rejected the defence and held that placement of the excess of loss cover did give the effect to reduce the reinsured’s net retention below 10 percent of each and every risk, but the provision as to the percentage of net retention did not establish a warranty in favour of the reinsurer. The word ‘fixed’ only allocated the risk to the parties to the quota share treaty rather than had an effect on other covers that either party took, therefore it did not prevent the any party from seeking further cover for its proportion of liability. So the reinsured had the freedom to seek further cover for its proportion of liability just as the reinsurer did by entered a retrocession. Such tendency can be found in a similar decision delivered by courts in *Kingscroft v Nissan*\(^\text{404}\) case discussed above. When placing the FQS, it was proposed that ‘the reinsured will retain 50% of not exceeding their 80% participation of the policies as defined for their own account. Besides the FQS, Weavers arranged the pool external excess of loss reinsurance to reduce 10% of the liability member’s retained line. The court held that there was no misrepresentation as to the statement concerning the pool’s retention. The members of the pool did intend to retain 50 percent of the risks for their own account uninsured, whether by excess of loss reinsurance or by FQS including WAQS insurance within the Weavers pool. It should be a true statement of present intention rather than a factual statement of fact giving the effect that the exact sum is to be retained with any further reinsurance protection.\(^\text{405}\) Besides, the court held that no material non-disclosure could be established because Nissan actually participated in the excess of loss treaty therefore the reinsurer knew about the additional cover. Moreover, the reinsurer was not induced by the reinsured’s


\(^{404}\) [1999] Lloyd’s Rep IR 603.

representation as they would enter into the agreement anyway whether the reinsured has additional protection or not. Furthermore, the learned judges commented that producing an excess of loss cover would be even immaterial at all because it was a common practice in the market especially for quota share treaty to seek about a further excess of loss cover as long as the amount purchased was not unreasonably beyond market norms.

Therefore, the current view can be concluded that the reinsured’s net retention is not necessarily a material fact that must be disclosed to the reinsurer during placement of the reinsurance agreement. The reinsured is neither under an obligation to retain a proportion of the risk by him, nor does he have to retain the stated amount in the terms for its net account without any further cover, unless the contract clearly provides to the contrary. If the reinsured does reinsure his retention under any other further cover, it is not necessary for him to make a disclosure of it, given that it is a common practice to reinsure the retentions in the market; unless the reinsurer makes any enquiry about it. It is not a burden on the reinsurer to ask such questions. But if he is interested in it, it is up to the reinsurer to ask, and the reinsured should not make any misrepresentation on it.

5.4.2 The reinsured’s potential exposure under the direct insurance

Generally, besides the material information concerning the underlying risks under direct insurance contract, the reinsurers are interest to know the financial basis of the direct insurance contract, such as whether the policy is written on a valued or unvalued basis, the method by which the reinsured underwritten the risks, whether the liability of reinsured accepted has arisen the possibility of adverse risk selection, the amount of potential liability exposed by the reinsured, what is the nature of the business underwritten by the reinsured, whether there is any unusual risks to be declared to the reinsurer, whether risks are short-tail or long-tail, whether there are any unusual terms of the ceded policy etc. That information may affect the risk exposed by the reinsured under the direct policy, reflect the manner by which the reinsured runs his business, and then extend to the reinsurer’s appreciation of the risks which he tends to be exposed under the reinsurance agreement. If the risk posed upon the reinsured by the direct policy is greater than that indicated by the
reinsured, misrepresentation or non-disclosure of it would be material to the reinsurers.

5.4.2.1 The form of the direct insurance

The reinsurers are interested to know the method by which the reinsured underwritten the risks under the direct policy, because such facts may affect the reinsured’s potential risk exposure like adverse risk selection, and even the probability of the further spread of the risk in the market.

In *Irish National Insurance Co Ltd v Oman Insurance Co Ltd*, the second plaintiff who was insurance brokers placed three-layer structured fire insurance for the Arabian American Oil Co.’s (ARAMCO) properties in Saudi Arabia in 1977. The first layer comprised claims up to $75 million in excess of $10 million; the second layer claims is up to $ 75 million in excess of $ 85 million; and the third layer comprises claims up to $ 50 million in excess of $ 160 million. Then reinsurance was arranged for certain of the insurers on the primary layer. In 1978, a loss figured $53 million occurred and was fully borne by the primary layer except the first $10 million retention. The first plaintiff reinsured undertook a 9.5 percent line in the first layer and reinsurance had been arranged for 50 per cent of their line. When the first plaintiff reinsured claimed against the defendants under the reinsurance policy, the defendants refused to pay and argued that they were entitled to avoid the reinsurance contract because the broker had described the original insurance as having been effected on a “first loss” basis when it was in fact an “excess of loss” policy. The court was requested to decide whether the original insurance under which the reinsured born a deductible was a first loss insurance. Leggatt J held that the nature of first loss insurance is that the sum insured was less than the value at risk. Neither did the presence of a deductible by the reinsured which can be deemed self-insured nor did the existence of additional layers ceiling on the primary layer change the nature of the original policy as a first loss insurance. Therefore, the insurance broker’s statement was not a misrepresentation which was actionable to render the reinsurance agreement avoided.

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The issue as to materiality of the form of the insurance contract arose again in *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins Ltd*\(^{407}\) which is mentioned in above chapter. It is decided that the form of the underlying cover as a facultative obligatory cover rather than a quota share cover is particularly material to the reinsurer as such form of direct insurance may expose reinsured and then the reinsurer to potential risk of adverse risk-selection. In *Aneco v Johnson*, the claimant was the reinsurers of marine excess of loss accounts of Lloyd’s syndicates under facultative obligatory treaties. Then the reinsurers instructed his broker to procure excess of loss retrocession cover for him. The leading retrocessionaire sought to avoid the retrocession by arguing that a misrepresentation about the nature of the reinsurance contract was made during the placing process because the defendants had presented that the risk underwritten by the reinsurers arose under quota share cover. Arbitration between the reinsurer and retrocessionaire was held in 1995 and the tribunal awarded the leading retrocessionaire entitlement to avoid the retrocession due to such misrepresentation, and declared that the six XL contracts had been validly avoided ab. initio by all the underwriters following. As compared in Chapter 1, there are crucial difference between a facultative obligatory treaty and a quota share treaty under which both parties are binding to cede and accept all the risks of a given class. The reinsurers under the obligatory treaty is potentially exposed the risk of reinsured’s risk selection as the reinsured has a discretion as to the risks which are to be ceded to the treaty, as a result the treaty may be under a tendency to become a ‘dumping ground’ for high risk or poor quality business.\(^{408}\) Therefore, such exposure is crucial and material to the retrocessionaire’s interests as inherent anti-selection permitted under the facultative obligatory treaty could be against the retrocessionaire under their cover.

In addition, setting aside the particularity of anti-selection in facultative obligatory covers, Cresswell J addressed that description of the reinsurer’s treaty itself is equally important, as the spread of business across the excess of loss underwriter’s book is highly material. The market evidence showed that it was almost impossible to obtain retrocession cover for a facultative obligatory reinsurance treaty. It is crucial to an established excess of loss leading underwriter that underwritten of a quota

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\(^{408}\) [2002] CLC 181 , at para. 70,71.
share under which agreed proportion of all risks of a given class must be accepted fairly spread the loss geographically well and probably protect its account better as a quota share could include cessions on overseas contracts which may be very unlikely to clash.\(^{409}\) Therefore description or representation as to method by which the risks is underwritten by the reinsured is plainly material to a prudent underwriter. Whether there is any discretion of the reinsured as to acceptance of risks fell within a cover facility or not also matters to a prudent underwriter. It is of important relevance of the qualities of risks under the direct policy, particularly under obligatory cover, as the reinsurers may be at the mercy of its reinsured’s risks selection. In *ERC Frankona Reinsurance v American National Insurance Co*,\(^{410}\) the defendant ANICO participated in a pool established by National Accident Insurance Group (NAIG). The pool was managed by National Accident Insurance Underwriters (NAIU). NAIU instructed London brokers to place a quota share reinsurance of Philadelphia Life’s one-third participation in the pool with ERC. In the placement, the claimant was told that ANICO’s activities were confined to direct insurance. While in fact the reinsured had entered into a reinsurance agreement under which the reinsured’s liabilities fell within the scope of the quota share cover provided by ERC. It was held that such misstatement was material.

5.4.2.2 The nature of the risks exposed by the reinsured

It is plainly material to the reinsurer to be informed of facts about the nature of the risk run by the reinsured in both facultative reinsurance and treaty reinsurance agreements; as such risk exposure by the reinsured may affect the reinsurer’s underwriting assessment of the reinsurance agreement. By contrast to the facultative reinsurance contract which is back to back to the direct insurance, the material facts relating to the treaty reinsurance agreements generally does not extend to details of individual underlying risks underwritten by the reinsured, but focus on the business portfolio as a whole, as such size of risks within the reinsured’s portfolio, the degree of the risk borne by the reinsureds, any exclusion of risks from the cover, the frequency and nature of large losses falling within the cover, the method adopted by the reinsured of allocating business of risk of that nature into the account, the procedures for calculation of premiums and losses, and the reinsured’s exercises of


any control over the risks accepted by the reinsurer etc. Whether a fact or statement regarding to the reinsured’s underwriting philosophy and methodology of running his business are material and need to be disclosed is a question of fact depending upon the form of the reinsurance treaty and the particularity of direct insurance underwritten by the reinsured.

In *Contrast Crane v Hannover Ruckversicherungs AG*,411 it was held that the reinsurer’s failure to disclose underwriting audits conducted was not a breach of duty, neither entitled the retrocessionaire to avoid the retrocession cover. The retrocessionaire entered into excess of loss treaties covering the reinsurer’s business which provided a specific class of casualty cover, i.e. carve-out cover, to an insurance company. The carve-out cover protected both a traditional account and another less strict account. The retrocessionaire participated in the carve-out cover for both accounts. In 1996, after the reinsurer changed its reinsurance pricing guidelines, the less strict program business could be allocated to the traditional account. Following this, the reinsurer’s audits had raise concerns about the reinsured’s claims handling and the appropriateness of using a loss rating approach for the program business without risk exposure analysis. Before agreeing to provide cover in 1998, the retrocessionaire requested details of how business was allocated between the two accounts, but he jumped into the agreement to secure the contracts by bringing his rates down without being presented the reinsurer’s guidelines. Then the retrocessionaire submitted that he was entitled to avoid the agreement by reason of failure of the reinsurer to disclose the underwriting and claims audits. The court held that such audits were not material. An adoption of loss rating for program business was just a matter on which underwriting judgment differed, but it was not significant enough to affect the judgment of a prudent insurer.

In *Limit No.2 Ltd v Axa Verischerung AG*,412 the issue as to the materiality of the level of deductibles in the direct insurance underwritten by the reinsured came before the court. In 1996 the plaintiff’s broker approached the defendant by fax proposing a first loss facultative obligatory reinsurance treaty for 12 months, protecting the plaintiff’s energy accounts. The broker in his cover sheet stated that as a matter of principle the reinsured maintained high standards and would not normally

411 [2008] EWHC 3165(Comm).
underwrite construction risks unless the original deductible were at least £500,000 and preferably £1,000,000. The reinsurer agreed to enter into the reinsurance and in 1997 agreed to extend the cover until 31 Jan 1998, further renewed the treaty for a 12 months effective from 1 Feb 1998. However the broker did not informed the reinsurer that the reinsured’s deductibles was not in fact being met due to deterioration of the energy market. The results turned out disastrous on the 1996 treaty, including the 1997 endorsement, and the 1998 treaty. By inspection the reinsurer found that the reinsured had not been following its policy as to deductibles in underwriting its construction risks, therefore the reinsurer sought to avoid the 1996 treaty and the 1997 endorsement and the 1998 treaty for misrepresentation and non-disclosure of material facts. It was held that the reinsurer was entitled to avoid the reinsurance treaties by the reason that the reinsurer was induced to have concluded on the basis of the reinsured broker’s misrepresentation as to the reinsured’s deductibles in the direct insurance and the non-disclosure of the change to the deductibles in 1998 renewal. The level of deductibles written by the reinsured in the original insurance would be highly material to a prudent reinsurer considering underwriting a first loss treaty. The smaller is the underlying deductible, the greater the reinsurer’s exposure is. In addition, high deductibles under a direct insurance covering construction risks which tend to produce a high frequency of claims would protect the reinsurer against high frequency lower level claims. Consequently, the broker’s representation as to high deductible in the case was particularly material to the reinsurer’s appraisement of the risk. Therefore, it suffices to say that a misrepresentation of particularity of risk run under the direct insurance of that nature may be material to the reinsurer even such representation was not of itself a material statement accordance with ordinary market standards.

5.4.2.3 The amount of the potential liability exposed by the reinsured

The issue as to materiality as to the amount of the reinsured’s liability arises in Toomey v Banco Vitalicio de Espana SA de Seguros y Reasseguros.\(^{413}\) Under the direct insurance, the Spanish football club Atletico de Madrid insured against the risk of club’s relegation to the second division under a valued policy for 2.9 billion Spanish Pesetas (Pts). The defendant reinsured Vitalicio reinsured with Toomey

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under a facultative contract on the same terms as original. After the club relegated at the end of the 1999/2000 season, the reinsurers asserted that there was a misrepresentation by the reinsured in that the direct policy was unvalued then based on indemnity for actual proven loss, whereas the direct policy was valued in fact. The court held that the financial nature of a direct policy could only be material if the amount recoverable was greater under a valued policy than under an unvalued policy. In this case, the football club’s total loss was Pts 3.169 billion including a relegation loss of Pts 2.639 and repayment of Pts 500 million to its exclusive broadcaster for failure to qualify for European club football competitions. However, the Pts 500 million loss had been disregarded as it had no relation to the relegation covered under the direct insurance. Therefore, the football club’s loss amounting to Pts 2.639 billion under the direct insurance cover was actually less that the insured value of the direct insurance. As a result, the court held that the misrepresentation was material rendering the policy voidable.

5.4.2.4 The nature of business underwritten by the reinsured

The risk run by the reinsurer is directly affected by the character of the business insured by the reinsured. It is plainly material to reinsurers to know what the reinsured has insured under the direct insurance contract, whether there is any unusual risks intended to be declared to the reinsurer and other such relevant information.

This point was at stake in L’Alsacienne, Premiere Societe Alsacienne et Lorraine d’Assurances contre l’Incendie les Accidents et les Risques Divers v. Unistorebrand International Insurances AS,414 In 1977 and 1978 a Norwegian insurance company ‘Dovre’ participated in a pool writing reinsurance business in the London market operated by an underwriting agency ‘Accolade’. By 1978 Dovre entered into voluntary liquidation after encountered severe financial difficulties. Dovre’s portfolio of incoming reinsurance treaties including the sessions arising out of its membership of the Accolade pool were not included in that liquidation but was taken over by Unistorebrand. Unistorebrand arranged a takeover of Dovre’s Accolade portfolio by Kansa Reinsurance Company Limited. Under the agreement, Kansa thereupon was

credited with the premiums which had been earned by Dovre, and undertook responsibility to meet Dovre’s share of the claims generated by the Accolade portfolio for the 1977 and 1978 years of account. Later, Kansa sought to avoid the Agreement for misrepresentation that the reinsured has described the portfolio as ‘mainly property’ and ‘mainly Europe’. While in fact at most 15 per cent of the portfolio was property business and no more than 20 percent was European. Rix J regarded the statement as to the nature of business underwritten, property in this case, potentially significant, because pure property insurance is short-tail in nature. Besides the misrepresentation of ‘mainly property mainly Europe’, Kansa alleged another non-disclosure of the nature of the risks underwritten by the Unistorebrand that four run-off or stop loss contracts in the portfolio was unusual. Although the agreement which arranged Kansa as a substitute for Unistorebrand was not regarded by the Judge as one of reinsurance at all so that no question of materiality arose, the issue as to the nature of business underwritten by the direct insurance is important information that the reinsurers need to know.

There is another different illustration of the materiality of the nature of the underlying risk in *WISE (Underwriting Agency) Ltd v. Grupo Nacional Provincial SA*.415 A Mexican insurer (GNP) insured a cargo cover for a shipment of luxury goods from Miami to Cancun. The defendant GNP got reinsurance cover in London market. The slip presentation prepared in Spanish, had referred to Rolex watches, but the English translation referred to clocks by mistake. Due to this faulty translation of documents, the claimant reinsurer did not aware that the consignment included Rolex and other expensive watches. A container of goods was stolen in transit and GNP made a claim for over US$ 800,000 of which US $ 700,000 related to the loss of the watches. The reinsurer sought to avoid the reinsurance contract, arguing that it had been induced by misrepresentation of material facts. The court decided that such misdescription amounted to a material non-disclosure which entitled the reinsurers to void the contract as reinsurers would not have agreed to cover watches if they were informed by the reinsured.

5.4.2.5 Unusual terms of the business underwritten by the reinsured

It is the general rule that there is no need for the reinsured to disclose to the reinsurers the terms of the direct insurance as long as such terms are commonly to be found in the policies of the direct insurance’s nature, as the reinsurers ought to have such knowledge in his ordinary business. However, the reinsurers would be interested to know any unusual terms in the direct policy which offers extended coverage to the assured or imposes extraordinary or unique liabilities upon the reinsured. This is of particular importance to reinsurers in a facultative reinsurance which commonly incorporates the terms of direct policies into it by the ‘full reinsurance clause’. Therefore unusual terms in the original insurance policy are material facts which must be disclosed to the reinsurers, although in many cases the reinsurers may not look at the direct policy at the time when reinsurance agreement are concluded. The terms need to be disclosed must be unusual. Even the same clause may have contrary effects under different insurance policies. It is a question of fact in each individual case depending upon the nature of risk in the direct policy.

It is not an uncommon practice in insurance policies that the insurers offer extended coverage to the assured by charging extra premium so that the assured would be deemed to be held covered within the specific limitations. In Charlesworth v Faber,\textsuperscript{416} Charlesworth was the insurers of the hull and machinery of the steamship Merrimac under a marine time policy for 12 months. The defendant reinsured the claimant’s exposure. However, there was a ‘held covered’ clause providing that in the event that the vessel was still at sea on the expiry of the policy, the assured would be held covered at a pro rate daily premium. After the Merrimac’s total loss, the defendant alleged to avoid the policy by reason of the non-disclosure of such held cover clause. The court held that the reinsurer was not entitled to avoid the reinsurance contract as such held cover clause was in common use in the hull and machinery maritime time policy which ought to be known by the reinsurers in the business. In contrast, in Property Insurance Co. Ltd v. National Protector Insurance Co. Ltd,\textsuperscript{417} it is demonstrated that some particular held cover clauses may need to be disclosed to the reinsurers. The reinsured issued a marine policy insuring the hull of a steamship for 500 pounds. The premium was 6 per cent of the sum insured. There was a held

\textsuperscript{416} (1900) 5 Com. Cas. 408.
\textsuperscript{417} (1913)108L.T.104.
cover clause in the policy conferred upon the assured the option to extend the cover for navigation on the Great Lakes for an additional charge of 3 per cent of the sum insured. The existence of the clause was not disclosed to the reinsurer. The reinsurer received a share of the basic premium only for underwriting half of the reinsured’s liability. After the steamship suffered damage while navigating the Great Lakes, the reinsurer sought to avoid the reinsurance contract for non-disclosure of such held cover clause. Scrutton J. held that whether the clause need to be disclosed must depend a great deal on the nature of the risk. In this case, the extension of cover to confer the steamship a liberty to do unusual and dangerous things was an extraordinary risk unexpected by the reinsurer so that it ought to be disclosed by the reinsured. As a result, the reinsurance was avoidable by reason of non-disclosure of such extension clause.

In this aspect, the US authority has the same decision as English authority on this issue. Reference can be made to the New York Court of Appeals in *Sumitomo Marine & Fire Insurance Co. v. Cologne Reinsurance Co. of America*, the reinsured issued an all risks policy covering a steel mill which contained an extraordinary clause extending to cover losses caused by radioactive contamination. Sumitomo reinsured the direct policy with Cologne Reinsurance without disclosure of such extended cover clause. When the reinsured claimed loss caused by contamination arises from the radioactive material on the premises, the reinsurer denied the liability on the ground of the non-disclosure of adoption of such unusual terms in the direct policy. Although the court finally decided that the reinsured had waived disclosure by issuing a formal reinsurance certificate after notice of the occurrence of the loss, it still affirmed that such abnormal appearance of the nuclear risks which is generally excluded in the reinsured’s general business need to be disclosed to the reinsurer.

Therefore, it suffices to say that general application of the rule excludes the reinsured’s disclosure of standard terms normally and customarily found in the direct policy of that nature, but existence of unique or extraordinary terms which would not normally appear in a policy of that kind and has the effect of extending the

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418 75 n.y.2d 295(1990).
419 The clause states: “sudden and accidental radioactive contamination, including resultant radiation damage...from material used or stored or from processes conducted on the described premises.”
reinsured’s liability scope in an unforeseeable manner in the reinsurer’s ordinary course of business need to be disclosed to the him. If the reinsurers waive the breach of the duty, then such unusual terms are binding on the reinsurers.420

The situations may be distinct between reinsurance agreements without any limitations on the terms and reinsurance agreements which contain express independent restrictions upon the reinsurer’s liabilities. If there are not any limitations on the reinsurers’ liabilities, like stated above, reinsurers’ attention need to be drawn from any existence of unusual terms in the direct policy. If there are express independent restrictions upon the reinsurance coverage, and the reinsured still chooses to accept any unusual extended liabilities under the direct insurance contract which exceed the reinsurance coverage, the reinsurer is not obliged to indemnify the reinsured in respect of such liabilities even the reinsured has to make the payment under the direct insurance. Consequently, such existence of unusual terms in the direct insurance does not affect the reinsurer’s liabilities at all so that such facts are immaterial and need not to be disclosed to the reinsurers.

The position could be even more complicated if there are independent restrictions terms qualifying the reinsurance coverage and the full reinsurance clauses worded as ‘subject to same terms and conditions as the original policy’ in the reinsurance agreement at the same time. It is debatable which clause has the prior force in application. Different positions would affect the extent of reinsurers’ liabilities and consequently affect the scope of the reinsured’s duty of disclosure. If the express limitation terms of the reinsurance agreement supersede the full reinsurance clause, then such specific qualification of the reinsurer’s liabilities excludes the incorporation of any contradictory clauses of the direct policies. Then such clauses are immaterial to the extent of the reinsurer’s liabilities and there is no need to draw the reinsurer’s attention to them.421 All other liabilities of reinsured’s arising from the standard and customary terms still fall within the express reinsurance coverage, not affected by the non-incorporation of the unusual terms. Alternatively, if the additional restrictions limiting the extent of the reinsurer’s liability are subject to the full reinsurance clause which worded as ‘subject to same terms and conditions as the original policy’, then

420 Property Insurance Co Ltd v National Protector Insurance Co Ltd (1913) 108 LT 104. It was held that the inclusion of a provision in the reinsurance contract ‘subject without notice to the same clauses and conditions as the original policy’ gave the effect that the reinsurer made a waiver of disclosure of such terms.
421 Marten v Nippon Sea and Land Insurance Co. Ltd (1898) 3 Com. Cas. 164.
the reinsurance incorporates the terms of original policies. Whether the unusual
terms of the direct policies extending the reinsureds’ liabilities or abnormally
appearing in the policy of that nature are incorporated into the reinsurance
agreement is ambiguous. However, the reinsured need to draw the reinsurers’
attention to the existence of such unusual terms so that such unusual terms can be
incorporated. At same time, such unusual terms need to be disclosed and not be
misrepresented by the reinsured so that duty of utmost good faith can be satisfied.
Any misrepresentation of such unusual terms in the direct policy would entitle the
reinsurer to void the reinsurance contract at any time, even after a loss has
occurred and tainted all other losses falling within the express reinsurance coverage.
Therefore, those unusual terms need to be addressed to the reinsurer first of all,
either to trigger the incorporation route, or falling within the duty of utmost good faith
route. Either, no mention of such unusual terms to the reinsurer gives the effect that
such terms are not incorporated into the reinsurance coverage, and then no duty of
disclosure arises as they are immaterial to the reinsurers at all.

Despite of judicial divergences on this issue, the current legal position is that the
effect of the wording ‘as original’ overrides the reinsurers’ own express restrictions to
the reinsurance coverage, incorporating the original terms and conditions into the
reinsurance agreement, so that the extent of the reinsurers’ liabilities could be the
same as the reinsureds’. However, it is a settled law that incorporation wording does
not encompass all of the direct insurance provisions. But the incorporation is
subject to the requirement in general contract law that a clause with an onerous or
unusual nature cannot be regarded as incorporated unless the party relying on it
proves that he drew the other party’s attention to it. Therefore, any unusual terms
that are unexpected to be found in original policies of the nature are simply not
incorporated into the reinsurance contract. Therefore, they are immaterial to the
reinsurers and the reinsured is thus not obliged to disclose them.

422 Charlesworth v Faber (1900) 5 Com. Cas. 408.
accepted, by obiter, that the appropriate question was not whether there had been incorporation, but whether the
reinsured had broken its duty of disclosure in relation to the unusual clause in the original policy.
426 Marten v Nippon Sea and Land Insurance Co. Ltd (1898) 3 Com. Cas. 164.
To summarise, the legal position as to disclosure of any unusual terms in the direct policy is in the following way. Generally speaking, terms normally found in the original policy of its nature need not to be disclosed to the reinsurers. If there are no express limitations on the reinsurance coverage, any unusual terms extending the reinsured’s liabilities or abnormally appearing in the original policy of its nature must be disclosed to the reinsurer. Any non-disclosure or misrepresentation of such unusual terms may entitle the reinsurer to void the reinsurance agreement. If the reinsurers waive the breach of the duty, then such unusual terms are binding on the reinsurers. If there are any express restrictions on the reinsurance coverage excluding indemnity of the reinsured’s liabilities arising from such unusual terms, such original terms and conditions are not incorporated into reinsurance, therefore not binding on the reinsurer at all. Consequently, such facts are immaterial and need not to be disclosed. If the reinsurance contains both express restriction clauses and the full reinsurance clause worded as ‘subject to the same terms and conditions as the original policy’, then the full reinsurance clause should supersede. But the unusual terms in the direct policy are not incorporated into the reinsurance and need not to be disclosed to the reinsurers.

5.4.3 The reinsured’s loss experience in respect of direct insurance

A reinsurer may be interested to be informed of the reinsured’s past loss experience in conducting his business, because a long enough period record of the reinsured’s loss experience is indicative of the level of care and competence exercised by the reinsured in his business. It is the same position in both facultative and treaty reinsurance contract that the reinsured’s loss experience in respect of direct insurance is material to be disclosed to the reinsurer.427 The experience is examined according to many aspects, such as frequency of the loss reflected by relevant number of times losses occur, the nature of the previous losses, the severity of the loss paid or occurred by the reinsured, the amount of the loss suffered by the reinsure, loss ratio and profitability of the direct insurance, the expectation of loss or amount of the reinsured’s anticipated losses which has the possibility to trigger future claim, especially in renewal or extension of the reinsurance arrangements etc. In some situations, the reinsurer may probably be interested to know the reinsured’s

past loss experience with any other reinsurers as well. The materiality of such losses is a question of degree depending upon their relationship with the risks to be ceded to the reinsurers. Such critical information enables the reinsurer to assess the quality of the risk run under the direct insurance, to evaluate the risk of a future claim under the policy to be issued, and to determine the proper premium, cost of protection and profit of the business. Therefore, the reinsured’s loss experience in respect of direct insurance may be material and need to be disclosed to the reinsurer.

In *Feasey v Sun Life Assurance Co of Canada*, the reinsurer entered into a reinsurance agreement to cover a P & I club ‘Steamship’ against its liabilities to indemnify its members for personal injuries and death suffered on board. Rather than entering into a conventional reinsurance, the reinsurer entered into a Personal Accident and Illness Master Lineslip Policy under which the reinsurer pay the club individual injuries suffered by original persons on board. The reinsurer syndicate retroceded to the retrocessionaire in respect of various liabilities under the lineslip. In Jan 2000, Sun life ceased to pay claims submitted by the reinsurer and alleged that the retrocession were voidable for the reinsurer’s misrepresentation that the payment of the reinsurer under the lineslip was to be a realistic estimate of average sums likely to be paid by the club to its members, and the reinsurer’s misrepresentation of its professional appraisal to fully investigate the reinsured’s loss statistics. Although the court rejected to affirm the misrepresentations, Langley J held that those facts in question would have been material had they been misrepresented.

It is notable that the reinsured’s loss experience which may need to be disclosed is not confined to the incurred or paid claims, but also extends to outstanding claims whether reported or not reported in connection with the account that he proposes to cede to a reinsurer. Such anticipated losses which may be greater than has been disclosed or appreciated are equally material to the reinsurer, at least if the amount of losses has reached a certain level which has the potential to trigger a claim. This was illustrated in *Aiken v Stewart Wrintson Members Agency Ltd*, the plaintiff were names of several Lloyd’s syndicates. In 1981, the syndicate through their agent entered into a contract of reinsurance with Syndicate 418 under with

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429 ‘IBNR’, incurred but not reported.
430 Groupama Insurance Co Ltd v Overseas Partners Re Ltd [2003] EWHC 34 (Comm).
Syndicate 418 agreed to provide aggregate excess of loss reinsurance in respect of all liability that might be incurred by the plaintiffs. Later, the reinsurer avoided the reinsurance agreement on the ground that the failure of the reinsured’s broker to disclose material facts. As a result of the avoidance of the reinsurance, the plaintiffs’ 1985 year of account was left open and brought the syndicates’ losses about £85m. An action was brought by the plaintiffs against their underwriting agents. Potter J held that misrepresentation of the nature which was long tail business for asbestos diseases claims rather than short-tail cargo business and the number of lines written by the reinsured made the reinsurer’s potential exposure greater than had been appreciated. In addition, non-disclosure of a block reserve established by the reinsured to meet particular forms of loss which was not transferred to ‘known outstanding’ loss was held by Potter J to be a material fact as it indicated the syndicate’s own estimate of its liabilities. Therefore, it suffices to say that an anticipated loss by the reinsured which results in enhance of the reinsurer’s potential exposure is a material fact. However, it is established that existence of outstanding claims against the reinsured is not material to a reinsurer who is simply fronting for retrocessionaires protected by a simultaneous settlement clause, because what the reinsurer really care is the solvency of the retrocessionaires rather than the reinsured’s underlying claims.432 In Limit No.2 Ltd v Axa Versicherung AG,433 it was similarly held that potential losses were significant therefore changes in claims between cover of the original treaty and its renewal was material.

There is no fast rule as to what kind of loss experience must be disclosed to the reinsurer. Generally speaking, the more remote from the risk run by the reinsured the loss experience is, the less likely it is to be considered as material to the risk, therefore whether relevant loss experience is material to a prudent underwriter is a question of degree, depending on particular circumstance in individual cases. There may be occasions where the reinsured has improved his level of care or business manner so that past experience may reveal less of the risk. If there has been any improvement or changes to the reinsured’s practice, it is more prudent for the reinsured to disclose such loss experience, and the improvement or changes undertaken to reduce the risk of similar losses, rather than keep silence at all.

432 Bonner v Cox Dedicated Corporate Member Ltd [2005] Lloyd’s Rep.I.R.569
433 [2007] EWHC 2321 (Comm)
5.4.4 Estimated premium income

The reinsurers may be interested to be informed of relevant information concerning the reinsured’s estimated premium income, such as deductions, commission, and cost of supporting reinsurance protection etc., as such information would affect the profitability of the reinsurance, particularly in proportional facultative reinsurance and treaties where the reinsured and reinsurer share the premium income in an agreed proportion. For example, the reinsurer may make underwriting assessment by reliance upon the estimated premium income of the reinsured under the direct insurance.\(^{434}\) In an unreported case *Allianz Assurance v Merchant*,\(^ {435}\) it was held that the reinsured’s insistence of increasing the premium rates was a material fact and need to be disclosed by the brokers to the quota share reinsurer, even though the additional part of premiums was retained by the broker rather than the reinsureds.

The reinsurer may also be interest to know the level of underlying deductibles borne by the assured in the direct insurance if a substantial deductible in some unusual way is requested by the reinsured. Therefore any concealment or misrepresentation by the brokers of unusually high level amount of commission obtained for the placing of the direct risk may be material fact to be disclosed to the reinsurer. Because such a high level of commission paid for the broker reveals the assured’s own risk assessment and evaluation of the business, reflecting a greater degree of risk under the direct insurance than the reinsurers have assess. It may consequently affects the reinsured’s premium income, particularly in a proportional facultative or treaty reinsurance agreement where the reinsurance premium is calculated on a proportional basis on the amount of premium payable under the direct insurance with a deduction for purpose of the reinsured’s costs and profits from the reinsurer’s premium income. Such case arose in *Markel International Insurance Company Ltd and another & v La Repblica Compania Argentian de Seguors Generables SA*.\(^ {436}\)

The reinsurer of an insurance companies who underwritten medical malpractice risks alleged that they had been misrepresented that the premium payable under the direct insurance would be approximately US$ 4.3m per annum with a commission of 27.5 per cent. However, the actual commission taken by the direct broker was far

\(^{434}\) Iron Trades Mutual Insurance Co Ltd v Companhia de Seguros Imperio [1991] 1 Re LR 213 ( PER Hobhouse, J); Simner v New India Assurance Co Ltd [1995] LRLR 240, 251 (per HHJ Diamond, QC)


\(^{436}\) [2004] EWHC 1826 (Comm).
greater than the sum stated, and resulted in more than double of the premium payable under the direct insurance. It was held that such misrepresentation was material to the reinsurer, as they might have taken an entirely different approach to assess the risk had they been informed of such high premium that the assured was willing to pay under the direct insurance.

In addition, the cost of reinsurance protection may be interest to the reinsurer. In *Hill v. C Insurance Co Ltd & Anor*, it was decided by the court that the cost of supporting reinsurance protection was material facts which ought to been disclosed by the reinsured. Hill was a Lloyd’s underwriter suing on his own behalf and on behalf all other members of Syndicates 186 and 193. The plaintiffs were excess of loss specialist syndicates. In 1989 and 1990 the defendants subscribed to quota share reinsurance treaties reinsuring all business allocated to the plaintiff’s excess of loss account. In placement of the quota share treaties, representations by Hills that ‘the cost of XL protection before reinstatement costs etc. has approximated within recent years to around 20 per cent of gross net premium income …’ was relied on by the defendants. A further statement was represented by the plaintiff in 1990’s renewal that ‘the cash position remains healthy preserved by a comprehensive common account XL programme placed at a very reasonable cost ratio’. After inspection of the account, the defendants delayed payment when the Hill failed to comply with the reinsurers’ request about the high cost of reinsurance. After an inspection of the plaintiff’s records in 191, the defendants avoided the contracts 1989 and 1990 for the reinsured’s misrepresentation and non-disclosure of material facts concerning the costs of XL protection. Cresswell J held that there was a material difference between the XL costs of 20 percent in recent years represented in the 1989 placing information and the actual costs of over 40 per cent in the relevant years, and such material fact ought to have been disclosed to the defendants. In addition, the increase in XL costs for the 1989 year and the likely increase for the 1990 year which reflected a material change to the information represented in the placement for the 1989 year ought to have been disclosed to the reinsurers in the 1990 renewal too. Therefore, the reinsurers were entitled to treat their contracts as void by reason of such material misrepresentation and non-disclosure.

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5.4.5 Claims handling by the reinsured

In addition to the manner in which the reinsured is running his business and the loss experience of the reinsured, information in respect of how the claims are developed by the reinsured may also be material to the reinsurer and need to be disclosed to the reinsurer. Particularly when the nature of the reinsured's claims handling processes, reinsured's claims monitoring approach, level of the claim amount, accounting, or the reserving policy deviate from what is usually expected in the market practice, such facts are material to a prudent reinsurer's underwriting assessment. For example, in *General Fire and Life Assurance Corp v Campbell*, it was decided that claims running at a high level was a material fact that need to be disclosed. The claimant underwriter of an accident insurance scheme placed its reinsurance in three layers. The defendant participated in the third layer of £50,000 to £100,000 at a premium of £500. The reinsurer sought to avoid the reinsurance on the ground of non-disclosure of a fact that the losses were running in excess of £10,000 per month. Branson J held that the defendant was fully entitled to avoid the reinsurance for such material non-disclosure because the reinsurer would have certainly rejected the risks had such information been disclose. Moreover, in *Feasey v Sun life*, the reinsured's misrepresentation in respect of his failure to monitoring the claims had been affirmed to be a material fact that the reinsurer was interested to be informed of.

The reinsured need to make effort to establish a full circumstance surrounding an event that had given rise to a claim, therefore it is an usual market practice that a proper and reasonable reserve would be set representing the most likely financial exposure of the reinsured under the direct insurance, including legal and any associated expenses on a regular basis of liaison and regular updates from external advisers, loss adjusters and lawyer etc. As to the materiality to the reinsured's reserving policy, it was established that the reinsured's practices for allocating reserves to potential claims to the extent that is unusual or unexpected need to be disclosed to the reinsurers. The leading authority addressing this issue is the Court of Appeal's decision in *Assicurazioni General SpA v Arab Insurance Group*. The plaintiff Generali was the reinsurer of several packages of insurance relating to US

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438 (1925) 21 L.I.R. 151.
construction risks. The reinsured retroceded the defendant ARIG a 7.5 per cent line in respect of the risks under a quota share retrocession agreement. As former direct insurer and later the leading reinsurer, Generali developed a system for investigation and evaluation of claims under direct insurance, through an independent loss adjuster. A claim file was established to 'investigate all claims and recommend the amount of loss reserve to be established with respect to such claims'. So ARIG sought to avoid the retrocession arrangement by reason of the reinsurer's failure to disclose that it adopted an unusual and impudent reserving principle. It alleged that such reserving policy that required losses to be established before any reserve are made gave the effect of understating the projected loss figures put forward by the reinsurer. Although the court of appeal disagreed with the retrocessionaire's allegation, by finding that the reserve policy adopted by the reinsurer was not sufficiently an imprudent and unusual in market practice so that the non-disclosure of such information was not material to render the retrocession voidable, it did accept that an unusual nature of a reserving policy would be a material fact.

5.4.6 Refusal of another reinsurer to accept or renew the risk

Generally, the refusal of another reinsurer's acceptance or renewal of a risk will be immaterial, particularly in marine insurance. It would be impracticable for the reinsured's broker to disclose all the approaches which have been made to the underwriters sitting in the underwriting rooms. Moreover, individual underwriter has his own philosophy of underwriting assessment to accept or refuse business, and what an underwriter consider good business may turn out to be unacceptable for the other underwriter. However if such refusal which reveal the financial performance of the direct insurance or reflect the premium income associated with the risk is misrepresented to the reinsurer, the issue of materiality may arise.

In *North British Fishing Boast Insurance Co Ltd v Starr*, the plaintiff issued a policy covered the total loss of the motor fishing vessel Present Help. The defendant who was an underwriting member of Lloyd’s shared the risk £8 odd with the plaintiff under reinsurance, covering this motor fishing boat from loss or damage by fire when engaging in fishing in 1921. After a loss suffered by the vessel from a peril insurance...
against, the defendant alleged to void the reinsurance policy by reason of non-disclosure of material facts that the plaintiffs' former reinsurer, who had been placing their reinsurance of the reinsured's fire risks on motor vessel since 1914 to 1920, refused to renew of the fire risks of the reinsured because there had been an exceptional increase both in the number and the amount of fire losses in 1920, because the reinsured refused to accept the premium charge quoted, i.e. a premium which was more than double the previous premiums. Although the judge held that the reinsurer was not entitled to avoid the policy, he did opine that a circumstance of this kind is material in that sense. 441

5.4.7 Identity of other co-reinsureds

Generally speaking, the identity of other co-reinsureds is not always material to reinsurers, particularly where the reinsured is the lead participant of the agreement because other co-reinsureds are free to make their own decisions in underwriting the direct insurance. However, in some situation the reinsurer may be interested to know and even induced to enter into the agreement by the fact that particular co-reinsured has participated in the underwriting the risks, even the co-reinsured is not leading underwriter under the direct insurance. Acceptance of risk by such co-reinsured of good reputation and professionalism may be an implication of the quality of the risks, so that the assessment of the risk by other co-reinsureds might be material in such appropriate circumstances, particularly where the reinsured itself has drawn attention to such fact. Such issue as to materiality was arisen in Assicurazioni Generali SpA v Arab Insurance Group, 442 the plaintiff Generali was the reinsurer of several packages of insurance risks relating to US construction workers. The reinsured retroceded the defendant ARIG a 7.5 per cent line in respect of the risks under a quota share retrocession agreement. After the defendant refused to pay any more claims after Feb 1999, Gennerali issued proceedings for unpaid claims. ARIG raised a number of defences, one of that was there was a material misrepresentation of Generali that the reinsurance agreement was 'supported' by Munich Re. The statement was actually partly true as the Munich Re did support the programme, albeit just one of the two sections of the reinsurance cover. Although there was huge division to the approach of the Court of Appeal, it was finally held that the representation did not

441 Ibid. p 210, per Rowlatt, J.
have falsity; neither did it induce the retrocessionaire to subscribe the slips. As to the materiality of the statement, although two judges found it satisfied the prudent underwriter test on a simple ground,\(^{443}\) it is still notable to the reinsured to be more cautious to represent such relevant information when he tries to cede the risk.

Situation may be different where the reinsured is one of the following market whose underwriting decisions are often highly affected by the leading underwriter’s acceptance of the risks, or even bound by the leading underwriter’s decisions to acceptance, fixing the terms, premiums and settlements under leading underwriter clause, line slip etc. It is clearly material and need to be disclosed to the reinsurer whether the reinsured was bound by decisions of other co-reinsureds.

### 5.4.8 Existence of other reinsurance cover and retention level

As discussed in the reinsured’s retention context above, since the *Trail v Baring*\(^{444}\) which decided that misrepresentation of the retention could entitle the reinsurer to avoid the contract, there has been a trend reflected in the courts’ decisions that the existence of other reinsurance cover and the reinsured’s retention level is not always material to the reinsurer. Alternative reinsurance arrangement covering the reinsured’s retention does not affect the retention’s primary function to eliminate the reinsurer’s liability for small claims. As it is shown in authorities,\(^{445}\) the reinsured is not under an obligation to retain the stated amount in the reinsurance terms for its net account unless the terms expressly provide so; and the reinsured is free to find alternative reinsurance arrangements to cover his exposure and such arrangements which are commonplace market practices in the reinsurance of that nature need not to be disclosed to the reinsurers, as those facts are immaterial information that the reinsurers ought to know in his ordinary course of business, for example in *Kingscroft v Nissan*,\(^{446}\) it was opined that it was a common practice in the market especially for quota share treaty to seek about a further excess of loss cover as long as the

\(^{443}\) Both Ward L. J. and Sir Christopher Staughton found that the misstatement satisfied the prudent underwriter test, on the simple ground that if the information had not been material it would not have been provided. It assumes that every fact stated is a material fact, a proposition which does not represent the law.

\(^{444}\) (1864) De G.J. & Sun. 318.


\(^{446}\) 1999] Lloyd’s Rep IR 603.
amount purchased was not unreasonably beyond market norms. Therefore, if the reinsurers are particularly interested in existence of reinsured’s alternative reinsurance arrangements, he need to make express enquiry into it and if it is particularly important for the reinsurer that the reinsured needs to bear such retention in its net account, the reinsurer need to draft the wordings expressly and clearly enough. In *Great Atlantic v Home Insurance*, it has shown that the wording ‘hold 10% of the risk for its own account’ did not amount to a promise by the reinsured to retain such share but just meant that it was not for the reinsurer’s account. The same situation happened again in *Kingscroft v Nissan*. The reinsured’s statement that it would retain 50 per cent of the risk was not a promise but merely amounted to a statement of intention. Again in *Assicurazioni Gennerali Spa v Arab Insurance Group*, it was held at first instance that representation by the reinsured of its retention was a statement of fact, not sufficient enough to perform as a continuing warranty giving the effect that all risks accepted by the reinsured would be retained for its net account during the policy period, as there was no good commercial reason for a reinsured to want to freeze its share for the whole year, nor the reinsurer would have such concern.

5.4.9 Retrocession protection offered to the reinsurer

Bearing an analogy to the relationship between the direct insurance and reinsurance contracts, retrocession is insurance of reinsurance between the retrocessionaire and the reinsurer. Although there is a market practice that the reinsured’s broker may be instructed to arrange satisfactory retrocession cover for the reinsurers before the reinsurers enter into the reinsurance agreement, the broker acts as the agent of the reinsurer rather than the reinsured’s in the arrangement, consequently the retrocession cover is a separate and distinct contract from the reinsurance contract, having nothing to do with the reinsured. Therefore, there is no any contract privity between the reinsured and retrocessionaire, nor is the reinsured imposed on any obligation to the reinsurer regarding to the retrocession cover. It suffices to say the nature of the reinsurer’s retrocession cover is prima facie a matter for the reinsurer rather than the reinsured. Whether the reinsurer is protected by proper retrocession arrangements is immaterial to the risk run by the reinsurers under the reinsurance

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agreement. Generally speaking, the reinsured is not obliged to disclose any information concerning the retrocession to the reinsurer without any express inquiry, even such information happens to be known by the reinsured.

The issue arose in *Societe Anonyme d'Intermediaires Lexembourgeois v Farex Gie (SAIL v Farex)*. The plaintiffs SAIL was part of an American insurance group (AIG), and the defendants Farex were a reinsurance group in which the first defendants were sued as a representative reinsurer. In 1988 SAIL instructed its London broker to place a facultative reinsurance facility with Farex. Farex indicated that it would be prepared to accept the business only if the broker could arrange retrocession protection for Farex. After the broker arranged the retrocession cover for Farex with St Paul Fire & Marine Insurance Company, Farex signed the lineslip on 17 Nov 1988. However, the retrocessionaire later repudiated the retrocession arrangements, claiming that the representative had no authority to accept the retrocession and the broker was aware of such information. In early 1991, Farex suspended performance of the facultative facility before repudiating all liability to SAIL. In June 1991 SAIL issued proceedings against Farex for summary judgment. On an application for summary judgment, 1994 Gatehouse J granted declarations that except for 24 declarations where Farex had an arguable case of material non-disclosure, all of the renewal declarations in the second year were valid and effect contracts of reinsurance. Farex appealed and SAIL cross-appealed from Gatehouse J's decision. Farex raised a new allegation of broker’s non-disclosure and misrepresentation concerning the invalidity of the retrocession arrangements, and further contention that broker’s knowledge of such fact was to be imputed to SAIL. The court of Appeal held that the broker acted as the reinsurer’s agent rather than the reinsured’s in the placement of retrocession arrangement. Therefore such knowledge known by the broker was not to be imputed to the reinsured under s.19 of MIA 1906 as the broker’s capacity was not the agent of the reinsured when he had acquired such information. Even if it was established that the reinsured happened to have knowledge of invalidity of the retrocession cover, the reinsured was under no duty to disclose it under s.18 (2) of the MIA 1906. The duty under the section did not extend beyond materials relevant to the reinsurance agreement between the SAIL and Farex, therefore the status of the retrocession agreement was not a material...

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circumstance within s.18 (2). Moreover, the reinsured was under no obligation to disclose the information because by s.18 (3) (b), there was no duty of disclosure on the reinsured to disclose the status of retrocession cover which ought to be known in the reinsurer’s ordinary course of business.

The *SAIL v Farex* case can be an example of the situation that there is a certain extent of independence between the reinsurance and retrocession. Under such circumstances it is impossible for the reinsured to have knowledge of the nature of the retrocession cover, or the reinsured coincidently possess some information that is immaterial to the nature of the risk run by the reinsurer under the reinsurance. Therefore, no duty of disclosure is born on the reinsured in placing the reinsurance contract. However, the position may be different under some circumstances where information possessed by the reinsured is highly correlated with the reinsurance agreement. Whether the facts within the reinsurer’s knowledge are material is a question of fact depending upon the relationship between the contracts involved and the nature of the information relating to the retrocession in individual cases.

In *Hill v Citadel Insurance Co Ltd* case mentioned above, in the Court of Appeal, the reinsured appealed from Cresswell J’s decision which granted the reinsurer entitlement to avoid the reinsurance treaties by reason of material misrepresentation and non-disclosure. The reinsurer were told by the reinsured’s broker that there was substantial excess of loss protection in place for them and the costs were ‘around 20% of Gross Net Premium Income’. The 1990 renewal information presented to the second defendant confirmed the existence of the excess of loss protection for the treaty, by providing that ‘The cash position remains healthy preserved by a comprehensive common account XL programme at a very reasonable cost ratio’.

The court held that such statements relating to the cost of excess of loss protection was misrepresentation and dramatic increase in the cost ratio should have been

449 [1994] C.L.C. 1094, per Hoffmann LJ, “it would in my judgment be going further than any court has gone if we were to impose an obligation to disclose matters relevant only to the interest of the insurer under a different contract to which the insured is not a party. The duty of disclosure is founded upon the likelihood that matters affecting the insurer’s likely liability under the contract...will be within the peculiar knowledge of the insured...But this cannot be said of the status of the insurer’s reinsurance contract. It would be pure coincidence for the insured or his agent to have any knowledge of these matters.”

450 For example, where the reinsurance and retrocession contract are interlinked and where the existence of valid retrocession protection is condition precedent to reinsurer’s subscription to the reinsurance facility, so information of the characters of integral retrocession arrangements in material to the reinsurer’s underwriting assessment.

disclosed to the reinsurer. The nature of such placing information was designed to encourage the reinsurer to participate in the reinsurance programme, and it was virtually self-evident that the reinsureds through their broker were putting forward the stated cost ratio as a stable feature and a guide to future expectations. Therefore, the reinsurer was entitled to avoid the reinsurance agreement for such material non-disclosure and misrepresentation.

In conclusion, the general rule is that the reinsurer's retrocession cover is prima facie a matter for the reinsurer rather than the reinsured, the reinsured is not obliged to disclose any information concerning the reinsurer's protection even such facts are coincidentally known by the reinsured. However, if such relevant information was within the exclusive knowledge of the reinsured and the nature of information is material to the risk run by the reinsurer, then the information still need to be disclosed by the reinsured.

5.5 Conclusion

It is long established under common law that the doctrine of utmost good faith applies to all form of insurance contract, therefore the reinsurance contracts should be subject to the same test of materiality like all direct insurance contracts. Although nowadays reinsurers tend to have a great deal of information at their disposal apart from which they obtain from their reinsureds, and the courts have accordingly tended to reduce the scope and application of the duty of disclosure where the reinsurer have great and independent knowledge of the risks they cover, the duty of disclosure is still retained as the most essential part of the doctrine of utmost good faith continuing to apply to the reinsurance business area, serving the purpose to enable the reinsurers to make informed underwriting decisions.

However, in business insurance market practice the duty of utmost good faith has become onerous to a certain degree, especially for large size, complicated nature and complex business. To minimise the difficulties and the deficiency of enforcing the law in applying to large size, complicated and complex reinsurance business, the reinsurers commonly follow the current business insurance market practice by designing particular standards and formal procedure of disclosure and inserting a specially draft clause in the reinsurance contracts overriding the default regime.
under current legislation, rather than seeking enforcement of the full requirements of the act. It is significant for the reinsured and reinsurer to identify various disclosure roles and allocate responsibilities, and the nature of the material facts and information in advance, so that it can facilitate a suitable and sufficient disclosure of material facts.

Material facts subject to duty of disclosure differ between the direct insurance and reinsurance contracts, determined by the nature of the insurance contract and the placing method by which the contract is concluded. As to material facts to be disclosed in placing reinsurance contract, in addition to the material facts relating to the underlying risks, any information relating to the manner in which the reinsureds run his business and operation of the reinsurance agreement itself may be material to be disclosed to the reinsurers. Although the types of material information may be different between direct insurance and reinsurance, there is a similar fact under both direct insurance and reinsurance context, i.e. there is no hard and fast rule that what circumstances can be material in placing insurance agreements. The reinsured and his broker acting on his behalf face most exposure of the reinsurer’s potential allegation of materiality of a particular representation or non-disclosure. There are always inevitable disputes between the parties, and even the market expert witnesses may put forward conflicting advices. Therefore the assessment of the materiality in respect of a particular circumstance is a question of fact in individual cases.
Chapter 6 Applicability and duration of the duty of utmost good faith in reinsurance contracts

6.1 Modifications of general rules of applicability and duration of the duty of utmost good faith in reinsurance

Reinsurance which in essence is insurance of insurers can be categorised as a contract of uberrimae fidei, so that the doctrine of utmost good faith should be applicable to a reinsurance agreement which is itself a contract of insurance. Generally speaking, placing a reinsurance treaty under which a contract of insurance is concluded attracts the duty of utmost good faith just as all other forms of insurance contract. Therefore the reinsured owes the reinsurer a duty of utmost good faith to disclose and make no misrepresentation of all material facts that may affect the reinsurer’s underwriting assessment until the underwriting decisions are made to conclude a contract of insurance. However, due to the distinctions nature of reinsurance relationship decided by special placing methods in subscription market practice, difficulties and problems arise as to the issue of applicability and duration of the duty of utmost good faith in reinsurance area.

6.1.1 Modification of applicability of the duty of utmost good faith in reinsurance

As discussed in previous chapters, distinctions exist between various types of reinsurance agreements. As an obligatory treaty is concerned, the cession of risks under the obligatory treaty is automatic, without any further underwriting assessment after conclusion of the treaty. Therefore such treaty can be regarded as a contract of insurance. However, position of the non-obligatory treaty is different as such treaty is only treated as a framework agreed in advance to make future reinsurance. Therefore such facility is in essence a contract for insurance under which reinsurance contract can be created by future cessions.

It is the nature of the reinsurance relationship and particular placing methods that determines the applicability of the duty of utmost good faith the reinsurance agreement. As a result, the positions with the various reinsurance agreements might be different where the doctrine of utmost good faith is modified, different from that in
direct insurance. Anomalies and difficulties can be created in such modification of
applicability and duration of the duty of utmost good faith in reinsurance context. In
deciding whether a reinsurance agreement attracts the duty of utmost good faith, the
most significant question to be answered is when the reinsurer exercises his
underwriting discretion to make assessment of the risks so that the application of the
duty is triggered and when the contract of insurance is concluded to terminate the
operation of the duty. Here suffice to say that the duty of utmost good faith only
attaches to a reinsurance agreement which of itself a contract of insurance rather
than a contract for insurance, such as a facultative contract, an obligatory treaty, or
facultative obligatory treaty, and any declaration made under a contract for insurance,
i.e. non-obligatory treaty. There is no duty of utmost good faith attaches to any non-
obligatory treaties or declarations to an obligatory treaty. Details in this respect will
be discussed in details in the latter part of this chapter.

6.1.2 Modification of duration of the duty of utmost good faith in reinsurance
contracts

6.1.2.1 General rules of duration of the duty in reinsurance

Since the duty is codified in the *MIA 1906*, it takes the courts a long time to finally
establish a set of rules concerning the duration of the duty. Briefly the rules can be
summarized as followings.

The assured is required to disclosure and accurately represent all information that a
prudent insurer may feel interested to know in decision making process at pre-
contractual stage, as codified in s.18(1) and s.20(6) of the *MIA 1906* ‘before the
conclusion of the contract’. Therefore not only the test of materiality is assessed only
during the negotiation process prior to the formation of the contract as stated in
s.20(1) *MIA 1906*, but also the duration of the duty of disclosure and the duty not to
make misrepresentation attaches to the contract only in a pre-contractual stage.
Prior to the conclusion of the contract, the reinsured remains under a duty to disclose
and to refrain from misrepresenting material facts coming into his attention, and is
obliged to correct any false statements made to the reinsurer.
For example, in *Assicurazioni Generali SpA v Arab Insurance Group (BSC)*\(^\text{453}\) which was discussed in above chapter, the Court of Appeal held that the reinsured was in breach of the duty by failing to correct a false statement before the contract had been concluded. It is worth notice that the point at which the contract is concluded does not necessarily requires any issue of a policy or payment of premium which is clearly stated in s.21 of the *MIA 1906*. Once the offer proposed by the reinsured or his broker is accepted without any reservation or condition by the reinsurer, normally demonstrated by the underwriters’ scratches of the slip in subscription market, the contract has come into being with the policies to be issued at a later point.

Once the risk has been accepted by the reinsurer, any false statement by the reinsured as to the risk or any information or changes to the circumstances which come into the reinsured’s knowledge after the conclusion of the reinsurance contract are irrelevant for the reinsurer’s underwriting assessment, consequently not material anymore for the purpose of the duty of utmost good faith.

This was illustrated in *Sirius International Insurance Corporation v Oriental Assurance Corporation*.\(^\text{454}\) It was held that the reinsurers who had entered into a reinsurance agreement covering a direct policy on the contents of a building could not avoid the contract on the simple ground that misrepresentation in respect of the sprinkler system which was equipped the building was made at post-contractual stage. Even the contract expressly gives the reinsurer a right to cancel the cover by notice to the reinsured after the inception of the risk, there is no continuing duty of disclosure created on the reinsured after the conclusion of the contract.\(^\text{455}\)

### 6.1.2.2 Continuing duty in continuous reinsurance treaties?

It suffices to say that the duty of utmost good faith which aims to enable the parties to make informed decisions terminates operation when the reinsurance agreement is concluded, unless express wording is incorporated into the terms to modify the


\(^{455}\) New Hampshire Insurance Co. v MGN Ltd [1997] 1 Re LR 213 (QB Com Ct).
duration of the duty. However, there still exists divergence in the courts as to a continuing duty of utmost good faith after formation of the contract.

Since *The Litsion Pride*, the courts are reluctant to give up importing the doctrine into the currency of the policy and even post-contractual stage before any litigation concerning the disputes between the contractual parties start, although the judges do accept that the duty of utmost good faith applies after the conclusion of the contract has to be curtailed to limited scope and with less harsh remedy. It is now an established rule that there is no general continuing duty of utmost good faith applicable to the currency and post-contractual stage of the policy. The reinsured is not obliged to continuously disclose any subsequent increase of risks underwritten. During the currency of the policy, any factors that may affect the parties’ rights and obligations are contractual issues to be governed by the express or implied terms of the policy itself.

However, a further distinction between the direct insurance and reinsurance may still create some problems as to duration of the duty in reinsurance market practice. In practice some treaty reinsurance is continuous until terminated by either party. It is suggest that the duty of disclosure only attaches again if such reinsurance cover is renegotiated as a pre-contractual duty attracted by a newly negotiated agreement. Whereas generally non-proportionate treaties are on an annual basis, so that the duty of disclosure is revived on each renewal.

Moreover as discussed above, distinct from direct insurance, under a quota share or non-proportionate treaties risks accepted by the cedent are automatically reinsured according to the terms of the agreement. Every time a declaration is made under the treaty, no further underwriting assessment is needed as this occurs after conclusion of the reinsurance contract. Therefore, it can be said that the duty of utmost good faith does not continue at the second stage of declarations.

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458 Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea) [2001] UKHL 1.
459 Bonner v Cox Dedicated Corporate Member Ltd [2005] EWCA Civ 1512; Goshawk Dedicated Ltd v Tyser & Co Ltd [2006] EWCA Civ 54.
In respect to situations where the reinsurers do have further underwriting decisions to make after the conclusion, the parties are actually conclude a fresh new policy by renewal, reinstatement, extension, variation of the existing reinsurance contract etc. It is suggested that the duty of utmost good faith attaches herein is pre-contractual per se and applicable only to the new policy created. So it is the revival of the pre-contractual duty rather than a continuing post one, and the reinsured is only obliged to disclose and make no misrepresentation of all material information relating to the reinsurer’s new underwriting decisions. Any breach of the duty make the induced decisions avoidable leaving the others untouched.

6.1.2.3 Problems as to duration of the duty arising in subscription market practice

The subscription market practice may create problems as to the duration of the duty. As noticed, there may raise practical problems where there is a gap between the initial presentation of a risk and the party’s decision to enter into the contract, either the reinsurer’s decision to underwrite the risk, or the reinsured’s decision to accept the reinsurer’s standing offer. Also problems may arise where there is a gap between the reinsurer’s subscription of the underwriting lines and the inception of the risk.

It is now established rule that any information or changes to circumstances, e.g. deterioration of claims figures which comes into the reinsured’s knowledge before the acceptance of the offer is material and should be disclosed, whereas has the reinsured been aware of such information after the acceptance of the offer, even if the risk is not attached at that time, no obligation of disclosure is imposed upon the reinsured. If the reinsurer has realized any materially increased risk between the acceptance and the inception, he might be discouraged to subscribe the risk at all or would like to alter the terms or premium acceptable to him. Then the reinsurer might attempt to notice the reinsured’s broker to withdraw from the contract and refuse to accept any premium. However, the duty of utmost good faith could not avail the reinsurer any right to avoid the policy on the ground of non-disclosure or

460 Limit No.2 Ltd v Axa Versicherung AG [2007] 2 CLC 610.
461 Bonner v Cox Dedicated Corporate Member Ltd [2005] EWCA Civ. 1512.
misrepresentation of such information concerning the changes of circumstances after conclusion of the contract.462

There are many facilities developed in the London market to promote the efficiency and reduce the cost of the placing process. Under those facilities, large numbers of similar risks can be placed fast and conveniently. In the following sessions, details will be discussed as to the modification and alteration of the applicability and duration of the doctrine operating in the reinsurance contracts which are placed in various methods.

6.2 Application of utmost good faith in facultative agreements

As discussed in above chapters, a facultative reinsurance agreement is used by the reinsured and the reinsurer for placing whole or part of a particular single risk that is underwritten by the reinsured under the direct insurance. A slip is commonly used in the London market by brokers in placing a facultative reinsurance agreement, appending to the original policy. By a ‘full insurance clause’ which can be considered as the most important term in the slip, terms of the direct insurance contract are incorporated into the reinsurance agreement so that the two contracts can provide identical covers. Therefore a facultative reinsurance agreement which is probably the simplest form of reinsurance contract is in essence a contract of insurance between the reinsured and the reinsurer. So the doctrine of utmost good faith as a principle of law is equally applicable to facultative agreements as it is to original insurances. The duty upon the reinsured is analogous to that of the original insured both as to the scope and the duration of the duty. Once the facultative reinsurer subscribes the slip, a facultative reinsurance agreement is concluded between the reinsured and the individual reinsurer. The reinsured is required to disclose and not to misrepresent all material information within his knowledge before the conclusion of the facultative agreement, so that the reinsurer can make an informed underwriting assessment. The consequences of misrepresentation or non-disclosure by the reinsured entitles the reinsurer to avoid the facultative agreement, even though the relative short-term risk period for which a facultative risk is reinsured may be over before such facts have come into light. There are few authorities on duration of the duty of utmost

good faith in facultative reinsurance context. In an very early case, *Federal Insurance Co of New Jersey v Westchester Fire Insurance Co*, it was held by the court that the reinsurance agreement which covers the reinsured’s liability under a direct policy insuring crops against damages was voidable on the ground that the reinsured failed to disclose material information that the crops had been subjected to severe hailstone storms. Such failure to disclosure the material information between the proposals submitted to the reinsurer and reinsurer’s formal acceptance render the facultative agreement voidable.

6.3 Application of utmost good faith in reinsurance treaties

6.3.1 Introduction

There are many facilities developed in the London market to promote the efficiency and reduce the cost of the placing process. Under those facilities, large numbers of similar risks can be placed fast and conveniently without individual presentations by the brokers to underwriters on a case by case basis. The reinsurance treaty can be one of the most common facilities effected to place risks. A reinsurance treaty is a continuing pre-arranged framework under which risks of a type or certain types or even whole book of the reinsured’s business is ceded to the reinsurers by future sequent declarations during the cover period. So a reinsurance treaty creates reinsurance contracts by a two-stage process, i.e. placing the treaty itself and the cessions of risks falling within the treaty cover.

In practice, treaty mechanisms are placed by different methods, generally including three types, i.e. obligatory, facultative-obligatory, and non-obligatory treaty. One significant effect of different methods in placing treaty agreements is to modify the reinsurer’s underwriting discretion as to acceptance of the risks which fall within the ambit of the agreement. Therefore there is a critical criterion whether the reinsurer has discretion as to the acceptance of the risks which are ceded by the reinsured, i.e. obligatory or non-obligatory for the reinsurer; rather than the manner in which the ceded risks are allocated to the treaty cover, i.e. proportional or non-proportional.

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[1929] 3 W.W.R.646.
The specific nature of different methods may result in different conclusion timing of the contract of insurance created under the treaty framework, and then affect the application and duration of duty of utmost good faith attracted under the treaty. Whether the duty of utmost good faith applies either or both on the placing of the treaty or on the declarations ceding individual risks under the treaty is determined at the moment when the contract of insurance is brought into existence by the parties. It suffices to say that the duty is only attracted when the reinsurer is making underwriting decisions to conclude a contract of insurance, rather than attracted in placing a reinsurance contract which only functions as a contract for insurance giving both parties discretion to future cessions. As a contract for insurance does not itself providing an insurance cover, but just provides a mechanism under which contracts of insurance can be made through declarations of individual risks to the mechanism.\(^{464}\) The modification and alteration of the applicability and duration of the duty of utmost good faith to each different type of treaty and declarations made to it are discussed below.

6.3.2 Operation of duty of utmost good faith in obligatory treaties

As a predominating method of placing treaty reinsurance, the most distinctive nature of an obligatory treaty is that all risks falling within the scope of the treaty cover, no matter profitable or inclined to make losses, are automatically ceded from the reinsured to the reinsurers. Neither party has discretion as to the cession, i.e. the reinsured is obliged to cede all the risks, even if it is beneficial to the reinsured to reserve them; while the reinsured is bound to accept the risks with no right of refusal. Therefore, it can be concluded that the obligatory treaty is a contract of reinsurance on its own right which attracts a duty of utmost good faith prior to conclusion of the contract; and then the duty terminates operation after the conclusion of the contract, so that there is no more room for the duty to live in later stage as regards to declarations to the treaty.

6.3.2.1 Applicability and duration of duty of utmost good faith to an obligatory treaty itself

6.3.2.1.1 Difficulties as to the applicability and duration of the duty to an obligatory treaty—contract of insurance or contract for insurance?

It is obviously established rule that the duty of utmost good faith is attracted in a contract of insurance before the conclusion of the contract. As discussed above, whether the duty of utmost good faith is applicable to the treaty depends on the nature of the treaty, i.e. whether it is a contract of reinsurance or a contract for reinsurance. There is no dissidence in the essence of an obligatory treaty that is a pre-arrange framework under which contracts of reinsurance are automatically concluded without individual presentations when the risks attach. However, it is controversial whether an obligatory treaty is contract of reinsurance or contract for reinsurance.

There is no case which authoritatively determines this issue. This point arose in a very early case *Glasgow Assurance Corporation v William Symondson & Co*\(^{465}\) which was cited in many sequent cases concerning the duty of utmost good faith in reinsurance treaties. In this case, reinsurers entered into an obligatory agreement with brokers under which the reinsurers were obliged to accept all risks of a certain class at a fixed percentage premium. Later the reinsurer sought to avoid the agreement by the reason that the broker had made non-disclosure of a fact that they were not acting as intermediaries but the reinsureds in their own right and had ceded their own liabilities to the reinsurers under the agreement. It was decided by Scrutton J that the fact non-disclosed was not material to the risk so that the reinsurer was not entitled to avoid the contract. However, the agreement was not a contract of reinsurance in its own but a contract of utmost good faith. It is doubted whether such proposition represents the law.

\(^{465}\) (1911) 16 Com. Cas. 109.
6.3.2.1.2 Critical criteria—any underwriting assessment made before conclusion?

According to the nature of the obligatory treaty, it is suggested that an obligatory treaty is in its own right a contract of insurance which attracts the duty of utmost good faith because the reinsurers has to make his underwriting assessment and then decide whether or not to subscribe the risks proposed by the reinsured when the treaty is placed.

The English contract law has long established two requisites of a contract which is legally binding, i.e. the parties should have reached agreement generally at the time when one party accepts an offer made by the other; and the agreement must be certain and final. In addition, in the process of reaching agreement, the requirement of contractual intention and consideration must be satisfied for the legal enforceability purpose. In respect of an obligatory treaty, an offer is made by the reinsured when his broker proposes the risks to the reinsurer by proposal form or a slip in the subscription market. Information about the risks is passed on to the reinsurers and questions may be asked as to all relevant circumstances which the reinsurers concern. The potential contractual parties may negotiate all the conditions and terms of the treaty and fix the premium to be charged. Once the reinsurer subscribes the risks, the offer proposed is accepted giving the effect that a binding agreement is concluded between the reinsurer and the reinsured. All the rights and obligations of both parties are created and settled at the time of conclusion of the treaty, leaving the whole future cessions of risks which satisfy all financial, geographical or other criteria set out in the treaty to be ceded automatically.

In the placing process to reach agreement, the reinsurers’ underwriting decisions are already made, without any further discretion upon the reinsurer to refuse when the risks attach to the cover. A future cession automatically operates through the treaty mechanism so that its effect does not depend upon whether a declaration is made validly and in time to the reinsurer at the second stage. As a result, it can be said that the obligatory treaty agreement itself is the contract of insurance through which the reinsurer reinsures the reinsured against particular type or types of risks, far more than mere machinery for placing contract of reinsurance. A bounding contract of reinsurance is coming into existence once the reinsurer accepts the risks

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proposed by the reinsured’s broker, although the risks which fall within the treaty cover has not been automatically transferred to the reinsurer until the inception of the risks. Therefore, an obligatory treaty as a contract of reinsurance ought to attract the duty of utmost good faith on its own. As discussed in the first section, the duty of utmost good faith applies only to the pre-contractual stage, consequently the duration of the duty in an obligatory treaty lasts until the treaty itself is concluded. The reinsured is obliged to disclose all material facts that would influence the reinsurer’s underwriting assessment so that the reinsurer can get a whole picture how the treaty facility will be used and make his own assessment that whether such arrangement will deliver a profitable business.

6.3.2.1.3 Problems as to allocation of uncovered risks to the treaty

It should be noticed that only risks within the cover provided by the treaty will attach to the cover automatically. The treaty is not touched by any class of business which falls outsider the agreed limits of the treaty. Problems may arise that where the reinsured or his broker tries to allocate some uncovered risks into the treaty. It seems that the duty of utmost good faith is unhelpful to the reinsurer in such situation in respect of the treaty, as those risks are never agreed to be covered by the reinsurers consequently no duty of disclosure arises as to such information concerning the risks at all. Moreover, avoidance of the whole treaty seems unfairly disproportionate as non-disclosure or misrepresentation of material facts in respect of risks falling outside the treaty cover does not affect the reinsurer’s underwriting decisions as to the treaty.

However, the duty of utmost good faith may sneak in through the route of variation of cover of the treaty on the reinsurer’s acceptance of the additional risks, or through the route of parties’ conclusion of a new ad hoc contract of insurance covering this particular class of risks besides the treaty. Either route gives the effect that a duty of utmost good faith is attracted to the new agreement which concludes a contract of insurance by the reinsured’s declarations. Non-disclosure or misrepresentation of material facts to the reinsurer make the contract avoidable, leaving all other cessions of the risks to the original treaty untainted.
This point is agreed by the courts in *Inversiones Manria SA v Sphere Drake Insurance Co Plc. (The Dora)*⁴⁶⁶, where the brokers sought to add to the reinsurance treaty a proposal from the claimants for direct insurance, rather than reinsurance which the reinsurers accepted. When the defendant reinsurers tried to deny liabilities by alleging a number of misrepresentations and non-disclosure of material facts, the claimants argued that the proposal had been incorporated into the treaty coverage, so that no additional duty of utmost good faith had attached to it. The court rejected the claimant’s argument and held that the proposal for direct insurance had not formed a part of the reinsurance, but a new contract of direct insurance agreed between the claimant and the reinsurers. Therefore, the claimant’s breach of the duty of utmost good faith made the contract avoidable.

### 6.3.2.2 Applicability of utmost good faith to declarations to obligatory treaties

#### 6.3.2.2.1 The duty applicable to treaty terminates after conclusion of the treaty

As suggested in the above section, the duty of utmost good faith applies to an obligatory treaty itself, as it is a contract of insurance under which the reinsurer undertakes to cover the reinsured against particular types of risks automatically at the inception of the risks. All the underwriting decisions have already been made at the time of conclusion of the treaty leaving all cessions of risks automatically binding the reinsurers, consequently arises no question of the reinsurer being influenced in deciding which individual risks to accept or what terms to apply. Information of increase of the risks or alteration to the circumstances after the conclusion of the treaty becomes immaterial to the reinsurers and does not fall within the scope of the duty of disclosure.⁴⁶⁷ So according to the general rule of duration of the duty of utmost good faith, the duty of utmost good faith does not apply anymore after an obligatory treaty has been concluded. The point arose in *Law Guarantee Trust and Accident Society Ltd v Munich Reinsurance Co.*⁴⁶⁸ where the reinsurer entered into a quota share treaty to reinsure the reinsured’s liability from the original mortgage

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⁴⁶⁸ (1915) 31 TLR 572.
insurance policies issued after a fixed time point. The reinsured was under a duty to notify the reinsurer of new insurance within eight days since their conclusion. When a claim against the reinsurer arose, the reinsurer alleged non-disclosure of a new insurance policy on the bordereau. But the argument was rejected by Eve J. on the ground that there is simply no room for application of utmost good faith to individual declarations within the cover provided by the treaty. Consequently, the duty of utmost good faith is not attracted in declarations made to obligatory treaties.

6.3.2.2.2 Effect of the declarations

The effect of a declaration itself determines that such an obligation to notice rather than effecting a contract of insurance does not attract the utmost good faith. Under an obligatory treaty, the reinsured may be required to prepare a bordereaux of the reinsurance account for a fixed period, for example quarterly, for administration purposes. The reinsured is normally obligated to inform the reinsurer his cession of risks by means of such regular bordereaux just for information purposes. It was an essential part of the contractual machinery, as it informed the underwriters exactly which risks had attached to the cover and enabled them to calculate and collect the premium due in respect of them.\(^{469}\) Actually a tendency of decline in use of bordereaux in practice makes the reinsurer under an obligatory treaty receives less or even little information about the individual risks ceded. It perhaps indicates an implicit recognition by reinsurers that continuing information on the details of individual original insurances is time-consuming and adds nothing to the operation of treaties.\(^{470}\) The effect of declarations does not extend to the cessions of risks to the reinsurer which is triggered by automatic attachment of risks within the terms of the treaty. Consequently, failure of declaration will not vitiate the automatic attachment of risks or affect the liability of the underwriters in respect of a risk, even if notification is not made until after the loss has occurred as long as the reinsured has intended to make the declaration but negligently failed.\(^{471}\)


\(^{470}\) Bulter & Merkin's Reinsurance p. 10567.

The view is confirmed by Court of Appeal in *Glencore International AG v Ryan (The Beursgracht)*,[472] where the claimant issued liability insurance protecting shipowners’ liabilities against third party claims, an obligatory treaty was entered between the claimant and the defendant underwriters in respect of any sums for which the defendant were obliged to indemnify chartered vessels shipowners. After a stevedore was accidentally killed on the vessel The Beursgracht, which gave rise to the reinsured’s liability under the direct insurance, the reinsurer denied their liability of reimbursement by alleging that no insurance contract in respect of the vessel had ever come into existence since no declaration was made to accepted by the reinsurer, as an implied term in the open cover declarations had to be made within a reasonable time. The court rejected such allegation, holding that making declarations under an obligatory open cover does not need to be linked to the attachment of risks. The failure by GI to include the Beursgracht in a monthly bordereau was a mistake made in good faith. It was an implied term of the contract that the declaration had to be made within a reasonable time and omissions to make declarations might only be rectified if occurred in good faith. However, such implied term was an innominate term rather than a condition precedent or warranty. Breach of such innominate term did not entitle the party to repudiate the contract unless serious consequences could be proven. Failing to make declarations did not affect the reinsurer’s liability; so such breach was not repudiatory.

In conclusion declarations made to an obligatory treaty have no relation with the attachment of the risks to the cover provided. Once the risks declared within the ambit of the cover of the treaty, the reinsurers are immediately on risk. Declarations only serve perforce retrospectively to declare the true position under the cover, rather than to create any risk or obligations. Consequently duty of utmost good faith does not apply to declarations to an obligatory treaty.

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6.3.3 Application of the duty of utmost good faith in Facultative obligatory treaty

Facultative obligatory treaty is a hybrid of facultative reinsurance and obligatory treaty. It confers the reinsured an option to utilise the facility or not. By Contrast, the reinsurer is obliged to accept all the risks which the reinsured selects to cede by declarations falling within the terms of the treaty, without any discretion to refuse. Difficulties arise in deciding whether the duty of utmost good faith attaches to such reinsurance contract and when it terminates if it is attracted by such contract. It suffices to say it is the nature of the hybrid reinsurance contract which determines the applicability and the duration of the duty. The answers need to be asked are still whether such hybrid treaty is a contract of insurance or not, and when the underwriting assessment is made by the reinsurers. It is suggested that the operation of the duty of utmost good faith under a fac/oblig treaty has a similar effect and duration as it applies to an obligatory treaty, although on different justification.

6.3.3.1 Applicability of the duty of utmost good faith to the fac/oblig treaty itself

According to the criterion discussed in obligatory treaty section, whether the duty of utmost good faith applies to a fac/oblig treaty depends on its nature, i.e. a contract for reinsurance or a contract of reinsurance. It is not easy to justify in a fac/oblig treaty. Before discussing the nature of a fac/oblig treaty, distinctions between an obligatory treaty and a fac/oblig treaty need to be addressed, although distinctions between them are not always clear.

6.3.3.1.1 Distinctions nature of a fac/oblig treaty

In previously mentioned case Glencore International AG v Ryan, The Beursgracht, the issue before the court was whether, on the true construction of the terms of the open cover, the relevant contract of reinsurance came into existence between the claimant and the defendants when the claimant charted the vessel Beursgracht and the charter was performed. In his opinion, the cover in questions is in essence an obligatory treaty, therefore the risks attach to the cover automatically when The
Beursgracht was charted. In answering the question, differences between a fac/oblig treaty and an obligatory treaty were explained by Tuckey L.J.\textsuperscript{475} Where the treaty is an obligatory contract binding both parties to its terms, the reinsured agrees to declare every item that falls within the scope of the open cover and does not have the option to place such risks elsewhere. Once the risks fall within the ambit of the cover, underwriters are immediately and automatically on risks. Therefore a declaration serves perforce retrospectively to declare the true position under the cover rather than to attach risks to the cover or to create any rights or obligations. While under a fac/oblig treaty which can be described as a form of open cover gives the reinsured a facility to declare risks to the cover at his option, although the underwriter is bound to accept declarations as long as they fall within the terms of the cover. The declarations to a fac/oblig treaty attach the risks to the cover. If the risk declared is within the terms of the cover, there is no need for any specific acceptance by the underwriter, as he is bound and only bound since the receipt of the declaration. Consequently, declarations have to be made to a fac/oblig treaty before the contract of insurance becomes binding on the reinsurers, by contrast to an obligatory treaty under which declarations have not always to be made to reinsurer before they are bound.\textsuperscript{476} As to the effect of failure to make declarations under an obligatory treaty, the common law seems to regard an obligatory treaty as having a certain flexibility that allows the reinsured to make declarations after the loss has occurred, even if such loss has been known by the reinsured as far as the reinsured act in good faith.\textsuperscript{477} However, under a fac/oblig treaty, a declaration that attaches risks to the cover can have the retrospective effect and can be made to the cover after the loss has occurred, but not if the reinsured has already known about the loss. It was confirmed by Moore-Bick J. in \textit{Glencore International AG v Alpina Insurance Co Ltd} \textsuperscript{478}

It should be noted that such distinctions are not always clear between the treaties, depending construction of the terms of the treaty, so the same situations would have different outcomes. The parties’ common agreement will prevail to distinguish the

\textsuperscript{475} [2002] 1 Lloyd’s Rep IR 578 per Tuckey L.J.
\textsuperscript{476} ibid, 564,579 para 26.
\textsuperscript{478} [2004] 1 Lloyd’s Rep 111.
nature of the treaty. When there is a dispute regards the nature between the parties, it is a question of construction of the terms and conditions of the cover, with the nature of the business and any established course of dealing between the parties taken into consideration as well.

Due to those specific features of a fac/oblig treaty discussed above, it is often used in the circumstances that the reinsurer has already subscribed to a quota share or surplus treaty with the cedant but is willing provide the cedant with additional automatic capacity on certain selected risks when the treaty is exhausted. However, it is potentially disadvantageous for the reinsurer that it involves a risk of anti-selection, thereby depriving underwriters of the premium recoverable from a ‘balanced’ portfolio of good and bad risks. As a result, such method of placing reinsurance is only appropriate when there is trust between the treaty parties and the reinsured is able to act in good faith or the cedant retains a proper proportion of the underlying risks for its own net account in an associated obligatory treaty.

6.3.3.1.2 Applicability of duty of utmost good faith to the fac/oblig treaty itself

6.3.3.1.2.1 When the contract of insurance is concluded between the parties

According to the features commented above, it can be said that a fac/oblig treaty is no more than a standing offer whereby the underwriter agreed to accept liability in respect of any declaration made within the terms of the cover, rather than a contract becoming binding between the parties. No contractual rights and obligations arise until risks are selected to be ceded and declarations are made by the reinsured, as an acceptance of the reinsurer’s standing offer.

This is confirmed by the Court of Appeal in Citadel Insurance Co. v. Atlantic Union Insurance Co. S.A. and followed by many English authorities. In the Citadel, a US broker approached a London reinsurance broker to seek for a hull open cover for his client. Then a facultative obligatory open cover was placed by the London broker with the Greek defendants by a slip which was initialed by C. on behalf of defendants.

A year later after the initial of the slip, the Canadian plaintiffs became clients of the US broker. A proportion of the direct risks insured by the plaintiffs were declared to the London broker under the cover with the defendants. After losses occurred under the direct insurance, the plaintiff brought an action against the defendants to recover the balance between the premium and losses. The defendants denied their liability by contending that those losses did not fall within the terms of the reinsurance cover. In considering where the contract were concluded, the effect of the open cover was examined by Kerr L.J., in his opinion the open cover under which the defendants accepted liability as reinsurers was a standing offer whereby they agreed to accept liability for any declarations made to them within the terms of the cover. The initialing of the original slip, which established the open cover, did not at that stage constitute any contract between the plaintiffs and the defendants.⁴⁸²

6.3.3.1.2.2 Divergence of justification of the applicability of the duty to such a standing offer

Although it seems settled that a fac/oblig treaty is no more than a standing offer rather than a contract of insurance, it is still controversial whether the duty of utmost good faith applies to the treaty.

There are some arguments affirming application of utmost good faith to the fac/oblig treaty on different reasoning. The first kind of view regards the fac/oblig treaty as a contract of insurance to attract duty of utmost good faith by itself.⁴⁸³ Such view suggests that the agreement constitutes an immediate contract of insurance pending latent declaration to be made to the cover, due to the underwriter's immediate commitment when declarations are made. However, it is suggested that such view seems inconsistent with the settled law that the fac/oblig treaty is just a standing offer and underwriters are not bound until declarations are made to the cover.

The second kind of view, contrary to the first one, holds that the reinsurer is bound merely to offer insurance and there arise no contractual obligations under a contract of insurance between the parties. Therefore it accepts that a fac/oblig treaty is not by itself a contract of insurance, but creates individual contracts of insurance when

declarations are made and individual policies issued.\textsuperscript{484} But the second view proposes that such a contract for insurance should be regarded as an insurance contract in broad sense to attract the duty of utmost good faith. Some authorities seem to be supportive to such view, but it is suggested that the justification of the view is problematic. In \textit{Glasgow v Sydmonson},\textsuperscript{485} the claimant submitted that the agreement under which the underwriter agreed to accept all risks of a certain class was not a contract attracting utmost good faith. Scrutton J. rejected the submission, but no reasons were given in the judgment. While in \textit{Berger v Pollock},\textsuperscript{486} the treaty from which the disputes arise was non-obligatory in nature which did not attract the duty of utmost good faith at all. Consequently, neither of the cases can be considered supportive of the view.

Although the reasoning in the second view is consistent with the authorities, the justification for applicability of utmost good faith is still not convincing. There is a third view which is quite similar to the second one but to certain degree different on the reasoning.\textsuperscript{487} It is consistent with the ‘standing offer’ authorities by holding that such declaration policies operate as contracts for insurance as opposed to contracts of insurance by providing a framework under which contracts of insurance can be made by individual declarations. Under this view, the fac/oblig treaty is regarded as a contract for insurance but one that ought to attract the duty of utmost good faith for practical reasons, because the insurer has no discretion to reject risks subsequently declared by the assured. Such lack of any discretion at declaration stage and thus the absence of any duty of utmost good faith at declaration stage would appear to be a conclusive consideration in favour of a duty applicable to the treaty stage.

\textbf{6.3.3.1.2.3 No duty of utmost good faith attracted by such a standing offer itself}

Although the second and third arguments are pretty convincing as to the nature of a fac/oblig treaty, the applicability of utmost good faith in such treaty is still unclear. It is suggested with respect that neither of the arguments has persuasive justification as

\textsuperscript{485} [1911] 16 Com Cas 109.
\textsuperscript{486} [1973] 2 Lloyd's Rep 442.
how a contract for insurance attracts the duty of utmost good faith just like the contract of insurance does.

There are no decided authorities providing room for creation of such a specific kind of contract uberrimae fidei by analogy to insurance contracts. To define the applicability and duration of the duty of utmost good faith to a fac/oblig treaty, some questions need to be answered first, i.e. what is the nature of the fac/oblig treaty, when a contract of insurance is concluded and when the underwriting decisions are made by the underwriters to attract the duty of utmost good faith. As to the nature of the fac/oblig treaty, according to the settled law, a treaty is merely a standing offer which is binding the reinsurer himself to offer reinsurance cover in respect of particular risks in the future and there are no contractual obligations arising between the parties when the fac/oblig treaty is made. Hence no insurance covers are provided by the fac/oblig treaty by itself, in other words the treaty is not by itself a contract of insurance. Individual contracts of insurance are created by the subsequent declarations under the facility. Therefore there is a time gap between the underwriting assess at the first stage and conclusion of the contract of insurance at the declaration stage. The reinsurer has already made his underwriting decisions in respect of the particular risks to be covered in the future when he is ready to make such offer to the reinsured by entering into the fac/oblig treaty, even though the contract of insurance has not come into effect at that time pending future declarations which might or might not be made by the reinsured. Once the reinsured opts to cede the risks and thus makes declarations, provided they fall within the terms of the cover, a contract of insurance is immediately concluded and risks are automatically attached to the cover without any more underwriting assessment or acceptance to be made by the reinsurer. As a result, it is fair to say that the fac/oblig treaty is not a contract of insurance. No duty of utmost good faith applies to the fac/oblig agreement itself which is a simple binding on the reinsurer to accept the reinsured’s offer in the future.

6.3.3.1.2.4 Timing of the attachment and duration of the duty

Even though the duty of utmost good faith does not attach to the fac/oblig treaty itself, it is proposed that there does live a duty of utmost good faith in the whole two-stage underwriting process. The justification of existence of the duty need not go through
the ‘analogous to a contract of insurance’ route, or the ‘specific kind of contract uberrimae fidei’ route. The duty is attracted on the simple ground that contracts of insurance are concluded between the parties under the mechanism, although the time of conclusion is postponed to the declaration stage, as opposed to circumstances under an obligatory treaty where contracts of insurance come into existence at the moment of conclusion of the treaty.

As to the duration of the duty, it is suggested the general rule of duration of utmost good faith applies here without any exceptions or modification, even though the fac/obligatory treaty has a hybrid nature. So that the duty arises from the point when a standing offer to provide insurance covers in the future is proposed, i.e. when the parties are negotiating a fac/oblig treaty; and lasts until the conclusion of a contract of insurance i.e. when a declaration is made to the fac/oblig treaty as acceptance of the offer. When a fac/oblig treaty is agreed, the reinsurer has exercised his judgment as to whether to accept such class or classes of risks in the future, so he deserves all material information in respect of the manner by which the business will be run and how the facility would be used in the future to make an informed underwriting decision; although the underwriting assessment seems terminates when he determines to enter into the fac/oblig treaty, rather than extending to the declaration stage when he is automatic on risks attached to the cover. According the settled rule of duration of the duty, there is no general continuing duty of utmost good faith after the conclusion of insurance contracts, therefore the duty terminates when the declaration is made to the fac/oblig treaty.

6.3.3.2 Applicability of the duty of utmost good faith to declarations to a fac/oblig treaty

As discussed in the distinctions between an obligatory treaty and a fac/oblig treaty, the effect of declarations to a fac/oblig treaty is crystal clear and confirmed by many English authorities. It is settled that declarations under a fac/oblig treaty attach risks to the cover. Once the reinsured makes a decision to ceded the risks to the reinsurer, he is imposed an obligation to notify the reinsurer what have been ceded by means of regular bordereaux.
6.3.3.2.1 Effect of the declarations to an fac/oblig treaty

Contrary to declarations to an obligatory treaty, declarations to a fac/oblig treaty is fatal to the cover because the risks will not attach to the cover until such requirement of notification is satisfied as same as declarations to a non-obligatory treaty, although the reinsurer does not have a right to refuse the cessions. If the risk declared is within the terms of the cover, there is no need for any specific acceptance by the underwriter, as he is bound and only bound since the receipt of the declaration. A new contract comes into existence when a declaration is made. Contractual obligations becomes binding between the parties. However, it is not clear whether the duty of utmost good faith arises in declarations to the treaty.

6.3.3.2.2 Waiver of the performance of the attached duty to declarations

Due to its effect commented above, it is suggested that a declaration made to a fac/oblig treaty serves as an acceptance of the reinsurer’s standing offer to conclude a contract of insurance, consequently should attract the duty of utmost good faith. The duty arises when the reinsurer is making his underwriting assessment at the first stage as discussed in last section, and terminates when the a contract of insurance is concluded i.e. when declarations are made to the treaty. However it is arguable whether the duty needs to be performed by the reinsured at the declaration stage for practical purposes, as it would not be consistent with the market practice. The reason why such fac/oblig facility is used in the practice is to provide a flexible, efficient and continuing coverage for a large number of particular risks without individual time-consuming presentations. As long as the risks declared fall within the ambit of the treaty, the reinsurers are automatically bound to accept them without any discretion anyway. So no more underwriting decisions are made at this stage.

490 Sedgwick Tomenson Inc v PT Reasuransi Umum Indonesia [1990] 2 Lloyd’s Rep 334, per Evans J.
493 In the Citadel, Kerr L.J. refused to confirm such statement, but just say that the declarations arise contractual obligations which becomes binding between the parties.
Therefore it is suggested that the reinsurer waives unnecessary performance of the duty of disclosure at the declaration stage by his automatic acceptance,\(^494\) which gives the effect that the duration of the duty of utmost good faith seems to terminate already when the fac/oblig treaty are concluded between the parties just like circumstances under an obligatory treaty.

### 6.3.4 Application of utmost good faith to non-obligatory treaties

A reinsurance treaty can be placed by a non-obligatory method. A non-obligatory declaration policy is in essence an advanced agreed facility which does not provide reinsurance cover by itself but merely establishes machinery whereby risks can be presented to the reinsurer by subsequent declarations at later stage for consideration. Such market practice has modified the applicability and duration of the duty of utmost good faith to this type of reinsurance contracts. It can be generally summarised that the duty of utmost good faith does not apply to the treaty itself but applies to the declarations made to the treaty at the second stage. The point will be expanded in following sections.

#### 6.3.4.1 Nature of the non-obligatory treaty

As previously discussed, whether or not the duty of utmost good faith applies to a treaty depends on the nature of the treaty, i.e. whether it is a contract of insurance or not. Contrary to an obligatory treaty, all risks are presented and accepted on a mutually facultative basis under a non-obligatory treaty. The reinsured has an option either to cede the risks or retain them for his own account. Equally the reinsurer is not bound to accept declarations proposed by the reinsured, but has discretion to accept or refuse the cession either. Once the reinsured has decided to cede risks to the reinsurer, he is under a duty of notification to the reinsurer. Such a declaration fulfills the function as an offer to present risks to the reinsurer rather than serves an informational purpose. The reinsurer will make his underwriting assessment as to the risks proposed. Once the offer is accepted by the reinsurer, a reinsurance agreement is concluded.\(^495\) Therefore it suffices to say that a non-obligatory treaty does not provide insurance covers by itself, but entirely a mechanism under which

\(^{494}\) Details as regards waiver of the duty of utmost good faith will be discussed in next chapter.

individual contracts of insurance are concluded. Such treaty is thus best categorised as a contract for insurance.

6.3.4.2 non-applicability of the duty of utmost good faith to the non-obligatory treaty itself

The issue of applicability of the duty of utmost good faith to a non-obligatory treaty was discussed in *SA d'Intermediaires Luxembourgeois v Farex Gie*. In this case, the claimant SAIL instructed his London broker to place a reinsurance facility with the defendant, provided valid retrocession cover could be arranged for the reinsurer. After the broker arranged the retrocession cover for Farex with St Paul Fire & Marine Insurance Company, the reinsurer signed the lineslip on 17 Nov 1988. In early 1991, after discovering the invalidity of the retrocession cover, the reinsurer suspended performance of the reinsurance facility before repudiating all liability to SAIL as regards all declarations made by the SAIL to the facility. In the proceeding issued for summary judgment, Gatehouse J granted that except for 24 declarations which had an arguable case of material non-disclosure all the renewal declarations in the second years were valid and effect contracts of reinsurance. Moreover, Gatehouse J held that the lineslip was not a contract of reinsurance in its own right, and a separate contract of reinsurance was made on each declaration. In Gatehouse J’s opinion, it was impractical for the reinsured to disclose and represent a large number of interests when the lineslip was entered into; in addition at the date of conclusion of the lineslip, no risk had been transferred to the reinsurer therefore disclosure at this time was inappropriate, furthermore had a duty of disclosure attached to the lineslip, all declarations made under the agreement would be avoided for want of disclosure, even though information withheld may have no connection with the declarations at all. Consequently, the duty of disclosure attached to the declarations individually, rather than applied to the lineslip which was merely a ‘procedural mechanism’ for bringing reinsurance agreements into existence.

It is suggested that the reasoning of Gatehouse J given in *SAIL v Farex* is generally convincing. The duty of utmost good faith only attaches to individually separate

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contracts of reinsurance made on each declarations, rather than attaches to the
treaty itself which is not a contract of insurance.

First, when the parties are negotiating a non-obligatory treaty, no underwriting
decisions are required to be made by the reinsurer at this stage. A duty of disclosure
on the reinsured here is inappropriate as such a duty aims to enable the reinsurer to
make informed underwriting decisions.

Secondly, the terms of the treaty are not designed to provide any specific covers to
the reinsured against any risks, but merely intend to establish a procedural
mechanism by which reinsurance covers can be provided in the future. It imposes no
obligations upon the parties to cede or to accept any cessions of risks at the first
stage. It is impractical and unnecessary for the reinsured to provide detailed
information as regards a large number of risks that might or might not be ceded by
the reinsured in the future.

Thirdly, the remedy for breach of a duty of utmost good faith is to entitle the party
who has been induced into a contract by misleading information to avoid the
agreement ab initio as if it has never been entered into. This is not a unique
manifestation of uberrimae fidei, but actually harmonious with the general notion of
remedy for breaching contractual obligations under common law, to reinstall the
parties to the position where they are before the breach is committed. Under a
contract of insurance, remedy for breach of utmost good faith allows the parties back
to their place when such material information is withheld or misrepresented, i.e. the
time before the contract is concluded, which gives the effect that the contract of
insurance is avoided ab initio like never coming into existence. If the duty of utmost
good faith had been attracted in the treaty which is a contract for insurance, then an
want of disclosure concerning particular risks which are just ceded in part of the
declarations will make all declarations made under the treaty would cease to operate,
even though the material facts withheld or misrepresented may have had no
connections with declarations at all. This is contradicted with the general notion of
the remedy which could just protect the innocent party from the other's wrongdoings
rather than erase all things that happen between the parties. Therefore, the
appropriate and proportionate remedy here is to entitled the reinsurer to avoid any
contract of insurance concluded by individual declarations, without prejudice to the
umbrella facility which also establishes valid contracts of insurance else. This is also consistent with judicial decisions.\(^\text{497}\)

In conclusion, the duty of utmost good faith arose not at the stage at which the contract was made, but rather at the stage at which each individual declaration was made. Consequently, the duty does not apply to the non-obligatory treaty itself.

It is worthy to mention that although no duty of utmost good faith attaches to the non-obligatory treaty which imposes the parties a duty to volunteer information, the treaty is still subject to the general misrepresentation rule under common law and the\(^\text{498}\) Misrepresentation Act 1967. If a material false statement induces the non-obligatory treaty, the innocent party is still entitled to treat the contract voidable and capable of being set aside. This may undermine all the declarations to the treaty as they never have come into existence. In addition, damages, which is not an available option of remedy under the duty of utmost good faith, may be awarded to the innocent party for negligent or fraudulent misrepresentation, subject to contrary terms in the agreement.

\section*{6.3.4.2 Application of utmost good faith to declarations to the non-obligatory treaty}

The applicability of utmost good faith to declarations to the non-obligatory treaty is relatively straightforward. As discussed above, the duty of utmost good faith is not applicable to the non-obligatory treaty itself at the first stage, but is attracted in the second stage when contracts of reinsurance are concluded. And it is settled law that each declaration under a contract for insurance creates a binding contract of insurance.\(^\text{499}\) Therefore, it is suggested that the duty of utmost good faith attaches to the declarations to the non-obligatory treaty at later stage.

It is confirmed by English authorities on this issue. The earliest important authority on this issue is \textit{Berger and Light Diffusers Pty Ltd v Pollock} concerning an open cover

\begin{itemize}
\item \textit{Svenska Handelsbanken v Sun Alliance and London Insurance plc} [1996] 1 Lloyd's Rep. 519;
\item \textit{Citadel Insurance Co v Atlantic Union Insurance Co SA} [1982] 2 Lloyd's Rep 543;
\item \textit{Sedgwick Tomenson Inc v PT Reasuransi Umum Indonesia} [1990] 2 Lloyd's Rep 334.
\end{itemize}
of original insurance. The broker placed an open cover arrangement with the underwriter Pollock. A provisional cover in the form of a cross-slip, later replaced with a binding signing slip, was issued by the underwriter to insure the plaintiff Berger’s property. When the property was damaged in course of transit, the underwriter denied liability by alleging non-disclosure of a number of material facts relating to the value and history of the property. Kerr J. affirmed that the assured owed a duty of disclosure to the underwriter in respect of a declaration under an open cover. In Kerr J.’s opinion, according the facts in Berger and Pollock, the open cover was actually non-obligatory in essence, no binding agreement was to be concluded until the underwriter had received full information as to each risk and had exercised his discretion over whether or not to confirm the insurance by issuing a binding signing slip. There were some arguments that in Berger v Pollock the open cover in question, not like general obligatory open covers in practice which are obligatory, possess an exceptional conditional nature of permitting the insurer to refuse a risk. However, the reasoning in Berger v Pollock was confirmed by Gatehouse J. in SA d’Intermediaires Luxembourgeois v Farex Gie and HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co, that in case an open cover which imposes no obligations upon either party to make or accept declarations, each declaration is a contract of reinsurance which attracts the duty of utmost good faith. The reinsurer is entitled to avoid any contract of insurance created by the declaration in the event of misrepresentation or non-disclosure of material facts. However, such avoidance does not extend to the non-obligatory treaty itself, leaving other declarations unaffected.

It suffices to say what matters in deciding whether the duty of utmost good faith is attracted in reinsurance contract is the nature of the agreement rather than the form of it, i.e. whether the reinsurance agreement qualifies as a contract of insurance. The nature of the treaty provided is also critical to any consideration of the role which declarations were intended to play in the reinsurance treaty. The words used to describe the treaty are not determinative. Therefore the duty of utmost good faith is attracted when underwriting assessment is made by the reinsurers to conclude a

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contract of insurance between the parties. In the case of a non-obligatory treaty, the crucial timing is when the declarations are made to the treaty by the reinsured, rather than the formation of the non-obligatory treaty itself.

6.5 Conclusion

In business insurance market practice, reinsurance contracts which have large size, complex nature are usually placed in various complicated methods. Such different placing methods result in distinct nature of the reinsurance contracts, and then modified the applicability and duration of the duty of utmost good faith in the contracts. No matter what method is adopted to place the risks proposed, there are always three significant timing in deciding the applicability and duration of the duty, i.e. setting up a facility under which risks are ceded by the reinsured, the reinsurers’ underwriting assessment of the risks proposed and conclusion of contract of insurance to cede the risks proposed. In direct insurance and facultative reinsurance contract which is similarly placed by a simple slip in practice, it is normally easy and simple to coordinate the three timing together in the negotiation of the contract. However, as to the treaties, especially where business is ceded to the reinsurer for example by use of bordereau under the treaties in future, it is more complicated than the direct insurance as there may exist gaps between the three timing according to the placing procedure in practice. As a result, applicability and duration of the doctrine is modified and varies under different types of reinsurance treaties. The determinative criterion is that whether the reinsurance agreement is a contract of insurance in nature synonymous to the direct insurance, as the incidence of the disclosure and representation obligation may arise only when the contract of insurance is made. If the reinsurance contract is in essence a contract for insurance which works more like a contract of agency between the parties rather creating a partnership, then the question to be answered should be when the reinsurers make underwriting assessment and when a contract of insurance is concluded according to the facility, then the attachment point of the duty to the policy is reallocated to the stage of each individual declaration which appears to be the case if the policy is facultative in that the reinsurers can refuse any individual declaration.

In conclusion, the application and duration of the duty of utmost good faith in reinsurance agreements could be summarised as following.
As to facultative reinsurance agreements which are in essence contracts of insurance between reinsureds and reinsurers, the doctrine of utmost good faith as a principle of law is equally applicable to facultative agreements as it is to original insurances.

As to reinsurance treaties, it can general be separated into three categories. The crucial criterion is when the contract of reinsurance is concluded.

Under an obligatory treaty, the treaty itself in effect operates as a contract of reinsurance, as the reinsurer is bound to accept the risks ceded by the reinsured automatically. Accordingly, a duty of utmost good faith applies to the obligatory treaty itself. Declarations to an obligatory treaty in later stage do not attract duty of utmost good faith any more.

Under a facultative obligatory treaty, the treaty itself is a standing offer only binding the reinsurer to offer cover in the future. No contractual obligations arise until declarations are made to the treaty in later stage. Consequently, the duty should apply to the contracts of insurance concluded by declarations rather than to the fac/oblig treaty itself. According to the general rule of duration, it supposes to last from parties’ negotiation of the fac/oblig treaty to their conclusion of the contracts of insurance by future declarations. However, as the reinsurer waiver the duty of disclosure at declaration stage by automatic acceptance of the reinsured’s cessions, the duration of the duty is modified as if it only attach to the first stage, i.e. conclusion of the fac/oblig treaty just like the practice in an obligatory treaty.

Under non-obligatory treaties which are best categorised as contracts for reinsurance, a duty of utmost good does not apply to such framework facility which does not bring any contract of reinsurance into existence. When the reinsurer decides to accept a declaration by the reinsured, a contract of reinsurance is concluded between the parties. Then the duty of utmost good faith arises in the declaration stage. Where the reinsured fails to make a fair presentation in relation to the risks ceded, only the declaration relating to the particular risks is avoided, leaving the non-obligatory treaty and other declarations under it untainted.
It suffices to say that the criterion in deciding whether the duty of utmost good faith is attracted in a reinsurance agreement is the nature of the agreement. Such nature is also critical to any consideration of the role which declarations were intended to play in the reinsurance agreement. Therefore the duty of utmost good faith is only attracted when underwriting assessment is made to conclude a contract of insurance between the parties. All other features of the agreement, such as the form or the words used to describe it by the parties, are not determinative.
Chapter 7 Waiver of the Duty of Utmost Good Faith in Placing Reinsurance Contract

7.1 Introduction

The doctrine of waiver plays a significant role in curtailing the duty of utmost good faith in business insurance market. Although the legislation does not codify the doctrine of waiver, it expressly stipulates that information waived by the insurer need not to be disclosed by the insured.\textsuperscript{505} Also there has long established a regime on balance of authorities in common law explaining how the doctrine of waiver affects the application of the duty of utmost good faith. Normally, in the business insurance market, the reinsurers can waive the duty of disclosure in following ways, by express contract terms discharging the reinsured of any duty of disclosure or relieving the reinsured of disclosure of particular information;\textsuperscript{506} by failing to discover relevant information presented by the reinsured or his broker;\textsuperscript{507} either by failing to make reasonable enquiry when they have been prompted by the reinsured’s presentation that further relevant material information might exist;\textsuperscript{508} or by asking limited questions in relation to specific information after having been altered by the reinsured’s presentation, etc.\textsuperscript{509} However, difficulties will arise in relating to the practicalities of applying the waiver principles to reinsurance placing process in both scenarios, where the parties expressly contract out of the default regime and where the reinsurer impliedly waive the duty by making non-enquiry or asking general or limited questions.

In this chapter, those difficulties will be analysed in details and solutions consistent with current reinsurance market practice will be proposed in the following context, to draw a whole picture of how the doctrine of waiver affects the application of the duty of utmost good faith in business insurance market practice. Three issues will be addressed in this chapter. The first issue focuses on what requirements need to be satisfied to establish the reinsurer’s waiver of the duty and how the market practice effects those requirements. Then second issue concerns the problems caused in

\textsuperscript{505} See section 18(3)(c) of the MIA 1906, and section 3(5) (e) of the Insurance Act 2015.  
\textsuperscript{506} HIH Casualty and General Insurance Ltd v Chase Manhattan Bank [2033] Lloyd’s Rep.IR 230.  
reinsurance practice by expressly contracting out of the default legal regime. The third issue considered thereafter is difficulties arising in practice where the reinsurer is treated as impliedly waiving the duty of disclosure by making no enquiry or asking limited or general questions in the placing process. Then the position of law regarding whether the reinsurer needs to ask questions and how far the reinsurer should ask questions in the placing process will also be discussed.

7.2 General rules of establishing waiver of the rights and remedies for the duty of utmost good faith

In general contract law, rights and remedies may be lost by waiver or estoppel.\textsuperscript{510} A party will be held to have waived his right and to require the contract to be performed as the original contractual terms agreed, if he accedes to the other party’s request by not insisting on the original way of performance of contract. Waiver of this type is referred to as waiver by affirmation or waiver by election. Also he may be estopped from insisting on the strict performance of contract, if the other party acts in reliance on his representation or conducts showing that he will enforce or rely on the contract terms to be performed or observed. It can be said that the core inspirit of waiver lies on the party’s election between possible alternative or inconsistent rights exercised with full knowledge of their rights,\textsuperscript{511} whereas the essence of estoppel turns upon the reinsured’s reliance upon the reinsurer’s unequivocal representation, even that the reinsurer may not possess knowledge of their rights.\textsuperscript{512}

In placing reinsurance contract, the parties’ rights and remedies may be lost by waiver or estoppel, so that it can be said that principles of waiver and estoppel in common law can curtail the duty of utmost good faith in insurance contracts in many ways.\textsuperscript{513} This section focuses on what requirements need to be satisfied to establish

\textsuperscript{510} There is no single unified terminology for the doctrine. In certain formulation and dicta the word waiver has been referred as a generic terms encompassing waiver by affirmation and waiver by estoppel. However, there is clear distinction between waiver and estoppel although the two conceptions may overlap in some circumstances.

\textsuperscript{511} Waiver by one party’s election requires a choice of the party whether or not to exercise his right available to him, with full knowledge of the facts giving rise to such right. Such choice between inconsistent rights can be treated as a distinction with estoppel. Once the party chooses to waive his rights, such election is final and no further reliance on the election is required by the other party.

\textsuperscript{512} In opposite to waiver, estoppel requires the other party’s reliance on the representation that he will not enforce his legal rights in future. See House of Lords in Motor Oil Hellas (Corinth) Refineries SA v. Shipping Corporation of India (The Kanchenjunga)[1990] 1 Lloyd’s Rep 391.

\textsuperscript{513} It should be noted that there is the distinction between loss of the rights and loss of the remedies for breach of the duty. Once it is established that the reinsurer has waived the duty of disclosure or disclosure of specific information, the reinsurer will not be entitled to avoid the reinsurance contract on the ground that material information had not been disclosed. The effect of loss of rights is that the reinsured is not in breach of duty of
the reinsurer’s waiver of rights or remedies for breaching the duty of utmost good faith, and how the market practice effects those requirements.

7.2.1 Establishing waiver of rights or remedies of the duty of utmost good faith

Under English insurance law, the contract of insurance is not avoided automatically due to qualifying breach of the duty of utmost good faith, but subject to the other party’s choice in respect of such breach, i.e. elects to avoid the contract ab. initio or affirms it for commercial reasons. Generally speaking, the right to avoid a reinsurance contract can be waived by the reinsurer either by express contract terms or by his conduct or representation if the contract is silent on this issue.

7.2.1.1 Requirements to be satisfied to establish waiver

A defendant will be regarded as having waived the right to avoid, if he has the knowledge of the facts giving rise to a right of avoidance for misrepresentation or non-disclosure and the knowledge of the right of avoidance itself, and then acts in a way which is only consistent with an intention not to treat the contract as at an end. Normally in practice there are two possible forms of waiver of the duty of utmost good faith, i.e. by affirmation or by election. In practice, there is actually little difference between the requirements of them. Both of the cases require the reinsured to establish the reinsurer’s knowledge of the existence of qualifying breach and his right to avoid the contract, and then his own reliance on the reinsurer’s behaviour which stated that the reinsurer would not rely upon his legal rights even he had been aware of them. In conclusion, it can be summarised that the following conditions had to be satisfied in order to establish an affirmation of the contract. First, the reinsurer must have actual knowledge of the facts that were concealed or misrepresented before formation of the contract. Secondly, the reinsurer must also know that qualifying breach of the duty creates the right to

514 Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd [1992] 1 Ll Rep 101, at p. 106 Waller J. For instance, the defendant may waive the right by invoking or asserting a contractual right is a clear example of electing not to treat the contract as at an end. See also in Iron Trades Mutual Insurance Co. Ltd and Others v. Companhia de Seguros Imperio (1992) 1 Re LR 213 (QB Com Ct).


avoid the contract. Thirdly, the reinsurer should have a reasonable time to decide what to do. Fourthly, there must be an unequivocal communication to the reinsured by words or a conduct that the reinsurer has made an informed choice to affirm the contract. Finally, whether such a communication is found depends upon how a reasonable person in the position of the reinsured would interpret the reinsurer’s words or conduct.

7.2.1.2 Knowledge of the qualifying breach and relevant remedies

To establish a waiver of the duty of utmost good faith, the full knowledge of qualifying breach of the duty and relevant remedies is necessary before an informed choice of affirmation is made. It means that the reinsurer must have the actual knowledge of the reinsured’s guilt of non-disclosure or misrepresentation, and his right to avoid the reinsurance contract due to such qualifying breach.

In *Pan Atlantic Insurance Co. v. Pine Top Insurance Co.*, the reinsurer Pine Top had reinsured the reinsured Pan Atlantic in respect of risks allocated to its casualty account under excess of loss reinsurance contracts. When the broker was renewing the reinsurance contract covering losses occurring the calendar year 1982, a file including two loss records was prepared and available to reinsurer for negotiating purposes, although only the short record was addressed to the reinsurer’s intention by the broker. The reinsurer intended to avoid the reinsurance agreement by arguing non-disclosure or misrepresentation in relation to the failure to disclose the long record of losses and the additional losses omitted from the short record. The Court decided that there was a non-disclosure on the part of the reinsured in relation to the additional losses omitted from the short loss record, but not in relation to the failure to address the reinsurer’s attention to the long loss record and Pine Top had affirmed the reinsurance contract so that he was not entitled to avoid the contact on the ground of non-disclosure and misrepresentation. Walker J commented that there would have been affirmation of the contract if the party is with knowledge of the fact giving rise to a right of avoidance for misrepresentation or non-disclosure and possibly with the knowledge of the right of avoidance itself.

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517 Ibid.
518 WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA [2003] EWHC 1706 (Comm) per Salmon J.
It should be noted that simply being put on inquiry that there may have been a breach of the duty of utmost good faith is not sufficient to be said 'informed'. There could be no waiver of material information unless such information would have been disclosed on a common prudent underwriter’s inquiry. Nor an affirmation of the contract could be established in such situation, unless the underwriter entered into or carried out the contract after he had full actual knowledge of such material information. Moreover, neither mere lapse of time or intention to waive the right to avoid is enough to establish a waiver by an election.

As to the scope of the reinsurer’s knowledge for the purpose of waiver, only actual knowledge will suffice rather than constructive knowledge, although it does not matter how the reinsurer obtains his knowledge. Therefore having only the means of acquiring actual knowledge is not sufficient for the purposes of avoidance. Whether the reinsurer has such knowledge is a question of fact in practice. It concerns the truth of the matter known and a firm belief in their truth, as well as sufficient justification for that belief in terms of experience information and reasoning. In practice, an active and professional participant in business insurance industry may acquire intelligence, information etc. in many different contexts and channels. So it is necessary to consider the extent to which the knowledge received and whether it can be imputed to the reinsurer’s knowledge so as to found an argument of affirmation of contract. Generally speaking, it is settled that it is sufficient for the assured to show that an agent of the insurer, especially an employee of the insurer, has the requisite knowledge if that agent is authorised or appears to the assured to be authorised to receive the information communicated. Therefore it is insufficient to found a waiver by affirmation by giving the evidence of mere communication to a reinsurer of a substance. Whether it would afford sufficient knowledge depended upon the circumstances of receipt of the information and how it was dealt with after it was received by the reinsurer, subject to some limits such as

521 Liberian insurance Agency Inc v. Mosse [1977] 2 Lloyd’s Rep 560 per Donaldson J.
522 Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd [1984] 1 Lloyd’s Rep 476, 498 per Kerr, J, 530 per Stephenson, LJ.
523 Leaf v International Galleries [1950] 2 KB 86.
524 Barrett Bros (Taxis) Ltd v Davies [1966] 2 Lloyd’s Rep 1, 5 per Lord Denning, MR.
the ability to impute the knowledge, and where the agent is defrauding the principal etc. 527

7.2.1.3 Unequivocal representation or conduct as to election or affirmation

Once the party has made an election whether to exercise his legal rights to avoid the contact, he should communicate his choice whether or not to enforce his right by an unequivocal representation or conduct with the other party. Conduct which is required for the purpose of election should be a continuing performance of the contract of insurance only when the contract exists. Whether the conduct is or not unequivocal is a question of fact in individual cases. General speaking, invoking or asserting a contractual right was a clear example of electing not to treat the contract as an end, 528 such as payment of claims, a claim or acceptance of unpaid or instalments of premium, 529 exercise the rights of inspection, 530 extension of cover, reliance on a policy defence, rejection of the claim on other grounds, variation to the contract, termination of policy etc. Mere lapse of time is unlikely of itself to establish an election. Therefore the reinsurer’s silence or inactivity will not generally constitute unequivocal conduct for the purpose of establishing waiver. 531

7.2.2 Establishing estoppel from insisting rights or remedies of the duty of utmost good faith

An estoppel arises where the reinsurer represents such promises by express words or unequivocal conduct that he will not exercise his right of avoidance of reinsurance contract, and the reinsured acts in reliance upon such promise, so that it would be inequitable for the insurer thereafter to enforce his right of avoidance of the contract. To establish an estoppel, first, it is necessary of the reinsurer to make a representation or conduct that intended to induce a course of conduct of the reinsured. The principles applicable to the representation appear to be much the same as for waiver.  It must be ambiguous and clear, therefore simply delay on the


reinsurer will rarely qualify as an unequivocal representation. However, in contrast to the principle of waiver, estoppel does not turn upon an election of the reinsurer between alternative or inconsistent rights. An unequivocal representation may be qualified even though the reinsurers do not possess the full knowledge of the facts that confer them the rights or remedies. Subsequently the reinsured need to react or makes an omission resulting from the inducement of the reinsurer’s representation or conduct. That is to say a requirement of reliance of the reinsured on the reinsurer’s representation or conduct which is difficult to prove is essential here and must be satisfied. Finally, it must be proved that there is detriment to the reinsured as a consequence of the reaction or omission. Such change of position to the prejudice of the reinsured’s reliance is the very fundamental element of establishing estoppel. As a result, the burden of proof rests upon the reinsured to prove that he has acted by reliance, and then suffered detriment on the reliance on the reinsurer’s statement or conduct. From this point, it can be said that it is more difficult to prove estoppel than waiver. As a result a plea of estoppel is unlikely to succeed if a plea of waiver had failed. Argument of availability of waiver is turned on in most cases rather than estoppel. Therefore, this chapter will focus on specific issues of waiver of the rights and remedies in context of reinsurance contract.

7.2.3 Reservation of rights

Due to the possibility of loss the right of avoidance by waiver, it is a common practice for reinsurers to issue a reservation of rights, providing that appropriate words are used while he is purporting to take advantage of contractual provisions. Such a clearly worded reservation can protect a reinsurer from being alleged to affirm the contract in later stage when he is committing such affirmatory act. Although it is not incumbent on a reinsurer to reserve his rights while making enquiries under the contract of insurance, the reinsurer is incumbent to reserve his rights if he takes a further step as invocation of contractual rights which would otherwise constitute

532 Iron Trades Mutual Insurance Co Ltd v Companhia De Seguros Imperio [1991] 1 Re LR 2123,224 per Hobhouse, J.
533 Barber v Imperios Reinsurance Co (UK) Ltd, unreported, 15 July 1993 (CA).
affirmation of the contract. To reserve the right of avoidance, the wording should be clear, explicit and adequate to cover the right.534

7.3 Difficulties of contracting out of the legal regime of duty of utmost good faith in reinsurance context

In contrast with the consumer insurance market which is regulated under a mandatory regime, business insurance market is inclined to adapt provisions which are appropriate in their particular circumstances and suitable for their own business interest. Commercial parties, who are normally in equivalent business power, will and should be allowed to contract out of the default provisions to design their own rules by clear and unambiguous contract terms which can bring sufficient attention to the business. However, difficulties will arise in deciding the extent of the alteration of the default legal regime by the parties. It is suggested to be a question of construction of the parties’ intention in interpreting the contracting out provisions in individual case. The approach of construction will be analysed and it will be analysed on how to draft a contracting out provision to achieve the purpose successfully and to reduce the uncertainty to the contract at the same time. In addition problems may be caused as to the permissible scope of contracting out provisions in reinsurance contract; especially in the circumstances where express terms are drafted purporting exclusion of the reinsured’s liability for his broker’s fraud and to limit the reinsurer’s right of avoidance on the ground of such fraud. It needs to be considered whether the public policy should prevent such exclusion or limitation of the right or remedies, and whether there is any possibility to develop a room for a lawful contracting out provision where the agent to insure commits fraud against the reinsured. If the answer is positive, then it need be considered how to find out a solution to be consistent with current reinsurance market practice.

7.3.1 Practicalities to waive the right and/or remedy in reinsurance area

It suffices to say that the more sophisticated the insurance market is, the more widespread will the parties’ expectation of contracting out of the default legal regime be. In terms of operation of the duty of utmost good faith in reinsurance area, it is

suggested that there may exist practical needs of the parties to curtail the operation of duty of utmost good faith in placing reinsurance contracts.

The reinsurance market practice is not any more the archetypal position in Carter v Boehm\textsuperscript{535} when the doctrine of utmost good faith originates. In contrary to parties of direct insurance who may have a disparity of knowledge, underwriter of reinsurance contract or the reinsured’s broker may have a far greater expertise and ability to judge the extent of the underwritten risks and materiality of the information subject to disclosure than the reinsured. Therefore, although the contracting out clause is less frequently encountered than it is under other commercial insurance context, the doctrine of utmost good faith may actually lose its realistic premise in the placing certain types of reinsurance contracts. Such contracting out clause is of particular importance in certain forms of reinsurance where full disclosure is more or less impossible. For example, practicalities of certain situation in reinsurance market may sometimes render the duty of disclosure onerous to a certain degree, especially for large size, complicated nature and complex business. As under such large size and complex insurance business, identification, collection and collation of all material information related to the risks can be extremely difficult tasks involving multiple sources of information, proportionate to the size, nature and complexity of the business. In addition, the reinsurance parties may incline to skip the disclosure process to provide an all but incontestable reinsurance cover for certain commercial reasons,\textsuperscript{536} such as in order to operate business with particular insurers in specific types of business, or due to the reinsurer’s relationship with the particular broker in niche business, or even because of the status of the business insurance market and the amount of premium etc.. As a result, the parties to business insurance contract may modify the unitary and strict duty of utmost good faith on the reinsured by use of express contractual terms in reinsurance contract. Such contracting out clauses, if suitably drafted to achieve the effect, can exclude, restrict, or limit the duty itself or restrict the reinsurer’s remedies in the event of breach of the duty.

Moreover such practical need to expressly waive the duty can arise in the situation where the broker devises a marketable product to potential underlying insurer which has been previously negotiated by the broker with leading reinsurers. As discussed

\textsuperscript{535} (1766) 3 Burr 1905.
\textsuperscript{536} CTI v Oceanus [1984] 1 Lloyd’s Rep 476 at p 511, per Parker LJ.
in the previous chapter on broker’s duty of disclosure in placing reinsurance contract, in business insurance market which is a broker-based world, placing procedure may differ from that of direct insurance practice. Brokers may develop some types of business package at first, then search for and introduce the package to reinsurers who is running this type of business. Once the proposal is accepted by the reinsurer, the broker will approach the market to find proper reinsured. Therefore, the reinsurance may come into exist before the direct insurance contract leaving the identity of reinsured open. The reinsured, who may be even a fronting company in some circumstances, would actually be insulated from the placing process at the time of formation of reinsurance. As a result it is impossible for the reinsured to perform the duty of utmost good faith before the formation of the reinsurance contract. Placing entire chain of insurance agreements is completely under the broker’s organisation. It is the broker who devises the business, possesses the whole information relevant to the risks and undertakes the obligation to pass on and inform the information. The brokers are not instructed by the assured to place the original risks, but are marketing the pre-conceived package of business to the assured. Since the reinsured is not in a better position than the reinsurer in respect of relevant material information, it is not unfair for the reinsurer to waive the duty of disclosure upon the reinsured under such circumstances.

In conclusion, such express contractual terms are efficient means used in practice to curtail the duty of utmost good faith in context of reinsurance contract. It is the parties’ own intention that decides the extent to which the default legal regime can be altered, and the meaning of the terms is a question of construction in individual cases.

7.3.2 Difficulties as to the permissible scope of contracting out provisions in reinsurance contract
In practice, problems may also arise as to the permissible scope of the express contract terms of waiver in a reinsurance contract. First of all, it should be clarified what determines the extent of alteration of the position of the default legal regime. In addition, it is arguable what the permissible scope of contracting out provisions is. Whether should there be any restriction to the reinsurance parties’ option of proposed changes, for example whether should such express waiver terms be
subject to any public policy or a rule of law which prevents use of contract terms to exclude liability for such fraud? What is the solution to be consistent with current business insurance market practice?

7.3.2.1 What determines the extent of alteration of the default legal regime?

It is suggested that it is the parties’ own intention that decides the extent to which the default legal regime can be altered. Therefore, interpretation of the reinsurance contract terms, which intends to modify the duty of utmost good faith, is a question of construction determined upon the specific meaning of words used in the terms, the parties’ particular intention, the context of the contract as a whole and the admissible factual background. 537 The leading authority on the impact and effect of the contracting out clauses is decision of the House of Lords in HIH Casualty and General Insurance Ltd v Chase Manhattan Bank (Chase). 538 It was held that the true question in each case was the proper construction of the contracting out clause. It did not matter whether specific word is mention in the clause or not. What really mattered was whether the contracting out clause made commercial sense in such construction. However the issue whether there is a rule of law prevents the use of a contract term to contract out default legal regime, for example to exclude or reduce liability of a principal for the fraud of his agent, was left unsettled in HIH v Chase.

In HIH v Chase, HIH issued a time variable contingency insurance to the Chase Manhattan Bank which had participated in a syndicated loan arrangement to finance a film production company and had insured against the inability of the company to repay the loan. This TVC insurance had been in part developed and placed as a whole package in the London market by brokers Health since 1992. The risk was negotiated and presented to HIH by the broker leaving the Bank no part to play in the placement process at all. There were clauses called “truth of statement clauses” in the contract which excluded the assured’s personal duty of utmost good faith, liabilities and restricted the insurer’s right of avoidance. When losses arose, HIH tried to avoid the line slip facility on the ground of a series of misrepresentation and non-disclosure concerning the nature and extent of the risk insured. The preliminary

537 HIH v Chase Manhattan [2003] 2 Lloyd’s Rep 61 at p 75, per Lord Hoffmann.

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issue before the House of Lords is the correct interpretation of the ‘truth of statement clauses’. In the ‘truth of statement clauses’ it provides that:

“6. … [the Insured] will not have any duty or obligation to make any representation, warranty or disclosure of any nature, express or implied (such duty and obligation being expressly waived by the insurers), and …

7. … [the Insured] shall have no liability of any nature to the insurers for any information provided by any other parties and any such information provided by or non-disclosure by other parties including, but not limited to [Heaths] (other than Section I of the Questionnaire) …

8. … and any such information provided by or non-disclosure by other parties including, but not limited to [Heaths] (other than Section I of the Questionnaire) shall not be a ground or grounds for avoidance of the insurers’ obligations under the Policy or the cancellation thereof.”

By deciding the correct interpretation of the clause, answers would be found to the controversial issues whether waiver of the right of avoidance under phrase (6) should include the broker’s separate duty of utmost good faith, and whether phrases (7) and (8) exclude the reinsured’s and the broker’s liabilities for negligent and fraudulent misrepresentation and non-disclosure so that the insurer was not entitled to claim damages for it, if the duty of disclosure was not excluded by phrase (6).

It was unanimously held by the House of Lords that the phrase (6) was a waiver of the insured’s personal duty of utmost good faith under s.18, separate from the duty of the agent to insure under s.19. The effect of relief of the insured’s duty by the clause did not extent to the broker. Therefore, the broker still owned the insurer a personal duty of disclosure. In respect of the paragraph (7), the wording ‘no liability of any nature’ prima facie excludes all the liability of the assured’s arising from misrepresentation or non-disclosure of the broker or any other parties. As the phrase (8) clearly restricted the insurer’s right to avoid the contract in case of misrepresentation or non-disclosure by the assured or his brokers no matter innocent or negligent, it is arguable whether paragraph (7) and (8) together are broad enough to restrict the insurer’s right to claim other remedies for breach of the
duty acted by the broker, such as damages for negligent misrepresentation under s.2(1) of the Misrepresentation Act 1967 and fraudulent misrepresentation under the common law tort of deceit.\textsuperscript{539} As to negligent misrepresentation, their Lordships held unanimously that, for commercial purpose, the construction of the phrase extended to negligence so that relieved the bank from any claim from damages as a consequence of negligent non-disclosure and misrepresentation by itself or by its broker, the absence of the word ‘negligence’ in the sentence is irrelevant. However their Lordships were divided on the fraud issue. The majority treated the fraud issue completely different from negligence. Only Lord Hobhouse and Lord Scott commented on this issue, with divided opinions. Lord Hobhouse thought it was impossible, as a matter of public policy, for such an express clause to entitle the insured a relief from the consequence of his own fraud. In addition if the insurer entered into the contract upon the broker’s fraudulent presentation of the risk, such express waiver terms could not itself have been validly consented by the insurers. Lord Scott held a completely opposite opinion supporting the possibility of agreed express terms to exclude liability of such fraud and broad interpretation of such clause so that paragraph (7) and (8) were clear enough to exclude the broker’s fraud from the assured’s liability. The rest of their lordships simply held that the clause in question had not excluded the broker’s fraud even if it was possible to do so.

As a result, it was decided that “truth of statement clauses” in the contract entitled the insurers in law to avoid the contracts of or for insurance against assured on the grounds, but only on the grounds, of fraudulent misrepresentation or fraudulent non-disclosure by the broker as agent of assured. In addition, the insurers were entitled to damages from the assured for, but only for, fraudulent misrepresentation and non-disclosure by the broker as agent of assured if, but only if, such fraudulent non-disclosure by Heaths amounted to fraudulent misrepresentation. Although it was unanimously acted by their Lordships that the assured cannot exclude his liabilities for his own fraud under public policy and settled rule of law,\textsuperscript{540} the issue whether there is a rule of law prevents the use of a contract term to exclude or reduce liability of a principal for the fraud of his agent was left unsettled in HIH v Chase.

\textsuperscript{539} [2003] 2 Lloyd’s Rep 61,66 per Lord Bingham.
According to the practicalities of the situation in placement of reinsurance contract, there are various different forms of agreement reached between the reinsured and the reinsurers to achieve the effect of limiting the duty of utmost good faith, generally in two aspects, i.e. limiting the duty itself or the remedy for breach of the duty. First but less frequently encountered, the reinsurance parties can reach an agreement to restrict the duty of disclosure by declaring all facts or certain types of information to be immaterial or restrict materiality to certain types of matters, so that no duty of disclosure is invoked by the reinsured or his agent to insure. Or the clause can be drafted to exclude the reinsured’s duty of disclosure or the duty of its agent to insure in its entirety or in part; and even probably to achieve the effect of excluding the reinsured’s duty not to make misrepresentation. Moreover, the reinsurance parties may expressly exclude the authority on the agent to insure to make representations on behalf of the reinsured, thereby excluding the reinsurer's remedy for any misrepresentation made by the agent to insure. As a result, no duty of disclosure or refraining from misrepresentation arises at all under the reinsurance contract. Alternatively or in addition it can be drafted to eliminate the reinsurer's right to avoid the policy due to an actionable non-disclosure or misrepresentation by the reinsured’s or the broker’s. In such circumstance, the reinsurer may have no substantive remedy, even if a breach of duty of utmost good faith by the reinsured or his broker can be established. It can be concluded that there is one critical difference between the waiver of the duty of utmost good faith itself and waiver of the remedy for breach if the duty remains. As ruled by Aikens J in the above HIH v Chase case, an agreement to exclude the innocent parties’ right to avoid a contract for non-disclosure or misrepresentation should not extend to fraudulent withheld of true information, as public policy did not allow the a party to escape from liabilities for breach of the duty of utmost good faith if he is implicated in any fraud. Therefore it is suggested that where the reinsurance parties reach an agreement to waive the remedies for actionable non-disclosure or misrepresentation, such contracting out clauses may be subject to some limitation or public policies. By contract, in situation where the contracting out clause removes the entire duty rather than the remedies, then there is simply no duty to volunteer information at all. As a result, fraudulent concealment of material information relevant to the underwritten risks would be of no consequences at all. The difficulties arising from the unsettled permissible scope of
the contracting out provisions which restricts the duty of utmost good faith itself will be discussed in the following section.

7.3.2.2 Difficulties as to the permissible scope of contract out provisions in reinsurance context

It suffices to say the enforceability of a contracting out clause which may modify the duty of utmost good faith in reinsurance contract should be subject to certain overriding limitations on the scope, and wording of the clause. Thus, besides the question of interpretation of the meaning and effect of the contract out clause, it is arguable what the permissible scope of express waiver is. Whether should there be any restriction to the parties’ alternations, for example is there any legislative limits on the parties’ contracting out rights? Or whether should such express waiver terms be subject to any public policy or a rule of law, for example which prevents use of contract terms to exclude liability for committing fraud? What is the solution to be consistent with current reinsurance market practice?

7.3.2.2.1 Legislation and justifiable public policy limiting the scope of contract out provisions

In the Insurance Act 2015, section 16 in part 5 expressly enunciates that any term in a non-consumer insurance contract, which put the insured in a worse position than he would be in under the act will be to that extent of no effect, unless the transparency requirement in section 17 has been satisfied.541 Therefore, it can be said that in a non-consumer insurance market, the legislation does not intent to propose any limitation to the scope of any contract out terms, even if it is disadvantageous for the reinsured. As long as it is the reinsurance parties’ true intention to make such alteration of default regime, the legislation will not make any intervention, provided that reinsurer takes sufficient steps to draw such terms to the

541 Section 16 Contracting out: non-consumer insurance contracts
(1) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects representations to which section 9 applies than the insured would be in by virtue of that section is to that extent of no effect.
(2) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects any of the other matters provided for in Part 2, 3 or 4 of this Act than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect, unless the requirements of section 17 have been satisfied in relation to the term.
reinsured’s attention before it is agreed, and draft such terms clearly and unambiguously to such effect.

However, where the reinsured’s agent to insure has made any fraud vitiating the reinsurer’s underwriting assessment, it is arguable whether the contracting out provisions can exclude or reduce liabilities of the reinsured that should be responsible for such fraud in default regime. At least the broad wording in legislation, qualified only by the transparency requirement, does not forbid such express waiver. However, it is not settled whether there is a rule of law or public policy preventing the contracting out provisions from excluding or reducing liabilities of a principal for the fraud of his agent in common law. In fact, fraud is a controversial issue in many disputes before the courts, which is always treated as a different issue apart unrivalled innocent or negligent misrepresentation. Like the reasoning behind fraud exception to the scope of the duty of disclosure imposed on the agent to insure discussed in previous chapter, it is not easy to reconcile the judges’ opinions and the courts are always reluctant to show mercy to the party who commits any fraud. Under the contract law the parties enter into a commercial contract recognising the fundamental basis that each party assumes the honesty and good faith of the other. It is arguable whether it should be forbidden that both of the reinsurance parties expressly agree to transfer the risk of the broker’s fraud from the reinsured to the reinsurer. According to their Lordships, the reason why such contract exclusion of liabilities for agent’s fraud should not be allowed is that the principal should not rely upon and take advantage of the very fraud that he is liable for. Therefore it is justifiable for a public policy to come into play to protect the reinsurer where the reinsured actually knows of or be complicit in his agent’s fraud or where the agent’s fraud could be attributed into the reinsured’s. Consequently the reinsured is not permitted to rely on such terms to get rid of responsibilities in the event of fraud on his part.

\[2003\] 2 Lloyd’s Rep 61, 81-82 per Lord Hobhouse.
7.3.2.2.2 Difficulties where the agent to insure commits fraud against his principal

As discussed above, it should be justifiable for a public policy to come into play to prevent the contract out provisions from excluding the reinsured’s liabilities for his agent's fraud non-disclosure or misrepresentation. However, there may be a difficult circumstance in the placing reinsurance where an agent to insure rather than agent to know of the reinsured committed a fraudulent misrepresentation in the placing process. In such scenario, neither was the reinsured complicit in such fraud, nor would such fraudulent knowledge be imputed into the reinsured’s knowledge. Especially in some scenario, like the facts in *HIH v Chase*, the broker possessed all the information and devised the whole reinsurance package without any involvement of the reinsured. It is hardly the case that the reinsured would rely upon and take advantage of his agent’s fraud.

7.3.2.2.2.1 Possibility to develop a room for such lawful contracting out provision

It is suggested that it not unfair to introduce a clause into the contract to exclude the reinsured’s liability for fraud of his agent to insure, provided that the reinsured is in no way implicated in the agent’s fraud. By use of such contractual terms, provided it is so clearly drafted to exempt the reinsured’s liability for his agent’s fraud, the reinsurer must feel commercially sensible for himself to enter such extraordinary bargain and should be responsible for his decision to take the risk of the fraud of the reinsured’s agent.

As to effect of such express waiver, it is proposed that such express waiver does not mean to establish a legal exception to the reinsured’s liability for his own agent’s fraudulent misrepresentation in placing process, nor the brokers are excused from conducting such fraud. It just suggests that it is at least legally permissible for the reinsurer to waive such consequences of fraudulent misrepresentation by the broker against the reinsured only, leaving the contract of reinsurance between them untainted. By agreeing to waive liabilities of the principal for his agent’s fraud, the reinsurer may give up possible remedies under the default regime, as the right to

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avoid the contract under s.17 of the MIA 1906, or the entitlements under the new remedies regime under s.8 of the Insurance Act 2015, the right to claims damages for misrepresentation under s s.2 (1) of the Misrepresentation Act 1967 or under common law tort of deceit against the reinsured etc. However, the door to claim damages against the broker for tortious or contractual liability is still open for the reinsurer, as long as he can establish the broker’s personal liabilities for his loss arising from such fraudulent conduct.

7.3.2.2.2.2 What is the solution to correspond with current reinsurance market practice?

It is suggested that by inserting such waiver clause in reinsurance agreement, the parties agree that the risk of fraudulent non-disclosure or misrepresentation made by the broker, no matter through the separate duty route codified by s.19 of the MIA 1906 or through the imputation route under s.3 of the Insurance Act 2015, is reassigned to the reinsurers, provided that the reinsured acts in good faith and does fair dealing with the reinsurer. As a result, broker’s fraudulent misrepresentation does not entitle the reinsurer a right to avoid the contract between him and the reinsured, or to claim any damages against the reinsured. The remedy is removed by such an agreement by the parties. There are two alternative approaches supporting such agreement, namely such waiver can be deemed to remove the broker’s authority to speak on behalf of the reinsured or to treat the broker as the agent of the reinsurers. Both of the approaches can give a justifiable effect for the assured to discharge the liabilities for the broker’s non-disclosure or misrepresentation as to the material facts.

Although it is settled that the broker is the agent of the assured in placing process, there is no reason to bar the parties to alter the relationship among them and shift the liability for the agent’s fraud by inserting a properly drafted term in the contract, as long as it can be consistent with their business practice. The scenario in HIH v Chase is a perfect example for the assured’s expectation to remove the broker’s authority to speak on behalf of himself in placing the risk, although it was decided by the court that “the truth of statement clause” in the contract did not success to achieve such effect. It does make sense that the assured expects to exclude his liability for the broker’s fraud when he is insulated from the broker’s placing process.
at all. Therefore to remove the broker’s authority to speak on behalf of the reinsured would be a practicable and easy means for the assured to achieve such purpose, provided the contracting out provision is suitably drafted.

As to the approach of treating the broker as the agent of the reinsurer, it may be inconsistent with the firmly established law which decides the broker to be the agent of the assured in placing insurance risks. However, it is a common practice in the business insurance market for the broker to play a role of dual agent. The existence of relationship of agency between the broker and reinsurer, for example underwriting agency, does not necessarily contradict the default legal relationship between the broker and the reinsured, although there may be some conflict of interests. Whether a relationship of agency can be established between the reinsurer and the broker depends on role of broker in the placing process and the intention of them. Sometimes the broker may function more like the agent of the reinsurer in placing practice in business insurance market, such as devising and managing a reinsurance facility for the reinsurers then find them proper underwriters to subscribe the risks. In such situation it is equally reasonable and justifiable for either of the parties to be protected by a contracting out provision from liability for his agent’s fraud. Therefore, it should be justifiable for the reinsured and reinsurer to reach an agreement to allocate the liability for the broker’s fraud to the reinsurer if the broker does actually serve as the underwriting agent of the reinsurer. Once the reinsured and reinsurer does reach such agreement, it is suggested that there is no burden of a duty of disclosure on the broker at all as the underwriting agent of the reinsurer, the duty of utmost good faith does not come into play, rather than waived by the reinsurer by such stimulation of the relationship between the parties.

7.3.3 Difficulties arising from draft and construction of the clause in reinsurance context

Although it is supported that the reinsurance parties should be able to contract out of the default legal regime, there was still significant concern of the business market that such freedom of contracting out of the default regime would result in uncertainty into reinsurance contracts. So that the parties would not know whether their express terms of waiver can be relied on until the wording of the terms had been tested before the court. It is impossible to set a standard clause of waiver for all classes of
complicated reinsurance insurance contracts; therefore the courts should be allowed sufficient flexibility to interpret the terms. Consequently, difficulties will arise as to how the contract out clauses should be drafted to achieve the effect of waiver of the right or remedy. In addition problems will also arise to the construction of the clause as to what approach should be adopted to construe the meaning of the wording so that it can reduce uncertainty to the reinsurance contract.

In order to avoid the uncertainty to the reinsurance contracts and make sure the business insurance market running well without interference by onerous contract out clauses, it is suggested that a narrow and restricted approach should be taken in construction of such terms with the assistance of the practice of the reinsurance market. First of all from the reinsurance contract parties’ standing point, they need to consider whether it is necessary or appropriate for them to contract out of the duty regime. Then they need to negotiate their position, and finally make an informed decision to agree with the alternative position with knowledge of all the facts and consequences of contracting out. Secondly, a transparency requirement is expressly enunciated in section 16 of the Insurance Act 2015. Therefore to serve such function of contracting out of the default regime, the clause must be expressed in clearest and unambiguous terms on the face of the contract. In addition, the clauses must be drafted appropriately and indicate their expectation explicitly to alert reinsurance contract parties sufficiently to such extraordinary bargain, considering individual parties’ statutes and abilities. If the meaning of the clause is unclear due to its ambiguity, or it is capable of more than one conflicting or alternative interpretation of the clause, then the rule of contra proferentem should be relied upon to construe the clause against the interest of the party who benefits from the intended modification. In general, it should be construed against the party who proposes and draft the clause, and in favour of the party who accepts the clause. As in context of reinsurance, the contract is often drafted by the reinsured’s broker, who is the regarded as the agent to insure of the reinsured and may sometimes play a dual agent role as the underwriting agent of the reinsurer, thus the contracting out clauses

\[ \text{Hertzell, Burgoyne, The Law Commissions and Insurance Contract Law Reform, Journal of International Maritime Law, 120 (2013) 19 JIML.} \]
relating to waiver of duty of disclosure can also be construed in favour of the reinsurer's interest.\textsuperscript{545}

It should be noted that, to achieve the effect of alteration of a specific position of the default regime, general wording in the clause, no matter how comprehensive in legal sense, would not serve such purpose. For example, the wording of the 'truth of statement clause' clause in the \textit{HIH v Chase} case—"the insured will not have any duty or obligation to make any representation, warranty or disclosure of any nature' is held by the HL to waive the reinsured's duty of disclosure. However the clause did not extend the waiver to cover any representation the reinsured might choose to make. Therefore, once the reinsured did voluntarily make any misrepresentation, the clause cannot protect him from liability for misrepresentations.\textsuperscript{546} In addition, it was held that such wording only waived the personal duty of disclosure on the reinsured, rather than removed the separate duty of disclosure placed on the broker under s.19 of \textit{the MIA 1906}, because the simple wording did not serve the function to waive the duty of disclosure in its entirety, nor did it waive the materiality of the information itself. Moreover, the exclusion clause, stating 'insured shall have no liability of any nature to the insurers for any information provided', is not clear and explicit to achieve the effect to exclude the assured's liability for the broker's fraud, even the word 'any nature' can have comprehensive meaning. Similarly, in \textit{HIH Casualty v General Insurance Ltd v New Hampshire Insurance Co & Others},\textsuperscript{547} an exclusion clauses was interpreted by the Court of Appeal to precludes the right to avoid for misrepresentation,\textsuperscript{548} but not necessarily to exclude the right to claim damages under \textit{the Misrepresentation Act 1967}, s.2(1), or possibly in very exceptional circumstances in tort for negligent misrepresentation. Although there had not been any reference to a case in which the contract term employed such language to be held to bar a remedy for fraudulent misrepresentation, it is suggested that the reinsurance parties should be allowed by law to do so as long as both of them truly agree with this, provided a clause is suitably worded to achieve the effect. The

\textsuperscript{545} Abrahams v Mediterranean Insurance and Reinsurance Co. Ltd [1991] 1 Lloyd's Rep 216.
\textsuperscript{546} [2001] 1 Lloyd's Rep 30 at p 49.
\textsuperscript{547} [2001] 2 Lloyd's Rep 161.
\textsuperscript{548} The exclusion clause stated that "To the fullest extent permissible by applicable law, the Insurer hereby agrees that it will not seek to be or be entitled to avoid or rescind this Policy or reject any claim hereunder or be entitled to seek any remedy or redress on the grounds of...non-disclosure or misrepresentations by any person or any other similar grounds. The Insurer irrevocably agrees not to assert and waives any and all defences and rights of set-off and/or counterclaim...which it may have against the Assured or which may be available so as to deny payment of any amount due hereunder in accordance with the express terms hereof."
“discovery limitation clause” in *Brotherton v Asseguradora Colseguiros SA (No3)*\(^{549}\) can be another example. In the Brotherton case, the reinsurance policies contained a ‘discovery limitation clause’ stated that “there shall be no liability in respect of any claim…arising out of or in connection with any circumstance or occurrences known to the assured prior to the inception hereof and that have not been informed to the insurers at the time of inception.” Morison J rejected the reinsured’s argument that the clause could exclude the reinsured’s obligation to disclose material matters to a claim within the reinsured’s knowledge prior to the inception of the cover, as the clause does not in principle mean that the reinsured is thereby excused from his duty of disclosure to reinsurers.\(^{550}\) In some way analogous to the ‘discovery limitation clause’ in Brotherton, it is held that a standard Errors & Omissions clause in a reinsurance contract does not refer to breach of the duty of utmost good faith either. In *Pan Atlantic Insurance Co Ltd & Another v Pine Top Insurance Co Ltd*,\(^{551}\) the Court of Appeal decided that such Errors & Omissions clause does not refer to breach of the duty of utmost good faith prior to conclusion of the contract or the right to avoid for misrepresentation or non-disclosure, irrespective of whether or not they were inadvertent, as such a clause in reinsurance contract is not drafted to apply to pre-contractual misrepresentation or non-disclosure at all.

### 7.4 Implied waiver of the duty of utmost good faith in placing reinsurance

In addition to the express contracting out provisions, implied waiver plays a significant role in reshaping the doctrine of utmost good faith attached in reinsurance placing process. When a reinsurer make an unequivocal conduct that can be regarded as giving up to be disclosed of material information or surrendering his right of avoiding the reinsurance contract, and then the reinsured acts in reliance upon such promise, then it would be inequitable for the reinsurer to enforce his right later on. Therefore it has been used by the courts to prevent a reinsurer from avoiding a reinsurance contract where he has impliedly waived the disclosure of relevant information as described in s.18 (3) (b) of the *MIA 1906* or section 3(5) (e) of the *Insurance Act 2015*, or where the reinsurer can be regarded to have impliedly waived the remedies for qualifying breach of the duty, if the duty remains. Difficulties

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\(^{549}\) [2003] 1 Lloyd’s Rep IR 762.

\(^{550}\) Ibid, at p 778.

may arise in respect of the test of establishing an implied waiver. Moreover the parties in the disclosing or representing process will face practical difficulties as to whether the reinsurers need to ask questions to reveal material information and if so how far the reinsurers are obliged to ask questions in the placing process, and then whether the reinsurer's non-inquiry, general or limited questions indicates his waiver of disclosure of those information falling outsider the questions. In solving those difficulties, the practicalities of the principles of implied waiver of utmost good faith in reinsurance placing process will be analysed first. In addition, Comparison will be made between the Australian law and English law to find a proper approach of establishing implied waiver, to purport the current legislative spirit of prompting both of the reinsurance parties to make fair effect to get relevant material information disclosed. Such spirit has been reflected by the partially codification of the current common law positions in respect of the principle of implied waiver in the Insurance Act 2015.

7.4.1 Practicalities of implied waiver of the right or remedy in reinsurance context

The s.18 of the MIA 1906 adapted an objective hypothetical prudent insurer test which does not require the insurer to ask questions or indicate what it wishes to know. However, the harshness and defect of the test has long been under criticism as it may be inappropriate to assume an absolute informational asymmetry between the business insurance parties in 21st century any more. It is not the time where the reinsured knows every details of the risk proposed whereas the reinsurer knows nothing about the risk at all. Moreover, practicalities of certain situation in reinsurance market may sometimes render the duty of disclosure under the Act onerous to a certain degree, especially for large size, complicated nature and complex business. As under such large size and complex insurance business, identification, collection and collation of all material information related to the risk can be extreme difficult tasks involving multiple sources of information, proportionate to the size, nature and complexity of the business. In fact, it is not an economical way nor of much commercial sense to formulate a strict duty of disclosure which incentives the reinsured to dump all the relevant information in respect of the risks to the reinsurer who has to allocate those necessary material information to make
informed underwriting decisions. As a result, no matter the parties expressly contract out of the default legal positions or not, there should exist a set of rules of implied waiver of the duty of disclosure which can resolve the difficulties created by the gap between the default legal regime and the reinsurance market practice. So existence of such implied waiver of can prompt both of the reinsurance parties to make fair effect to get relevant material information disclosed. It is consistent with the spirit of current trend to encourage the reinsurers to get involved in the disclosure process more actively, rather than waiting for the reinsured to present relevant material information.

7.4.2 Comparison between the Australian and English insurance law in respect of establishing implied waiver

It is suggested that the Australian insurance law can be regarded as a good example and reference for reforming insurance legislation in past decade. It merits attention of the Australian insurance laws to provide a useful experience and guidance to clarify the positions of English insurance law. The sources of the Australian insurance law contain two aspects, i.e. legislation, both Federal and State, and the common law and equity as established by case law. *The Insurance Contracts Act 1984* is the most relevant legislation in context of the duty of utmost good faith in insurance contract. By contrast to English consumer insurance law, the duty of utmost good faith is still alive in Australian insurance law, in both consumer insurance and reinsurance context. However, it should be noted that this Act regulates insurance contracts rather than reinsurance, marine insurance, workers’ compensation or health insurance. Consequently, the duty of utmost good faith in the context of reinsurance in Australia has not been modified by the legislation, but depends substantially on the MIA 1909,552 and case law developed from English law in reinsurance context. The decisions of the English courts, though not binding, still remain of considerable persuasion. Even though, the formulation of the implied waiver of the duty in the Act can be a useful reference to analyse the proper rules governing the context of implied waiver in reinsurance area. 553

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552 It is equivalent of the MIA 1906 in UK.  
553 The Australian style is also mentioned in next chapter on regime of remedies. It is analysed and referred to for the same purpose of this chapter, namely providing guidance to possible interpretation of the regime in English law, although the act does not applies in reinsurance context.
As per the scenario where general or limited questions are asked by the reinsurer in the placing process, the principle that such questions can amount to a waiver of related information appears to be a good law under the *ICA 1984*.\(^{554}\) After a s. 21 A was added by *The Insurance Laws Amendment Act 1998*, the original test was modified into a new test that required the insurer to identify the information required to the underwriting assessment by asking appropriate questions in a clear and specific manner. The insurer would lose his right and remedy unless he make an enquiry to the assured relating to specific information, in addition, to disclose exceptional circumstance. Also a general or limited question asked by the insurer had the practical effect of waiving the duty of disclosure in respect of matters which would otherwise have required disclosure, unless such questions were directed towards “exceptional circumstances”. However, there appears a shift of attitude recently so that such right of the insurer to ask limited or general question is thought to be unjustified, and then has been removed by the *ICAA 2013*. The new version of s.21A is then substituted by the *ICAA 2013*, which is going to takes effects in 2015. According to the *ICAA 2013*, it stipulates that before conclusion of the contract, the insurer may request the insured to answer one or more specific questions that are relevant to the decision of the insurer whether to accept the risk and, if so, on what terms. If the insurer does not make such request, the insurer is taken to have waived compliance with the duty of disclosure in relation to the contract. If the insurer makes such request and requests the insured to disclose to the insurer any other matter that would be covered by the duty of disclosure in relation to the contract; then the insurer is taken to have waived compliance with the duty of disclosure in relation to that other matter. It is suggested that this new version actually reproduces the effect of the previous one, with just a significant modification of removing the provision whereby the insurer could ask for disclosure of exceptional circumstances. As a result, the current test of implied waiver of the duty of disclosure in Australian insurance law can be summarised as following. There is a duty of disclosure only where the insurer requires the assured to answer one or more specific questions relevant to the underwriting assessment. As to the insured, he is deemed to comply with the duty of disclosure if he discloses each matter actually known or deemed to

\(^{554}\) It states in ICA 1984, s.21 (3) that: Where a person: (a) failed to answer; or(b) gave an obviously incomplete or irrelevant answer to; a question included in a proposal form about a matter, the insurer shall be deemed to have waived compliance with the duty of disclosure in relation to the matter. The Insurance Laws Amendment Act 1998 added a new s 21A to the 1984 Act, although it has since been replaced in a simplified form by ICAA 2013.
be known by him. However, if no such specific questions are requested, such failure to ask a specific question is a complete waiver of disclosure. And a general question asked by the insurer can be regarded as a waiver of disclosure of that information even if it would otherwise been disclosed by the assured. While a limited question need to be answered only to the extent that the assured actually knows the information and to the extent that a reasonable person in the circumstances would have answered that question.

In comparison with the Australian law, the English law turns out to be relatively flexible and more ambiguous in establishing implied waiver of the duty of disclosure. As the English legislation governing reinsurance context, i.e. the current MIA 1906 and the Insurance Act 2015, is silent on the issue of implied waiver of the duty of utmost good faith, the sources on this issue all come from the English common law authorities. The common law authorities used to adopt a relatively tough attitude to establish an implied waiver of the reinsurer. It is suggested that there is no settled rules of implied waiver of the duty of utmost good faith in common law, which can affirm establishment of an implied waiver once certain requirements are satisfied. Neither is there a firmly established duty on the reinsurer to ask questions in the placing process. So the duty is still strictly upon the reinsured to make a full disclosure of every material circumstance and refrain from making misrepresentation. Moreover, there neither has any legal presumption in favour of the reinsured proposing that silence or asking limited or general questions suggests reinsurer’s implied waiver of such material information. So that the mere non-enquiry of a particular fact by the reinsurer or general or limited enquiry of that fact does not necessarily implies that the reinsurer is not interest in it and then waived the disclosure of the information. However, the court starts to gradually give greater recognition of the waiver principles to limit the application of the duty of utmost good faith. Although there has been shown a shift of attitude introducing a notion of

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555 It will come into force in August 2016.
556 Since the Consumer Insurance (Representation and Disclosure) Act 2012 comes into force in 2013, the duty on consumers to disclose any facts that a prudent underwriter would consider material is removed and replaced with a duty to take reasonable care not to make a misrepresentation. Therefore there is no room for implied waiver of duty of disclosure to live in context of consumer insurance any more. So the difficulties arising in the issues relating to implied waiver of the right and remedy are only relevant in non-consumer insurance context now.
fairness into the test, it cannot be said to be easy for the reinsured to establish an implied waiver.

Therefore difficulties will arise in deciding whether an implied waiver of the right or remedy can be established in reinsurance context. The attitude of the court in deciding whether there is an implied waiver in individual case is becoming less strict than before, by introducing a notion of fairness to focus on whether the reinsured has presented the information fairly and whether the reinsurer has asked questions fairly. Such shift of attitude will modify the test of implied waiver, thus modify operation of the duty of utmost good faith in reinsurance context. Difficulties and problems will be discussed in details in the following sections, and advice will be put forward to the parties to make a good performance of the duty in the placing process of reinsurance contract.

7.4.3 The need of reinsurer to make enquiries to reveal information prompted by the reinsured's fair representation

It is recognised that the reinsured and his broker may discharge the duty of disclosure by making a fair presentation of the risks. If any matters brought into the reinsurer's attention invoke the reinsurer to make further enquiries, the reinsurer ought to ask questions if he indeed requires further information. Failure of the reinsurer to put on appropriate inquiries of relevant material facts, which would be revealed by enquiries of a reasonably careful reinsurer, may imply that he had waived the disclosure of that information. As a result, the reinsurer is prevented from avoiding a contract by such implied waiver. However, it is suggested that the test of implied waiver as to the context of duty of disclosure in reinsurance contract is still to certain degree unsettled. Problems may arise as to whether the reinsurers need to ask questions in the placing process.

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7.4.3.1 Traditional formulation of implied waiver of the duty of disclosure in common law

There were authorities across the time illustrating this doctrine of implied waiver, indicating whether the insurers need to ask questions and if so how far the insurers are obliged to ask questions in the placing process. In recent cases there has appeared a shift of attitude as to the test of the implied waiver. A notion of fairness has been introduced into the test to strike a right balance between the business and the insurers. This was discussed in details in the leading case on implied waiver of duty of utmost good faith, *WISE v Grupo*.\(^{558}\)

In *WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA*,\(^{559}\) a Mexican insurer (GNP) insured a cargo cover for a shipment of luxury goods from Miami to Cancun and then got reinsurance cover in London market. The slip presentation prepared in Spanish, had referred to Rolex watches, but the English translation referred to clocks by mistake. Due to this faulty translation of documents, the claimant reinsurer did not aware that the consignment included Rolex and other expensive watches which were more susceptible to theft. A container of goods was stolen in transit and GNP made a claim for over US$ 800,000 of which US $ 700,000 related to the loss of the watches. The reinsurer sought to avoid the reinsurance contract, arguing that it had been induced by a non-disclosure of material fact that the luxury Rolex watches rather than clocks were on shipment. Waiver and affirmation issues were submitted for decision. At first instance, the court decided that such mis-description amounted to a material non-disclosure which entitled the reinsurers to void the contract as reinsurers would not have agreed to cover watches if they were informed by the reinsured and the judges dismissed the argument that disclosure of such material fact had been waived by the reinsurers. Then the reinsured appealed on the waiver issue. In the Court of Appeal, majority Longmore L.J and Gibson L.J. decided that that there was no waiver by the reinsurers, as the representation of the list of consignment goods was complete and reliable from the point of view of a reasonable careful insurer. The judges followed the traditional

\(^{559}\) [2004] EWCA Civ 962; [2004] 2 All ER 613.
formulation that has long been adopted at common law.\textsuperscript{560} In order to establish an implied waiver from non-enquiry, the reinsured needs first to make a fair presentation of the risk to discharge his duty of disclosure. If he has not, a failure of the reinsurer to put on inquiry will not relieve the reinsured of his duty to make proper disclosure. Then after the reinsured performed his duty of disclosure, the reinsurer is favoured of an assumption that the assured has performed his duty of disclosure properly by making a fair summary of material facts and there is nothing exceptional or unusual regarding the representation, so the reinsurer is entitled to take at face value what is presented to him. Then the question need to be answered is whether the facts disclosed by the reinsured or his agent, in addition to the facts within a reasonable reinsurer’s knowledge, would raise in the mind of a reasonable reinsurer \textsuperscript{561}at least a suspicion that there were other circumstances which would or might vitiate the presentation made to him.\textsuperscript{562} If it does remind a reasonably careful reinsurer of a suspicion and naturally prompt him to make further inquiries so that a full knowledge of material information can be acquired,\textsuperscript{563} but he still kept silence rather than making appropriate check, it would be regarded that the reinsurer had waived the disclosure of that information that would necessarily have been revealed by the appropriate inquiry. This was the situation in SAIL v Farex where the reinsurers alleged non-disclosure of the absence of a significant retention. It was decided by Gatehouse J that although such retention was material, the reinsurer must assume there is no retention unless told otherwise. However declarations had been offered which mentioned retention in earlier years, so the reinsurer’s failure to ask amounted to a waiver of that material retention. But, if nothing in the presentation of the risks prompted a reasonable insurer to make further enquiries, the reinsurer was entitled to take the presentation at face value. Then there is no waiver by the reinsurer as regard to further material information. This was the situation in Hill v Citadel Insurance Co Ltd where the retrocedants’ broker argued that full details of historical reinsurance protection of the retrocession had not been provided. It was decided by the Court of Appeal that the inception date of the reinsurance protection was material information that should be disclosed. However the statement as to the full details not


\textsuperscript{561} This must mean the same as the prudent insurer.

\textsuperscript{562} Ibid, 511-512 per Parker L.J

\textsuperscript{563} CTI v Oceanus [1984] 1 Lloyd’s Rep 476 at pp 511-512, per Parker LJ, at pp 529-530, per Stephenson LJ.
being provided was insufficient to put the retrocessionaire on enquiry. Therefore no implied waiver of such information can be established.

In addition to the reinsured’s making a fair representation of risks, the burden to prove the state of mind of the reinsurer is also upon the reinsured. In order to rely on implied waiver from non-enquiry of further information which would or might vitiate the presentation made to him, the reinsured must prove that the reinsurer has been put on at least a suspicion. As a result, no implied waiver of the duty of disclosure by the reinsurer can be established if the reinsured did not fulfil the obligation to make fair and complete representation, or if the reinsurer was just aware of the possibility of the existence of other material circumstances rather than was invoked to put on enquiries on further information.

**7.4.3.2 Introducing a new conception of fairness into the test**

It can be said that under the traditional formulation of implied waiver of the duty of disclosure, it is not easy for the reinsured to establish an implied waiver of material facts by the reinsurers in practice. Even if the reinsured can establish successfully that a fair misrepresentation is made, it is not easy for him to prove the state of mind of the reinsurer. Therefore the reinsured had better perform the strict duty of disclosure to the full extent rather than simply makes a fair presentation of the risk leaving the reinsurer to discover material information for themselves. However, by contrast to the majority opinion, Rix L.J. suggested a more extensive fairness conception\(^{564}\) in a different approach as to the insurer’s duty to ask questions. The Insurance Act 2015 applying to non-consumer insurance context corresponds with such notion by introducing a new duty of fair presentation which reduces the strictness level of the reinsured’s duty of disclosure in placing process and encourage the reinsurer to play more active role in discovering material information.

**7.4.3.2.1 Core of the wide fairness conception—whether the reinsured’s representation is unfair or not**

This new approach which combined the doctrine of waiver and the duty of utmost good faith integrated the possibility of waiver by the reinsurer into a wider questions,

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\(^{564}\) WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA [2004] EWCA Civ 962;[2004] 2 All ER 613, [64] by Rix LJ.
namely whether the reinsured’s representation was unfair. According to Rix L.J., notion of fairness should be taken into consideration to examine the performance of the mutual duty. The need of the reinsurer to ask questions fairly arises both from the doctrine of waiver under s.18 (3) and the mutuality of the duty under s.17. The reinsurer is also under a duty to deal with reinsured fairly before he is entitled to avoid the contract. So whether the reinsurer needs to put on inquiries depends on the whole picture of information that had been presented to him in conjunction with the information he knows or ought to know under s.18 (3) (b). That is to say waiver of the information by reinsurer under the purpose of s.18 (3) (b) should also be considered when discussing the issue whether the presentation is unfair or not.\(^{565}\) It is unfair for the reinsurer to avoid the contract on the ground that the reinsured did not disclose relevant information that a reinsurer had waived under s.18 (3) (b). Therefore, the question ultimately turns out to be whether the presentation is unfair or not, considering the notion of fairness applied to both of the parties. Then the question needs to be answered first: has the insurer been put fairly on inquiry about the existence of other material facts that would necessarily be revealed by such inquiry?\(^{566}\) It should be noted that the test is an objective one at the standard of a hypothetical reasonably careful insurer described by Lord Justice Rix as neither a detective on one hand nor lacking in common sense on the other. If the hypothetical reasonable reinsurer would put on inquiry to discover other material information, but the actual reinsurer kept silence on it, it should be treated as the reinsurer waives the information impliedly, as the wholly true position can be acquired by a simply ask, based on all the information processed by the reinsurer, the reinsurer chooses to stay ‘unknown’. Then it is not unfair to determine that the reinsured had not presented the risks fairly. The reinsurer should be prevented from refusing the reinsured’s claims on the ground of the reinsured’s non-disclosure of further information.

It is suggested that such approach gains support by the *Insurance Act 2015*. Section 3 (4) reflects such notion by expressly enunciating that a disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances is a fair

\(^{565}\) [2004] EWCA Civ 962, para 46.  
\(^{566}\) WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA [2004] EWCA Civ 962; [2004] 2 All ER 613, [64] by Rix LJ.
presentation, even though it fails to disclose every material circumstances known or ought to be known by the insured. Consequently, in reinsurance context, a presentation of material information should be fair enough to put a prudent reinsurer on notice. If the reinsurer chooses not to make any further enquiries to reveal that material information which he has already been put on notice, then it can be regarded that the reinsurer waives disclosure of such information.

7.4.3.2.2 Difficulties arising from the new approach

Although the new approach seems more welcome as it limits to some extent the draconian pre-contractual duty of disclosure on the reinsured, it is still not perfectly consistent with the reinsurance market as such approach may create uncertainties in the practice. In the traditional analysis, the reinsurer is entitled to assume that the presentation is fair, therefore he waives nothing if he proceeds to negotiate based on the presentation without enquiry as to its accuracy, although he cannot complain that the full details of the material information are not disclosed as long as the summary is fair.\(^{567}\) By contrast, under the new approach the reinsurer is not favoured of an assumption of fair presentation any more. As a result, the reinsurers cannot be sure whether the presentation of the reinsured is sufficient so that he can accept the facts disclosed at face value. Even if he is not prompted to put on any suspicion or thought as to the accuracy of the information disclosed, the reinsurer may confuse whether he needs to dig into the facts presented to find out further relevant material facts. If he does not make reasonable enquiry, he may face the risk of committing an implied waiver of further information. Therefore there has been a division between the authorities as to which approach should be treated as the sound solution to establish implied wavier from non-enquiry.

7.4.3.2.3 Which approach prevails?

It is suggested that, in comparison to the traditional approach, the fairness approach that introduces notion of fairness into consideration of test of implied wavier should be given applause.

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\(^{567}\) CIT v Oceanus [1984] 1 Lloyd’s Rep 476, at 511-512
First, it transformed the test of implied waiver into an objective test that strikes a right balance between the business and the insurers. It emphasises how a reasonably careful insurer of this business would react to the presentation rather than focuses on whether the presentation is fair or not. It makes more commercial sense as it urges the reinsurer to deal with the reinsured prudently and fairly as a reasonable insurer should do. Under the new approach, the reinsurer cannot turn a blind eye to obvious incompleteness or keep certain information which indicates vitiation to the presentation to himself, and then complain of the bargain made in ignorance of the whole information. If he had not acted as a prudent insurer to put on reasonable enquiry to pursue relevant information, he should be treated as having waived the information and take responsibility for his inexperience, negligence or stupidity.

Moreover, it encourages the reinsurers to play a pro-active role in acquiring material information of the risks, rather than taking the advantage of the traditional test which appears difficult and unfair for the reinsured to prove the state of mind of a reasonably careful reinsurer. The reinsurer need to be more cautious of the information presented by the reinsured and get more involved in the disclosure procedure to assist the reinsured to comply with the duty of disclosure of relevant material information. In the situation where the reinsured’s has made an obviously incomplete representation of material information, the reinsurer cannot shut his eyes, and then allege that he was not provided a full disclosure of information, unless such circumstances can be regarded as an unusual circumstances which cannot be disclosed in an ordinary course of business. The doctrine of waiver cannot be applied to undisclosed facts which are unusual or special so that their non-disclosure distorts the presentation of the risk. In such cases, the underwriter is not put on enquiry about the existence of any such facts. If the non-disclosed information is an ordinary incidence of the matters, the reinsured’s obvious incompleteness of presentation of such matters would invoke the reasonable reinsurer to ask about more information about this. As a result, even if the presentation was unfair, there may still be a waiver if the information disclosed was such as would prompt a reasonably careful insurer to make further inquiries. A recently case which follows the new approach has shown such shift of attitude. In Garnat Trading & Shipping

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568 CTI v Oceanus [1984] 1 Lloyd’s Rep 476 at p 529, per Stephenson LJ.
569 Ibid.
(Singapore) Pte Ltd and Another v Baominh Insurance Corporation,\textsuperscript{570} there was an alleged non-disclosure of fact that a risk assessment contained a declaration that sea towage of a floating dock was permissible in certain conditions (a wave scale up to 5 with a maximum wave height of 4.5 metres). It is found, at first instance, that there had been a fair presentation of the risk, and there was a waiver by the insurer of the height limitation that the floating dock could withstand, as he failed to put on inquiry into such information as a reasonable insurer would do based on the relevant information on the wind disclosed by the policyholder. But even if it had not been a fair presentation, the reinsurer was still put on notice that there was a towage plan which contained wave height restrictions. Therefore the insurer waived the disclosure. The decision was upheld by the court of appeal.

7.4.4 Difficulties in the situation where the reinsurers ask limited, general questions

As discussed above, the reinsurer may loss his right or remedy by impliedly waived the non-disclosure of material information by making no enquiry. Difficulties may still arise in certain scenarios where the reinsurer indeed expressly asks questions. Where a reinsurer is prompted to put on inquiries after the reinsured has made a presentation, the reinsurer may expressly ask a limited question, for example a readymade form may be created by the reinsurer putting forward the questions to acquire information that he would like to know, or he may be interested to ask specific questions about particular facts besides the information disclosed by the reinsured. In those scenarios, it may be doubted whether there is an implied waiver by the reinsurer in respect of those information falling outside the questions asked by the reinsurer. Such difficulties can be the result of two related unsettled issues. Is it indicating that, by asking limited questions, the reinsurer has no interest in the information which would otherwise be material but falls outside the scope of the limited questions? And has the duty of utmost good faith been modified to confine to the level of disclosure upon the reinsured dictated by the extent of the express questions asked by the reinsurer? If the answer is positive, then the duty of disclosure upon the reinsured may be modified by the form and nature of the questions asked by the reinsurers. As a result, the reinsurer may lose his right or

\textsuperscript{570} [2010] EWHC 2578 (Comm) at para 135(g), perChristopher Clarke J.; [2011] 1 Lloyd's Rep 589.
remedy due to waiver of the duty of disclosure of further information by asking limited questions.

7.4.4.1 No legal presumption in favour of the reinsured

With respect to limited questions asked by the reinsurer, there is no legal presumption that facts not mentioned in the proposal from are not material. The mere non-enquiry of a particular fact by the proposal form does not necessarily implies that the reinsurer is not interest in it and then waived the disclosure of the information that falls outside the scope of the question asked.

This was illustrated in *Schoolman v Hall*[^571^] where it was held by Asquith LJ that detailed questions about the trading nature of the insured’s business did not waive the obligation on the part of the insured to disclose that he had had criminal convictions. Although there are numerous cases which have proceeded on the basis that asking of a limited question is a waiver of further information relating to that peculiar matter, it can be said that the common law is not ready to take a further step to conclude that a failure to ask all questions amounted to a waiver of disclosure. The reinsurers cannot, nor is obliged to frame their questions so as to discover every material information that may affect the reinsured. After all, the information subject to disclosure may be something peculiar to an individual case. Therefore, whether there could be wavier of disclosure depends on the reinsurer’s intention as a whole, when he was formulating the questions.[^572^] That’s to say whether there is an implied waiver by the reinsurer depends on the question asked by him under the whole framework of the policy rather than the answers provided by the reinsured. If the formulation of the question implies necessarily that the underwriter only requires information of a particular type, subject-matter or defined scope, then the reinsurer has waived his right to receive all other material information, otherwise the reinsured is still under a duty to disclose every material information.

[^571^]: [1951] 1 Lloyd’s Rep 139; Asquith LJ formulated the principle in the following words: It is unquestionably plain that questions in a proposal form may be so framed as necessarily to imply that the underwriter only wants information on certain subject-matters, or that within a particular subject-matter their desire for information is restricted within the narrow limits indicated by the terms of the question, and, in such a case, they may pro tanto dispense the proposer from what otherwise at common law would have been a duty to disclose everything material.

7.4.4.2 What equals a necessary implication of waiver in such scenario?

As to what equals a necessary implication of waiver where limited questions are put forward by the insurers, in *Doheny v New India Assurance*, Lord Justice Longmore formulated, in obiter, the test as whether or not there is a waiver depends on a true construction of the proposal form. When a reasonable man was reading the proposal form, is it justified in thinking that the insurer had restricted his right to receive all material information and consented to the omission of the particular information in issue. This doctrine of waiver by putting forward limited questions has been accepted and illustrated in many authorities. For instance, in *O'Kane v Jones*, where the insurer’s express questions on maintenance were held to waive further information potentially affecting the maintenance of the vessel, including the insured’s financial position. In *Cape Plc. v Iron Trades Employers Insurance Association Ltd*, Rix J held that the insurer, who had extensive experience as an insurer in this particular industry and knew that the insured’s claims were endemic in the industry, had waved separate disclosure of mesothelioma liability, as he had not required pneumoconiosis exposure to be disclosed separately.

It should be noted that all the authorities relates to waiver of specific information rather than a wide category of information. It may be difficult for the reinsured to prove that the reinsurer had waived a broad category of information which was too wide or hard to define by ask a specific or limited question. This happened in *Synergy Health (UK) Ltd v CGU Insurance Plc and others*, where the judges decided that a form of Declaration of Material Facts concerning moral hazard was not supposed to obviate the duty of disclosure of the totally unrelated information such as an intruder alarm had not been installed on the premises.

In a sentence, whether there is a waiver depends on the intention of the reinsurer which should be construed on the questions asked and the whole policy itself. Even if the reinsurer intends to waive other information falling outside the scope of his limited questions, the reinsured may still fail to answer the limited questions or

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574 [2005] Lloyd's Rep IR 251 at [19].
provide a full answer. In such circumstances, acceptance of such proposal by the reinsurer may indicate an implied waiver of the material information in the part omitted. The same test should be applied as implied waiver by the reinsurer in normal placement procedure. If a reasonable reinsurer would put on enquiries upon the material information provided by the reinsured in the proposal, then non-enquiry of the reinsurer indicates a waiver of any further relevant information which would vitiate the reinsured’s representation.

7.4.5 Conclusion

On the balance of the existing authorities and legislation, it can be said that there is not a general assumption that a failure to ask an express question by the reinsurer will be construed as a waiver of further information by the reinsurers.578 The current position of law suggests a mutual fairness of both parties in the placing process to make all the relevant material information disclosed. When the reinsured has presented the risks fairly, the reinsurer may be put on notice of any further material information, consequently prompted to ask questions about the existence of those material facts which would necessarily have been revealed by a reasonably careful insurers inquiry. That's to say, as long as a reasonably careful reinsurer put on an appropriate inquiry, he would acquire full knowledge of material facts. Failure to ask such obvious questions will be construed as a waiver of such material information, and then the reinsurer would be prevented from avoiding the contract due to non-disclosure of such material facts. However once the reinsurer puts forward enquiries about any further information prompted by the reinsured’s representation, the limited questions asked by the reinsurer may indicate a waiver of the information that falls outside the scope of the questions. But the test is still the same as the general doctrine of waiver, so that no general assumption of waiver will favour the reinsured. Whether the reinsurer has the intention to waive any relevant information not covered by his specific or limited questions depends on the questions he asked under the whole picture of the policy, leaving the courts to use his discretion to construe the facts of each case.

7.5 Conclusion

The doctrine of waiver becomes a practical method used by the insurance market to modify the scope of the duty of utmost good faith in reinsurance market. Whether there has been a waiver of the disclosure of material information depends on the reinsured’s and reinsurer’s intention construed under the whole policy terms, no matter it is expressly incorporated into the contract subject to suitable and effective wording or implied from the representation or conduct of the reinsurer. The principle of waiver modifies the operation of the duty of utmost good faith in reinsurance context in following ways.

The parties to the reinsurance contracts should be allowed to use express contract terms to tail the strict statutory duty of utmost good faith as long as the terms make commercial senses for them, unless it is restricted by the law or a public policy. For instance, a party is not entitled to exclude his liability for his own personal fraud. But it is conceptually possible in law to have an express clause in the contract that exclude the liabilities for negligent non-disclosure or exclude liability of a principal for fraudulent misrepresentation of his agent, only if such clause is suitably and effectively worded. To achieve the purpose of contracting out of the default regime, the clause must be worded clearly and unambiguously to alter the parties sufficiently to any extraordinary position caused by the clause.

As to establishing an implied waiver by the reinsurer, it can be said that there is not a general assumption that a failure to ask an express question by the reinsurer will be construed as a waiver of further information by the reinsurers on the balance of the existing authorities. It is suggested that Rix L.J’s approach supported by the Insurance Act 2015 which emphasises a mutual fairness of both parties in the placing process to make all the relevant material information disclosed should be given applause. The test should be formulated as when a reasonable reinsurer would ask obvious questions to reveal further material information prompted by the reinsured’s presentation, failure to make such appropriate enquiries would imply a waiver of disclosure of relevant information. Once the reinsurer did put forward enquiries about any further information prompted by the reinsured’s representation, the limited questions asked by the reinsurer will not be assumed as a waiver of the information that falls outside the scope of the questions. Whether the reinsurer has the intention to waive any relevant information not covered by his specific or limited
questions depends on the questions he asked under the whole picture of the policy, leaving the courts to use his discretion to construe the facts of each case and take the particular type of insurance business into consideration.
Chapter 8 Deficiencies and difficulties of the regime of remedies applying in reinsurance context

8.1 Introduction

It is fair to say that the right to rescind is firmly established as the primary remedy for breach of the duty of utmost good faith under English law. Although alternative formulations to recover damages for actionable breach can be established in certain situations, it is suggested to only exist in theory. In fact, in practice the right to damages appears to have fewer practicalities in reinsurance context, leaving the right to rescind as the only actionable remedy in reinsurance market. The current regime of remedies which adopts an ‘all or nothing’ approach receives more and more criticism as it gradually shows deficiencies in practice. This chapter will analyse the deficiencies and difficulties of the regime of remedies applying in reinsurance context, and then suggest a proper solution to those problems after comparing the regimes under the ICA 1984 in Australian law, the current English law regime and the new proportionate remedies regime proposed by the Insurance Act 2015.

This chapter will start with the summary of the current regime of remedies under English law that has long been criticised to be too harsh widespread the insurance market. Then it will proceed to scrutinize of the deficiencies, shortcoming of the current regime of remedy and difficulties caused to reinsurance practice. Thereafter an alternative approach to modify current remedy regime by introducing a notion of proportionality is discussed to find proper reforming resolution to make the duty of utmost good faith function better in the reinsurance market. The core spirit of the proportionate approach will be clarified first. Under the proportionate regime, the parties should only be restored to positions according to what the reinsurer would have responded, had the information been truly disclosed and represented. The most important change is to divide the regime into two parts according to the state of mind of the wrongdoer in committing the breach. And then it will be followed with detailed analysis of the proportionate approach adopted by the ICA 1984 in Australian law and the new regime proposed under the Insurance Act 2015. A method of comparison will be adopted to find a proper alternative approach to introduce the notion of proportionality into the regime of remedies.
However problems will arise in drawing a hypothetic picture of what the contract would have been and what the hypothetic ultimate position the reinsurance parties would have been in, had all the material information been truly and fully disclosed. Also difficulties will be incurred in defining the scope of the parties’ contractual obligations and duties. Even the above problem can be solved, it will still cause practical problems in applying the proportionate remedy approach in reinsurance context. Difficulties will arise in referring and proving a hypothesis of what the reinsurers would have been done had all material information been truly represented. It is not easy to resolve the issue of defining difference between what the reinsurers would have done had it made a fair presentation and what actually occurred. In addition such potential difficulties even become more complicated in applying the new regime in specialist or complex reinsurance contract. Especially where reinsurance is written "back to back" with the direct insurance, or placed on a proportionate basis, proportionate remedies should be problematic in operation. Whereas in the situation where the reinsurance contract is not back to back with the direct insurance, or placed on a non-proportionate basis, it is still arguable whether such proportionate regime will play practical roles in reinsurance market. Despite the problems mentioned above, the current proposed regime in the Insurance Act 2015 that significantly changes the current common law rules gains strong support. However it to certain degree complicates the remedies available to the reinsurance parties for qualifying breach. It is suggested that it is better for the legislation to set up only ground principles of proportionality and allow the sophisticated and specialist parties free to opt out of the default proportionate remedies regime and find a suitable solution for their own practice.

8.2 The current regime of remedy for breach of the duty of utmost good faith in reinsurance context

Although the Consumer Insurance (Disclosure and Representations) Act 2012 comes into effect and removes the duty of utmost good faith in the consumer insurance context, the doctrine still remains applicable to the reinsurance context. As a result, the current regime of remedy for breach of the duty of utmost good faith, which origins both from the Marine Insurance Act 1906 and numerous common law cases but to be reformed by the Insurance Act 2015, applies to reinsurance context
too.\textsuperscript{579} Before discussing the deficiencies and difficulties of the current regime of remedy in reinsurance market, the current positions will be summarised in this section.

### 8.2.1 Rescission and its consequence

Under the current legislation, s.17 of the \textit{MIA 1906} declares without uncertainty that the contract may be avoided by the innocent party if the duty is not observed by either party. Moreover, section 18(1) and 20(1) also emphasises the right of avoidance again in case of material non-disclosure and misrepresentation. Therefore, an actionable breach of the duty entitles the innocent party a right to rescind the contract. It is firmly entrenched to be the primary remedy for breach of the duty of utmost good faith. Consequently once the party decided to exercise his right to rescind, the whole contract of insurance is treated as avoided ab. initio like it had never been in existence before.\textsuperscript{580} However, the remedies receive a reputation of harshness widespread the insurance market. It is to be reformed by the \textit{Insurance Act 2015}. According to s.14 (3), s. 17 of the \textit{MIA 1906} is replaced and the wording ‘if the utmost good faith be not observed by either party, the contract may be avoided by the other party’ is removed. However, the new regime proposed retains the right to rescind but only under the relevant requirements is satisfied, namely the insurer may avoid the contract, refuse all claims and need not return any of the premiums paid only if a qualifying breach was deliberate or reckless.\textsuperscript{581} The practical difficulties arising from the deficiencies of both remedy regimes will be discussed later in this Chapter.

Current English law adopts an ‘all or nothing’ approach in formulating the remedy for breach of the duty of utmost good faith. The wording ‘may be avoided’ in s.17 of the \textit{MIA 1906} reveals that the avoidance does not happens automatically, neither is the

\textsuperscript{579} See Highlands Insurance Co.v. Continental Insurance Co. [1987] 1 Lloyd’s Rep 109. Since the MIA 1906 partially codifies the common law, the duty of utmost good faith has a statutory source. As there are not many differences between the marine and non-marine insurance contracts in respect of misrepresentation context, the English law is held beyond questions that the relevant sections describes the duty of utmost good faith in the MIA 1906 apply to reinsurance contracts the same way as they apply to marine insurance.

\textsuperscript{580} So the remedies for breach of the contractual duties will not come into play at all, as such contractual duties never exist from the beginning.

\textsuperscript{581} Schedule 1 INSURERS’ REMEDIES FOR QUALIFYING BREACHES, Part1 Contracts, Section 2 of the Insurance Act 2015. Deliberate or reckless breaches if a qualifying breach was deliberate or reckless, the insurer—(a) may avoid the contract and refuse all claims, and (b) need not return any of the premiums paid.
judicial intervention required. The contract turns to be avoidable rather than void, so that its voidability entitles the reinsurer an election to avoid the contract retrospectively to the time of its conclusion or to affirm it like the duty has been perfectly performed.

Until the contract is elected to be avoided by the reinsurers, the terms of the contract of insurance will remain valid and bind both parties. Therefore the reinsurer is bound to pay valid claims arising under the cover and the reinsured remains bound to pay the premium. Once the election of avoidance is made, the decision of avoidance becomes effective immediately and irrevocably. From then on the reinsured is not entitled to payment for any outstanding losses, and any premium paid is returnable to the reinsured, unless the reinsured is in breach of the duty fraudulently according to s.84 of the MIA 1906. It is a draconian consequence for the reinsured as it deprives the reinsured all cover whereas the reinsurer discharges all liabilities under the policy even the loss paid already is recoverable. Both of the parties go back to the exact position as they were as if the contract had not been brought into existence ever.

Alternatively, the option of affirmation of the contract is also available to the reinsurer. If he elects to affirm the reinsurance contract which is of commercial sense to him, then the contract remains valid and enforceable as the reinsurer has waived his remedy by such affirmation. It should be noted that the reinsurer is entitled to choose either avoidance or affirmation. There is no discretion of the remedy of avoidance upon the reinsurer. There have been arguments that the non-disclosure or misrepresentation of a material fact would permit the insurer to refuse to pay a claim

582 The notion that a non-disclosure or misrepresentation of a material fact automatically rendered the contract void, without allowing the innocent party an opportunity to elect to continue with or affirm the contract, other than the agreement of an entirely new contract, was favored by the courts until the middle of last century.

583 To make an informed election, it is a prerequisite for the reinsurer to have knowledge of the breach of the duty and his right to avoid the contract or to affirm it. Moreover, the election may be made at any time but within a reasonable time until the innocent party affirms the contract by express words or by unequivocal conduct. For election to affirm the contract, details can be found in previous chapter on waiver of the duty of utmost good faith.

584 Note that Lord Mansfield’s original formulation in Carter v Boehm (1766) 3 Burr 1905 stated that the contract would be void. That principle has not survived in the modern law. See: Dawsons Ltd v Bonnin [1922] 2 A.C. 413 at 422, 437; Joel v Law Union and Crown Insurance [1906] 2 K.B. 431 at 438, 440; Merchants’ and Manufacturers’ Insurance Co Ltd v Hunt [1941] 1 K.B. 295 at 312, 318.

585 Schedule 1, part 1, section 4 addresses the remedies for the breach neither deliberate or reckless. If, in the absence of the qualifying breach, the insurer would not have entered into the contract on any terms, the insurer may avoid the contract and refuse all claims, but must in that event return the premiums paid.

586 This position is re-affirmed by Insurance Act 2015. In Schedule 1, part 1, section 2(b) it clearly enunciates that in the case of deliberate or reckless breach, the insurer need not return any of the premiums paid.

587 Brit Syndicates Ltd v Italaudit SpA [2008] UKHL 18, which confirms that until avoidance the policy is perfectly valid.
under the policy, rather than avoiding the contract. Then the necessary consequence of the refusal of the claim is the refund of the premium paid by the assured. However, such attempts have been dismissed by the court, at least in the situations where there is no contrary provision in the policy. Therefore it is not open to the reinsurer to affirm the contract but decline a claim under it under the current legislation.\(^{588}\)

**8.2.2 Damages**

Reinsurance contracts, as one of the types of contract uberrimae fidei constituting an exception to the general contract law,\(^{589}\) are based upon a doctrine of utmost good faith, deriving from a separate rule of law before a contract comes into existing.\(^{590}\) The different origin of the doctrine determines its distinct effect. As a result, particular remedies for breach of the duty turn out to be different from those for breach of general contractual duties. It has been firmly established in common law authorities that avoidance of contract is the only available remedy for breach of the duty of utmost good faith.\(^{591}\) Therefore, without assistance of alternative formulations falling outside the duty of utmost good faith, the remedy of damages is not available to the innocent party.\(^{592}\)

As general contract law does not recognise a duty of utmost good faith, there is no right to damages for breach of such duty through a contract route. However, damages are recoverable due to breach of contract if the duty is expressly or implied included into the contract as a contract term. The test of breach of contract and measurement of the damages should be subject to the general contract law. However, once the contract is chosen to be avoided on the ground of breach of the duty of utmost good faith imposed by the law in respect of insurance contracts, it is

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588 Anderson v Fitzgerald (1853) 4 H.L. Cas. 484; Biggar v Rock Life [1902] 1 K.B. 516.
589 There are no general rules in contract law imposing obligations on the parties engaging in commerce volunteer information. So there is no general common law liability for non-feasance or inaction, leaving parties looking after their own interests in an adversarial mode.
590 It can be said that the origin of the duty is of significance to reveal its nature, consequently determines its application in practice, particularly the remedy available for breach of the duty. The origin of the right to rescind as an equitable remedy for non-fraudulent misrepresentation has been established since the latter 19th century. Then this controversial issue was finally arguably determined by the House of Lords in Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd, the Star Sea. [2001] UKHL1.
591 In HIH v Chase[2003] 2 Lloyd’s Rep 61, the right of avoidance of the contracts of or for insurance in relation to negligent or fraudulent misrepresentations or non-disclosure was clearly decided as: if the duty was broken and the test of inducement can be satisfied, the only remedy available to the innocent party was avoidance of the contract and there was no right to damages.
erased entirely ab. initio like it has never existed at all. As a result, there is no existence of a contract of insurance from which an action for damages for breach of contract can arise.

Since the contract route is closed unless the contract provisions provided, damages can only be claimed upon ordinary principles of law through the tortuous route and under statute on the ground of tort of deceit by making deliberate or negligently misrepresentation. It is firmly established by the common law that a fraudulent misrepresentation that has induced conclusion of a contract is the tort of deceit for which the innocent party may be able to claim damages. In addition, the Misrepresentation Act 1967 provides a statutory recourse to damages for misrepresentation. In s. 2(1) it entitled the innocent party to the contract to claim damages against the other contractual party, not their agents who may be personally liable for deceit or misrepresentation, if all the following requirements are satisfied, namely where he has been induced to a contract due to such representation and has suffered loss thereby. However, such ground for damages is independent of breach of the duty of utmost good faith itself. Such right to claim damages for the tort of deceit in general law is considered as a cumulative rather than alternative remedy to the right of avoidance of the contract on the ground of breach of the duty of utmost good faith. And the ground for claiming damages survives independently of the contract which may be avoided or not. However, such damages would normally be awardable only where avoidance is not the preferred remedy or not an adequate remedy, or where the courts declined to justify an avoidance of the contract, or where the reinsurers waived the remedy for  

594 Section 2 of The Misrepresentation Act 1967. (1) Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made the facts represented were true.
595 Morin v Bonhams & Brooks Ltd [2003] EWHC 467 (Comm);[2003] 2 All RE (Comm) 36, [40-43].
596 If the misrepresentation had been made fraudulently, the defendant would be liable in damages. It should be noted that in the case of negligent or unreasonable misrepresentation, it is not necessary for the innocent party to establish negligence or duty of care in order to recover damages, while the innocent defendant shall be liable in damages, unless he can prove that he had reasonable ground to believe and did believe that the facts represented were true up to the time of conclusion of the contract. Therefore, a fraudulent misrepresentation not only renders the contract voidable, but also entitles the innocent party to bring an action for damages against the misrepresentor in the tort of deceit.
597 Though the test of misrepresentation in general law is different from that of the misrepresentation branch of the notion of utmost good faith that applies to insurance contracts, it is submitted that such difference will not affect the innocent party's right to recover his damages.
breach of the duty of utmost good faith, choosing not to avoid the policy or being estopped from doing so. 598

In addition to the possibility of recovering damages discussed above, s.2 (2) of the *Misrepresentation Act 1967* provides a further statutory recourse for damages, namely damages in lieu of rescission. It entitles the court a discretion to award damages to the claimant, who is seeking avoidance of the contract induced by the non-fraudulent misrepresentation, in lieu of rather than in addition to avoidance, if the court considers that it is equitable to grant a relief from avoidance of the contract, 599 and then substitute damages for avoidance as the remedy, by taking into account the relevant circumstances such as the nature of the misrepresentation, the consequences of the avoidance of the contract, the losses suffered from the avoidance or upholding of the contract etc. Such empower of discretion on the court can be considered as a balancing power and safeguard where the avoidance of contract on the ground of non-fraudulent misrepresentation works injustice, especially in the event of minor misrepresentation, though the underwriter would have still accepted the risks on a higher premium or different terms. As such discretion of the court to grant relief from avoidance on the ground of material misrepresentation may erode the efficacy of the rules set up by the doctrine of utmost good faith where the rules fulfill an important policing functioning in ensuring brokers to make a fair representation to underwriters. Moreover, such discretion is unlikely to be exercised by the court in a sophisticated and specialist reinsurance market.

To sum up, although damages are not available as a remedy under the doctrine of utmost good faith itself, there are alternative formulations to recover damages for an actionable breach. The actionable routes includes the tortuous route for suing fraudulent misrepresentation as a deceit for damages under the common law, the contractual route where the contract has incorporate the duty of utmost good faith expressly or impliedly, and a statutory source under the *Misrepresentation Act 1967*

598 Toomey v Eagle Star Insurance Co Ltd (No 2) [1995] 2 Lloyd’s Rep 88,93 (per Colman, J).
599 It is suggested that there is a pre-requisite for the court to exercise such discretion that, to be substituted for damages, there must be a right of rescission available to the innocent party as a remedy. However opinions divided as to the time when the right to rescind the contract should be possessed by the innocent party, at the time when the representation was made, at the time when the dispute came before the court, or at the trial. See Atlantic Lines v& Navigation Co Inc v Hallam Ltd: The Lucy 599. [1983] 1 Lloyd’ Rep 188, 201-202; Thomas Witter Ltd v TBP Industries Ltd, 599 [1996] 2 ALL ER 573, 589-591; Highlands Insurance Co. v. Continental Insurance Co.599 [1987] 1 Lloyd’d Rep. 109 per Steyn J.
to claim damages in addition to the remedy of avoidance of the contract. However, it is possible for the court to exercise its discretion to award damages alone in lieu of avoidance of the contract if the court considers it equitable to grant a relief from avoidance by taking into account particular circumstances in the dispute. It should be noted that such alternative formulations to recover damages for actionable breach only exists in theory. In fact, in practice the right to damages appear to have fewer practicalities in reinsurance context. It is not surprising that there are even no known cases in which a reinsurer has successfully claimed damages from the reinsured, even in cases involving fraudulent breach of the duty.\footnote{MA Clarke, The Law of Insurance Contracts Vol 2, Chap 23, para 23-15. It is written that, there are no known cases in which an insurer has claimed damages from a policyholder.} In practice of reinsurance market, the main potential loss of the reinsurer caused by the reinsured’s breach of the duty of utmost good faith will normally be prevented by avoidance of the reinsurance contract. Even if in cases where there has been fraudulent breach of the reinsured, the reinsurer's right to retain the premium may cancel out any further claims for damages.\footnote{section 84(3)(a) of the 1906 Act states: Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured.} As a result, the right to rescind of the innocent party can be regarded as the primary and only practical remedy for an actionable breach in practice.

8.3 Deficiencies of current remedy regime for breach of duty of utmost good faith

Although the approach of remedy adopted by English law gradually shows deficiencies in practice, it is argued here that the approach of the remedy is in fact more reasonable than it is generally assumed to be. Some of the particular aspects of the remedy approach can be better explained by more general principles of contract law and just illustrates the general position of English law. There should be a legal room for such doctrine and proper remedy regime to survive in reinsurance practice. However, the approach has long been criticised to be too harsh widespread insurance market, not only due to its all or nothing character which might deprive the reinsured of all coverage, but also because of the great injustice it may be capable of working, for instance the approach is disproportionate, lack of consequence, irrelevance of the state of mind of the wrongdoer when committing the breach and
maybe one-side favorable to the reinsurers. In the following sections the current approach will be under scrutiny, and the shortcoming and deficiencies of the current regime of remedy will be analysed.

8.3.1 Draconian and inconsequential remedy?

It has been commonly criticised that the remedy for breach of the duty of utmost good faith is lack of consequence between the non-disclosure or misrepresentation of material facts and the losses that the reinsured would claim payment for. However, it is argued here that the requirement of consequence between the reinsured's non-disclosure of relevant material information and the loss suffered by the reinsured is a misunderstanding of the relevant causal link. In English law, a causal link is required between the wrongdoing of a party and the loss caused by such a wrong before the innocent party can claim indemnity. Where a reinsured has made a non-disclosure or misrepresentation of material facts, the loss caused to the reinsurer by such breach is the possibility that the reinsurer may have been induced into entrance of the contract of insurance, rather than paying for particular claim which indeed has no link with the undisclosed matters. Therefore the remedy for breach is an indemnity for conclusion of the contract of insurance that the reinsurer might not have entered into, rather than for particular claims arising under the contract. As a result, it is irrelevant how minor or inconsequential the non-disclosure or misrepresentation is in respect of the effect upon the losses under claims.

In fact, the spirit of the remedy for breach of the duty of utmost good faith plays nothing special in the general principles of contract law. The justification of the remedy just represents the spirit of general principle of remedy under English contract law, namely that innocent party is entitled to the indemnity to restore his position where he would have had the duty been performed. Breach of duty of utmost good faith occurs before and induces the formation of the policy, vitiating the parties’ consensus leading to conclusion of the contract. Accordingly the remedy makes the parties go back to the position before the vitiation of the negotiation consent, namely it entitles the innocent party a right to rescind the contract. Though the remedy of avoidance ab. initio having a retrospective effect seems to be different from the remedy for breach of a contractual duty that appears to operate prospectively arising from the time of breach, they are actually the same in essence,
namely to restore his position where he would have had the duty been performed. Therefore, it can be said that there is nothing in the approach of remedy magic but the doctrine of duty of utmost good faith is. It is the specific characters of uberrimae fidei of the contract of insurance that makes the duty so draconian and harsh remedy is sure to result. It is still necessary to partially retain such so called harsh remedy, as least for deliberate or reckless breach.

8.3.2 Shortcoming of the current disproportionate approach in reinsurance context

As discussed above, although the remedy is not inconsequential or unique as alleged to be, it is suggested that the current approach adopted by English law is indeed harsh in certain aspects, which will cause injustice and problems in the reinsurance market practice.

First of all, the disproportionality of the all or nothing approach might work injustice in the market practice. There exists a possible risk that a reinsurer may avoid the whole policy in respect of non-disclosure of a matter totally unconnected with the loss, or material information which may have at best a minimal effect on the assessment of the risk and calculation of the premium, subject to the reinsurer’s successful proof of inducement. Also it may be unfair to void the whole policy in certain circumstances where the reinsurer would have been happy to take the risk for a higher premium or to have included an additional term, such as a higher excess. Such disproportionate avoidance allows the reinsurer to refuse all claims under the reinsurance policy, including those which might have been accepted had the truth been disclosed. Especially in the case of obligatory treaty which is of itself a contract of insurance, avoidance of the whole treaty due to actionable breach at the first stage will erase all the declarations to it at the later stage, even if the non-disclosure or misrepresentation may be so disproportionate, and unconnected with the loss occurred in relation to other declarations to the treaty. There is no conception of proportionality recognised in current English law to accommodate an intermediate position as to the remedy. Although such proportionate approach may not always be suitable for all types of reinsurance contracts, especially for quota share or surplus treaty under which the reinsured and reinsurer share the premium in an advance agreed proportion, the all or nothing approach shuts the door which leads to an
intermediate balanced position so that it can protect both parties' interest to the
greatest extent, reduce the parties' loss caused by the breach, and make the
contract be performed according to the parties' original intention. Therefore the
reinsured is not able to recover the part of the loss represented by the short payment
of premium, neither is him permitted to recover the full amount of any loss by tender
the shortfall in premium in the situation where the reinsurer may have been happy to
take the risk for a higher premium. Even the reinsurer may find themselves in an
embarrassed position where they do not wish to avoid the reinsurance policy but
have to do so, because no other remedy other than avoidance is available.

Secondly besides the disproportionability of the remedy, the approach is also alleged
to be one-sided to favour the reinsurer. Although the principle imposes a mutual duty
on both parties and the remedy are open to both parties, in practice the remedy
seems available only to the reinsurer rather than the reinsured. There is a debate
that the draconian nature of the remedy can be balanced by the introduction of the
subject test of inducement. It is suggested that such point of view is not quite
convincing. The inducement into a contract of insurance by the reinsured’s non-
disclosure or misrepresentation is a necessary part of the establishment of the
causation chain. Although it increases difficulty for the reinsurer to discharge the
burden of proof, the result of avoidance is still one-sided as it is no benefit to the
reinsured to seek avoidance in practice, as often the avoidance of the contract is
undesirable or inadequate. In practice, it is probably unlikely for the reinsured to
allege an avoidance of reinsurance cover so that he can get back the premium rather
than get indemnified for all the losses. In most cases, the reinsured will probably
prefer to maintain covered by the reinsurance contract. While from the reinsurer’s
point of view, although the reinsurer may be prima facie one-sided favored, in some
cases there may exist possibility that the reinsurer in fact is undercompensated for
the reinsured’s breach. Where the courts wish to protect the reinsured against
harshness of the remedy and counteract the effect of the unfairness of the remedy,
they may be forced to find against the reinsurer that he was not induced or that he
has waived its right to that material information, so that the claim can be ordered to
be paid in full. As a result, in practice, in many cases claims are often settled by the
parties rather than avoided, even though the reinsurer may have been able to
challenge the completeness and accuracy of the information disclosed. The
existence of all or nothing remedy would encourage litigation. It fails to reflect the commercial realities of the reinsurance market.

Moreover, according to current doctrine to invoke a remedy of avoidance of the reinsurance contract, the state of mind of the wrongdoer is irrelevant when he commits the breach. That is to say that the reinsurer is entitled to avoid the contract ab. initio even if the reinsured’s commitment of breach is lack of fraud, i.e. innocent or negligent. It should be logical and fair to claim a remedy of avoidance in the event of a fraudulent or deliberate breach. However, in the event where the reinsured’s commitment of breach is negligent or innocent, it is arguable whether such approach is still appropriate for reinsurance practice any more. In fact in the reinsurance market, some reinsurers have already operated an informal system of proportionate remedies in practice. The underwriter in practice may do not seek avoidance of the reinsurance contract, unless he suspects dishonesty by the reinsured. For instance, on discovering the true facts, the reinsurer would still provide the reinsurer cover rather than avoid it, but cap the payment for a claim for loss, or pay the full claim on a different contractual term such as imposing a higher excess figure. This issue can be regarded as one of the most significant point calling for reform in the proposed proportionate regime which will be discussed in the later section. The most important part of the reform should focus on how the new framework should be established to reflect the core spirit of the proportionality of the new regime in the situation where no dishonesty is involved in the breach of the duty.

In a sentence, the disproportionate approach of remedy for breach of the duty of utmost good faith under current law may overprotect the reinsurer then work injustice. The reinsureds have to disclose every material circumstance, whereas the reinsurers do not have sufficient incentive to ask questions to reveal all the material information that he might be interest to know of. The reinsured’s failure to discharge the duty of disclosure may erase the whole policy and as a result deprive him all the benefits from the policy, even if the breach is so minor that the reinsurer would still have underwritten the risks with a small amount of additional premium or on slightly different terms had the material information been disclosed. Such all or nothing nature of the remedy are so draconian that it divorces with the commercial reality and encourages litigation in particular where most of the non-disclosure or
misrepresentation are not fraudulent and arose from genuine misunderstanding of the disclosure or statements, or sometimes even arose from the failure by reinsurers to ask appropriate questions to discover the true position. In addition such draconian remedy may even have a positive effect on the claim stage where the reinsured has a chance to negotiate for a settlement instead of losing the whole coverage, as the entitlement of avoidance of the reinsurer confers him a much stronger bargaining power in the negotiation of settling disputes in the claim stage.

8.4 Alternative approach of proportionate regime of remedies

Due to the practical difficulties caused by the harshness and disproportionability of current regime of remedy, alternative approaches to replace the current regime have been proposed all the time.602 In the reinsurance industry, some reinsurers have operated an informal system of proportionate remedies in practice already. In Insurance Act 2015 which reflects the latest legislative spirit, a new regime of remedy for breach the duty has been proposed, bringing significant changes to non-consumer insurance context. It is fair to say that almost all the current reforming proposals support an introduction of concept of proportionality into English business insurance law. Therefore, in this section, proportionate approaches to modify current remedies regime are discussed to find proper reforming resolution to make the duty of utmost good faith function better in the reinsurance market.

8.4.1 The core spirit and the potential difficulties of the proportionate approach

It is suggested that the core spirit of the concept of proportionality is to adjust the party’s rights and obligations to make up the damage or loss caused by non-disclosure or misrepresentation of relevant material information, so that the availability of the remedy should be in proportion to severity of the breach. As a result, it is the nature and extent of the loss suffered through the reinsured’s non-disclosure or misrepresentation that decides the relevant extent of the remedies available to the reinsurers. Accordingly the reinsurer will not be permitted to avoid the whole policy for minor breaches of the duty of utmost good faith. The contract of insurance will remain its enforceability unless the reinsurer can prove that the breach

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602 Reform of the remedy regime of the doctrine of utmost good faith has been a hot issue discussed in common law cases, the Law commission’s consultation papers and bulks of research reports relating to reform of the current insurance contract law.
is so serious that the insurance could not have been entered into at all had the proper disclosure been made.

As discussed above, under the proportionate approach, once the contract of insurance remains enforceable rather than avoided, then the parties should be restored to positions where both of them had performed their contract obligations perfectly and got proper consideration in performance of the contract. However difficulties will arise in drawing a picture of what the contract would have been and what the hypothetic ultimate position the reinsurance contract parties would have been in. A question must be answered to define the scope of the parties’ contractual obligations and duties first, namely what contractual terms the parties should perform? Shall the law keep digging in pursuit of the hypothesis of ultimate position where the parties would have been in or focus on the insurer’s response to the disclosure of the true information, had the duty of utmost good faith been performed successfully. Answers would be found and suitable approach would be proposed in following discussion by comparison of current reforming proposals and the Australian legislation which can be the forerunner of the modification of the duty of utmost good faith in insurance law.

8.4.2 The regime of remedy under the ICA 1984 in Australian law

The Insurance Contract Act 1984 in Australia had taken an earlier step to depart from the common law principles by laying down a new statutory regime of remedies for breach of the duty of utmost good faith. A notion of proportionality has been introduced into the regime of remedies.\textsuperscript{603} The new regime of remedies under the Insurance Act 2015 in UK refers to and is built up based on but not identical to the Australian style.\textsuperscript{604} The regime for remedies for breach of the duty can be described as follow for later comparison purpose.

First of all, the test of inducement is officially codified into the insurance legislation.\textsuperscript{605} According to s.28 (1), the only circumstance that can give rise to a remedy for any

\textsuperscript{603} Insurance Contract Act 1984 Part 4, Division 3, ss 28-33.

\textsuperscript{604} Rob Merkin, Ozlem Gurses, The Insurance Act 2015: Rebalancing the interests of insurer and assured, not published yet.

\textsuperscript{605} ICA s.28 General insurance:

(1) This section applies where the person who became the insured under a contract of general insurance upon the contract being entered into:
qualifying breach is where the insurer would have not entered into the contract for the same premium or on the same terms and conditions. That's to say if the failure to perform the duty of utmost good faith does not induce the actual insurer into the contract, namely the insurer would have entered into the same contract of insurance anyway, the insurer should not be entitled a remedy, as there are no losses having been suffered by him.

Once it is proved that the insurer has been induced into the contract by the assured’s failure to comply with the duty, different remedies available to the insurer will depends on the state of mind the insured when he was committing the breach. The ICA 1984 s.28 (2) and (3) abolished the former rules and made the state of mind at the time of breach one of the decisive elements when measuring the corresponding remedy. As a result, the insurer is only entitled to avoid a contract ab. initio for fraudulent non-disclosure or misrepresentation that is considered as a serious breach of the duty of utmost good faith.

For innocent or negligent non-disclosure or misrepresentation which causes little or less serious damage, the insurer is not entitled to any remedy which exceeds the losses that he has suffered from the breach, so that avoidance of the whole contract is not open to the insurers anymore. Instead of avoidance, the remedies open to the insurer tear in two parts, one concerns the obligation to pay the existing claims and the other relates to the effect of the contract prospectively. In respect of the existing claims, the insurer is not entitled to refuse a claim, however the insurer should be able to reduce his liabilities to pay a claim, accordingly the amount of the payment would place the insurer in a position in which he would have been if the failure had

(a) failed to comply with the duty of disclosure; or
(b) made a misrepresentation to the insurer before the contract was entered into;
but does not apply where the insurer would have entered into the contract, for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation before the contract was entered into.

This was totally different from current doctrine of utmost good faith in English law that disregards the state of mind of the wrongdoer. Under current English law, the state of mind of the party who breaches the duty of utmost good faith is irrelevant; accordingly the contract can be avoided ab. initio for innocent or negligent disclosure or misrepresentation without any fraud.

ICA 1984, s.28

(2). If the failure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract.
(3) If the insurer is not entitled to avoid the contract or, being entitled to avoid the contract (whether under subsection (2) or otherwise) has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made.
not occurred or the misrepresentation had not been made at all. On the balance of authorities it proposes that the amount payable to the insured in respect of the claims can be reduced to nil if it can be proved by the insurer that he would not have entered into the contract at all had the true position been known. As in such circumstances, the damage suffered by the insurer equals the total amount of the payment of the claim. In the circumstance where the insurer would have entered into the contract but on different terms, the insurer is only liable for the amount that he would have been liable for, if the full disclosure had been made. This was the case in Dickinson v National Mutual Life Association of Australasia Ltd where the insurer made a third party claim against his agent for not asking the assured questions about the previous injuries to his back. The insurer had successfully shown that there was a 20% chance that the insurers would have imposed exclusion if the correct questions had been asked. As a result the insurer was able to recover from his agent that proportion of the loss. In respect of the effect of the contract prospectively, s 60(1) of the ICA 1984 allows a right to cancel the contract for the future if there has been a failure to comply with the duty of the utmost good faith.

As far as fraud non-disclosure or misrepresentation concerned, the right to avoid the policy is still open to the insurer. However, the court should have power to grant relief in the case where avoidance of the policy would be unjustly disproportionate to the degree of the prejudice suffered by the insured’s fraud conduct. Therefore, the

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611 Insurance Contract Act 1984 s.60 Cancellation of contracts of general insurance:
(1) Where, in relation to a contract of general insurance:
(a) a person who is or was at any time the insured failed to comply with the duty of the utmost good faith;
(b) the person who was the insured at the time when the contract was entered into failed to comply with the duty of disclosure;
(c) the person who was the insured at the time when the contract was entered into made a misrepresentation to the insurer during the negotiations for the contract but before it was entered into;
(d) a person who is or was at any time the insured failed to comply with a provision of the contract, including a provision with respect to payment of the premium; or
(e) the insured has made a fraudulent claim under the contract or under some other contract of insurance (whether with the insurer concerned or with some other insurer) that provides insurance cover during any part of the period during which the first-mentioned contract provides insurance cover; the insurer may cancel the contract.

court has a discretion to disregard the right of avoidance on an objective test where such remedy would be too harsh and it was unfair for the court not to do so; or on a subject test based on the degree of prejudice suffered by the insurer by the fraud conduct, namely where the insurer has not been prejudiced by the fraud or the prejudice is held to be minimal or insignificant by the court. It was the assured who has to burden the onus to prove the absence of the prejudice suffered by the insurer. However, If it can be proved that the insurer would be clearly prejudiced had the avoidance of policy is set aside, then the disregard of the fraud conduct should not be applied by the court, for instance it can be shown that the insurer would have significantly reduced the cover, or he would have not insured the risks at any price, or where the information fraudulently misrepresented or concealed has causal link to the claim itself etc. It should be noted that the right to obtain relief arising from s.31 can only be invoked in the case where there has been fraudulent non-disclosure or misrepresentation on the assured’s part. Moreover, a further safeguard is designed to ensure the fairness of the regime. If the right of avoidance is disregarded, the rights of the insurer and the assured will be adjusted by the court by taking consideration of the interests of both the parties. To exercise the power, the court has a discretion to take into account relevant matters, such as the need to deter fraudulent conduct in relation to the insurance, to weigh the extent

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613 ICA 1984, s 31 Court may disregard avoidance in certain circumstances:
(1) In any proceedings by the insured in respect of a contract of insurance that has been avoided on the ground of fraudulent failure to comply with the duty of disclosure or fraudulent misrepresentation, the court may, if it would be harsh and unfair not to do so, but subject to this section, disregard the avoidance and, if it does so, shall allow the insured to recover the whole, or such part as the court thinks just and equitable in the circumstances, of the amount that would have been payable if the contract had not been avoided.
(2) The power conferred by subsection (1) may be exercised only where the court is of the opinion that, in respect of the loss that is the subject of the proceedings before the court, the insurer has not been prejudiced by the failure or misrepresentation or, if the insurer has been so prejudiced, the prejudice is minimal or insignificant.
(3) In exercising the power conferred by subsection (1), the court:
(a) shall have regard to the need to deter fraudulent conduct in relation to insurance; and
(b) shall weigh the extent of the culpability of the insured in the fraudulent conduct against the magnitude of the loss that would be suffered by the insured if the avoidance were not disregarded; but may also have regard to any other relevant matter.
(4) The power conferred by subsection (1) applies only in relation to the loss that is the subject of the proceedings before the court, and any disregard by the court of the avoidance does not otherwise operate to reinstate the contract.

614 Plasteel Windows Australia Pty Ltd v Heath Underwriting Agencies Pty Ltd (1990) 19 NSWLR 400 at 411 (CA), See also Tyndall Life Insurance Co Ltd v Chisholm (2000) 11 ANZ Ins Cas 90-104 at 86,148.
615 Gio General Insurance Ltd v Zeidan (2005) 13 ANZ Ins Cas 61-633
616 Burns v MMI-CMI Insurance Ltd (1994) 8 ANZ Ins Cas 61-287; Porter v GIO Australia Ltd (2003) 12 ANZ Ins Cas 61-573; Syddall v National Mutual Life Association of Australia Ltd unreported, 2011, Qld SC.
617 Tyndall Life Insurance Co v Chisholm (1999) 11 ANZ Ins Cas 90-104
618 No relief will be granted in the case of general insurance where the non-disclosure or misrepresentation is innocent and the liability of the insurer has been reduced proportionately, even if the liabilities has been reduced to nil on the ground that the insurer would never have entered into the contract on any terms if he had been disclosed all the true information.
of the culpability of the insured in the fraudulent conduct against the magnitude of the loss that would be suffered by the assured if the policy is avoided. As a result, the insured shall be allowed to recover the whole or part amount that would have been payable if the contract had not been avoided, and the assured shall be entitled to recover at least part of the loss, as long as the court decides it is just and equitable to do so in the circumstances. Therefore, it can be said that the spirit of the court’s power to disregard the avoidance of the policy is to make the parties get fair and just premium and recover of the loss regarding to the claims tainted by the fraud conducts. So it is clearly stated in s.31(4) that the exercise of the power by the court to override the insurer’s right of avoidance is only effective to preserve the claims in respect of the assured’s loss rather than to reinstate the contract which should presumably remain avoided for all other purposes.

Moreover, as clarified in s.13 of the ICA 1984, the duty of utmost good faith is relied upon as an implied contract term in the contract of insurance rather than a duty from common law rules, so the insurer should be able to claim damages on a contractual basis rather than the tortious basis envisaged by s.28 (3) in the ICA 1984. The measurement of the damage is on a tortious basis to restore the insurer to the position that he would have been in had the non-disclosure or misrepresentation not been made. The damage suffered by the insurer from a non-disclosure or misrepresentation under s.28(3) cannot be separated from a claim that was made by the assured under the contract as the breach of the duty commonly reveals at the claim stage. When a claim is made by the assured under the contract, the insurer is entitled to set-off his loss suffered from the non-disclosure or misrepresentation against his liability of payment of the claim, for instance set-off of the short part of premium if a higher amount would has been charged, so that he is only obligated to pay the amount which he would have been liable for had he known all the true information and made an informed decision.

Finally, as the ICA 1984 s.33 provides, the provisions are exclusive remedies which are open to the insurers against the assureds in respect of a failure to comply with the duty of utmost good faith, therefore no other greater remedies are available to

619 ICA 1984, s.13 The duty of the utmost good faith
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.
the insurer in the case of breach of the duty.\textsuperscript{620} As a result, the regime established by
the act provides the widest scope of remedies available to the insurer so that it is not
possible for the insurer to contract out of the regime to confer itself any remedies
wider than that conferred by the Division.\textsuperscript{621}

8.4.3 Comparison between the ICA 1984 and current English law

The Australian legislation relating to the doctrine of utmost good faith laid down a
new regime of remedies departing from the common law rules. The difference
between the two regimes suggests an alternative approach for reforming the current
English regime.

First of all, the legislation officially codified the test of inducement in common law. In
order to justify an avoidance of the contract the first threshold to pass by the insurer
is to prove that he would have acted differently had there been a fair presentation.
Secondly, the Australian remedy regime makes the state of mind of the wrongdoer at
the time of committing the breach significant criteria in deciding whether the choice
of avoidance is available. This was totally different from current doctrine in English
law that totally disregards the state of mind of the wrongdoer. As a result, the insurer
is only entitled to avoid a contract ab initio for fraudulent non-disclosure or
misrepresentation. Therefore, once the burden of proof of inducement is discharged
successfully, the issue turns out to be whether the insurer is entitled to avoid the
policy.\textsuperscript{622} The proportionate approach of measuring the remedies on a hypothetical
basis what the insurer would have done had the true information been known by him
can be one of the most significant parts introduced by the Act that is different from
the all or nothing approach under current English law. The nature and extent of the
remedies depend on the nature and extent of the non-disclosure or misrepresentation.
In the case of innocent breach, the insurer is not entitled to avoid
the contract or reject the existing claims. However, the insurer is only liable for the

\footnotesize
\textsuperscript{620} ICA 1984, s 33 No other remedies:
The provisions of this Division are exclusive of any right that the insurer has otherwise than under this Act in
respect of a failure by the insured to disclose a matter to the insurer before the contract was entered into and in
respect of a misrepresentation or incorrect statement.
\textsuperscript{621} Advance (NSW) Insurance Agencies Pty Ltd v Matthews (1989) 166 CLR 606 at 615; Sherry v FAI General
Insurance Co Ltd (in liq) (2002) 12 ANZ Ins Cas (SC SA) at 76,011
\textsuperscript{622} In this case, fraud must be proved by the insurer to be granted the right to avoid. If it was not the case, then
the insurer would only be indemnified the gap between what would have happened had a fair presentation been
made and what actually occurred in reality.
amount that he would have been liable for if the full disclosure had been made.\textsuperscript{623} Moreover, a right of cancellation of the policy prospectively is introduced into the new regime so that the insurer would be free to re-consider whether he would like to continue the business with the assured. Furthermore, different from the current English regime, in order to ensure that proper remedies are granted so that it is just and fair to both parties, a power is conferred to the court to relief the insured from the harsh remedy of avoidance and adjust the parties’ rights and obligations by taking both parities’ interest into account, where avoidance of the policy would be unjustly disproportionate to the degree of the prejudice suffered by the insured’s fraud conduct, even if the insurer is entitled to avoid the contract; as long as the assured can successfully prove that insurer suffered only minimal or insignificant damage from the fraud breach.

In addition to the proportionate rational governing the remedy regime, the \textit{ICA 1984} clarifies that the duty of utmost good faith is relied upon as an implied contract term in the contract of insurance rather than a duty from common law rules. It is completely different from the English law under which the avoidance of the contract is the exclusive remedy open to the insurers. So it makes the possibility for insurer to claim damages on a contractual basis rather than the tortious basis. The measurement of the damage is on a tortious basis to restore the insurer to the position that he would have been in had the non-disclosure or misrepresentation not been made.

\subsection*{8.4.4 Reform of the English law proposed by Insurance Act 2015}

The common law decisions and insurance market practice have clearly shown that the current legislation governing the insurance contract area is in many aspects outdated, uncommercial and divorced from realities of 21\textsuperscript{st} century business practice. \textit{The Law Commission of England and Wales and the Scottish Law Commission} have started a joint project to reform the law of insurance contracts since 2006. The reform programme has been divided into two parts in relation to consumer insurance and business insurance. After the \textit{Consumer Insurance (Disclosure and

\textsuperscript{623} The difference between the premium that had been charged and that would have been charged can be set-off against the insurer’s liability to pay the claims, or the amount of the insurer’s liability to pay can be reduced proportionately depending on the terms of the contract that would have been based on.
The Insurance Act 2015 was born, reforming proposals and draft clauses regarding the non-consumer insurance context have been intensely published by the Law Commission since 2012. On 17 July 2014, HMT introduced a version of the Bill into parliament. Then a Special Public Bill Committee has been convened to scrutinise the draft Bill. Written and oral evidence was debated before the Committee and amendments was proposed accordingly by the Committee, before it was finally approved by House of Lords and House of Commons, and then obtained royal assent in February 2015. The Insurance Act 2015 has had force of law and will come into effect in August 2016. In contrast to the new legislation regime governing the consumer context which removes the duty of disclosure, the proposal of the duty of fair presentation in non-consumer context can be described to a large extent.

624 It published its third consultation on wide range of reforming issues to the business insurance law including disclosure in business insurance in June 2012. It could be found at The Law Commission Consultation Paper No 204 and The Scottish Law Commission Discussion Paper No 155 INSURANCE CONTRACT LAW: THE BUSINESS INSURED’S DUTY OF DISCLOSURE AND THE LAW OF WARRANTIES, A Joint Consultation Paper. It can be found here: http://lawcommission.justice.gov.uk/docs/cp204_ICL_business-disclosure.pdf. And then from January 2014, the Law Commissions have subsequently published a number of draft clauses of the Insurance Contracts Bill. On 28 January 2014, the Law Commissions published the first draft of the Insurance Contract Law Bill (‘the Draft Bill’) which indicates that some of the most significant reforms to insurance law, covering the duty to make a fair presentation of the risk in non-consumer insurance contracts, proportionate remedies, fraudulent claims, late payment of claims, and a short provision repealing the remedy of avoidance for breach of duty of utmost good faith. Subsequently a further consultation has been launched on draft clauses covering warranties, insurers’ remedies for fraudulent claims by members of group insurance schemes and contracting out of the legislation. The draft clauses can be found here: http://lawcommission.justice.gov.uk/consultations/insurance-draft-clauses.htm; and http://lawcommission.justice.gov.uk/docs/draft_insurance_clauses_January2014.pdf. By June 2014, over eight years detailed consultations with the stakeholders, the commissions published the second report, i.e. The Law Commission and The Scottish Law Commission (LAW COM No 353)(SCOT LAW COM No 238) INSURANCE CONTRACT LAW: BUSINESS DISCLOSURE; WARRANTIES; INSURERS’ REMEDIES FOR FRAUDULENT CLAIMS; AND LATE PAYMENT Presented to the Parliament of the United Kingdom by the Lord Chancellor and Secretary of State for Justice by Command of Her Majesty Laid before the Scottish Parliament by the Scottish Ministers July 2014. The report can be found here: http://lawcommission.justice.gov.uk/docs/ic353_insurance-contract-law.pdf.

625 After HM Treasury consulted on the draft bill in June 2014, on 15 July 2014 a new draft of Insurance Contracts Bill was published and then submitted for further approval. The Law Commission and The Scottish Law Commission (LAW COM No 353)(SCOT LAW COM No 238) INSURANCE CONTRACT LAW: BUSINESS DISCLOSURE; WARRANTIES; INSURERS’ REMEDIES FOR FRAUDULENT CLAIMS; AND LATE PAYMENT Appendix A at p.347. Following this, HMT introduced another version of the Bill into Parliament on 17 July 2014. That Bill includes all of the Law Commission’s recommendations apart from two provisions: the clause relating to late payment, and the clause concerning warranties and other terms relevant to particular descriptions of loss. These were omitted as HMT did not consider them suitable for the special procedure for uncontroversial Law Commission Bills. The Law Commission will continue to work with stakeholders to find a workable solution on these points, to be introduced at the next legislative opportunity. The detailed introduced version of the draft can be found here: http://www.publications.parliament.uk/pa/bills/lbill/2014-2015/0039/1.htm. For details please refer to http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm; http://services.parliament.uk/bills/

626 The Law Commission bills are normally committed to Special Public Bill Committees. This bill, the Insurance Bill [HL], was committed on 30 July 2014. Detailed information can be found here. http://www.parliament.uk/business/committees/committees-a-z/lords-select/insurance-bill/

627 Rob Merkin, and Ozlem Gurses, The Insurance Act 2015: Rebalancing the interests of the insurer and assured, unpublished yet, p.1. The Bill was referred to a Special Public Bills Committee of the House of Lords, chaired by Lord Woolf, and it passed in December 2014 with minor amendments after four days of evidence from a variety of judicial, market, practitioner and academic witnesses, and one day of debate. The Bill then completed its House of Commons’ stages unsathed and with virtually no discussion.

628 The whole progress of the Bill can be found here: http://services.parliament.uk/bills/2014-15/insurance.html
degree to clarify and codify the current rules of disclosure in common laws. However, the introduction of proportionate remedies regime is worth noted as new rules in the reinsurance law area.

8.4.4.1 The key changes brought by the new range of proportionate remedies

Generally speaking, the new regime proposed by the Insurance Act 2015 has gained positive responses and strong support across the commercial insurance market. As one of most significant issues addressed, the current all or nothing approach of remedies for breach of the duty of utmost good faith is replaced by a new default proportionate regime which fundamentally changed the current position of law in non-consumer insurance context. It has certain similarities with the Australian regime discussed above.

First of all, remedies should be commensurate to the seriousness of the qualifying breach, i.e. that the reinsurer would have acted differently without the inducement either entered the contract on different terms or not entered the contract at all had

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629 Although there are arguments that reinsurance should be excluded from the reforms as such default proportionate regime may be not suitable for sophisticated and specialist reinsurance agreements conclusion of which are relied upon skilled reinsurance brokers in practice, the proposal of proportionate remedy regime in Insurance Act 2015 applies to all business insurance, including reinsurance and the insurance of large risks. The applicability to reinsurance context is not clarified in the sections, but can be referred from section 4(5) (b). It is suggested that it had better keep the legislative unity of the business insurance kingdom rather than isolating the reinsurance context as a separated regime, but keep the gateway of contacting out open for this sophisticated and specialist industry so that the parties can design and constitute their own terms.

630 The section 8 named ‘Remedies for breach’ of the Part 2 ‘The duty of fair presentation’ introduced a regime of remedies for qualifying breaches:

(1) The insurer has a remedy against the insured for a breach of the duty of fair presentation only if the insurer shows that, but for the breach, the insurer—
(a) would not have entered into the contract of insurance at all, or
(b) would have done so only on different terms.
(2) The remedies are set out in Schedule 1.
(3) A breach for which the insurer has a remedy against the insured is referred to in this Act as a “qualifying breach”.
(4) A qualifying breach is either—
(a) deliberate or reckless, or
(b) neither deliberate nor reckless.
(5) A qualifying breach is deliberate or reckless if the insured—
(a) knew that it was in breach of the duty of fair presentation, or
(b) did not care whether or not it was in breach of that duty.
(6) It is for the insurer to show that a qualifying breach was deliberate or reckless.

The relevant remedies under Clause 8 are explained in details in Schedule 1 of the Bill. The Schedule named ‘Insurers’ remedies for qualifying breaches comprises of 12 paragraphs in three parts, i.e. contracts, variations, and supplementary.

631 The duty of fair presentation is breached if the presentation fails to satisfy one or more of the three elements in section 3(3) which indicates: A fair presentation of the risk is one—
(a) which makes the disclosure required by subsection (4),
(b) which makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer, and
(c) in which every material representation as to a matter of fact is substantially correct, and every material representation as to a matter of expectation or belief is made in good faith.
been no such breach of the duty of fair presentation, although the remedies available is independent from the cause of the breach. The 'inducement test’ which must be satisfied as a pre-requisite of remedies remains the same position of the current law. Although the test of inducement is not fresh concept in law, it is the first time that this subjective test established in common law is codified in legislation. Therefore, to invoke the remedy for a qualifying breach, the insurer must be able to show that without the non-disclosure it would have not entered into the contract at all, or would have done so only on substantially different terms.

Besides the codification of the test of inducement, the key changes proposed by the new regime lies in a new range of proportionate remedies. It can be concluded in the following aspects. As same as the Australian regime, the state of mind of the party when committing the breach of the duty is introduced into the regime as a significant criteria which divides the remedies for disclosure failures into two camps: one for dishonest conduct and the other for non-dishonest failures to make a fair presentation of the risk. Accordingly where the qualifying breach is deliberate or reckless, the insurer is still entitled to avoid the contract as under the current remedy regime, refusing all the claims under the contract and still keep the premium. Besides the remedies for deliberate or reckless breaches, all other breaches fall into the non-dishonest failures to make a fair presentation of the risk and then lead to proportionate remedies. Accordingly, the new range of proportionate remedies will

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632 Section 8(1) of the draft clauses bill indicates that the insurer has a remedy against the insured (formerly the proposer) for a breach of the duty of fair presentation only if the insurer shows that, but for the breach, the insurer would not have entered into the contract at all, or would have done so only on different terms. Such codification effectively clarifies the status of common law and receives strong support consequently. See the para. 10 of the evidence of AIRMIC submitted to the Special Public Bill Committee on the 'Insurance Bill'.

633 Section 8 (4): A qualifying breach is either—
(a) deliberate or reckless, or
(b) neither deliberate nor reckless.

(5) A qualifying breach is deliberate or reckless if the proposer—
(a) knew that it was in breach of the duty of fair presentation, or
(b) did not care whether or not it was in breach of that duty.

(6) It is for the insurer to show that a qualifying breach was deliberate or reckless.

634 Article 2 Deliberate or reckless breaches
If a qualifying breach was deliberate or reckless, the insurer—
(a) may avoid the contract and refuse all claims, and
(b) need not return any of the premiums paid.

635 Paragraphs 4 to 6 of the Schedule 1 of the Act set out a new proportionate approach to provide remedies for a qualifying breach which was neither deliberate nor reckless:
4 If, in the absence of the qualifying breach, the insurer would not have entered into the contract on any terms, the insurer may avoid the contract and refuse all claims, but must in that event return the premiums paid.
5 If the insurer would have entered into the contract, but on different terms (other than terms relating to the premium), the contract is to be treated as if it had been entered into on those different terms if the insurer so requires.
only apply to non-dishonest behaviours which are neither deliberate nor reckless, depending what the insurer would have done had all the true material facts been fair presented. If the insurer can show that it would have not entered into the contract at all, he will be entitled to avoid the contract and return the premium. If the insurer can prove that the contract would have been concluded on different terms, then such terms can be treated as having been included into the agreements. If the reinsurer can proved that a higher premium would have been charged, and then the amount of claims will be reduced proportionately. As the evidences submitted to the Special Public Bill Committee, it can be shown that the new regime of remedies received a major welcome from the business in the London insurance market, although dissenting voices also can be heard either expressing that the new regime is only acceptable, or even rejecting the proposed regime due to its inefficiencies in application. The new regime will be analysed in details. Each possibility is discussed as following.

8.4.4.2 Dishonest breach of the duty of fair presentation

As summarised in the above section, the state of mind of the party when committing the breach of the duty is introduced into the regime as a significant criteria which divides the remedies for disclosure failures into two camps: one for dishonest conduct and the other for non-dishonest failures to make a fair presentation of the risk. However, it should be noted that the reform of English law proposed here used a different concept of ‘dishonest’ from the ‘fraud vs innocent’ approach in the Australian law. To define the concept of dishonesty, the idea of ‘deliberate or reckless behaviour’ was adopted to avoid confusion with the criminal law which also

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6 (1) In addition, if the insurer would have entered into the contract (whether the terms relating to matters other than the premium would have been the same or different), but would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim.

(2) In sub-paragraph (1), “reduce proportionately” means that the insurer need pay on the claim only X% of what it would otherwise have been under an obligation to pay under the terms of the contract (or, if applicable, under the different terms provided for by virtue of paragraph 5), where—

\[ X = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100 \]

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636 See the para. 15 of the written evidence from AIRMIC SPBC/14-15/12; para 4 of the written evidence from Marsh & McLennan Companies SPBC/14-15/5; para 7 of the written evidence from London & International Insurance Broker’s Association SPBC/14-14/16; para 5 of written evidence of British Insurance Law Association SPBC/14-14/17 , para 6.1 of the evidence of Wills Ltd SPBC/14-15/10; and para. 7.1 of the written evidence from Catlin Underwriting Agencies Ltd. And Catlin Insurance Company (UK) Ltd. SPBC/14-15/14

637 See the para. 6 of the written evidence from LMC.

638 See the para.11 of the evidence from ComBar.
uses the common law concept of fraud. Therefore, where the assured had actual knowledge of the relevant information or shut its eyes to the relevant information and where the insured knew that the facts were relevant to the insurer or did not care whether or not they were relevant to the insurer, but failed to disclose the information to the insurer, it can be defined as a deliberate or reckless non-disclosure. So where the reinsured is shown to have known that it was not making a fair presentation of the risk but still conceal the non-disclosed information deliberately, or shown not to have cared whether it made a fair presentation at all, the reinsurer should be entitled to avoid the policy and retain the premium like the existing principle. The elements of entitlement to rescind the contract should stay the same as the common law authorities decide before.

It is arguable whether it is just and fair for the reinsurer who did not bear any risk to keep any premium paid. In practice, the reinsurer may be liable to pay or incur costs claims or expenses in dealing with the reinsured. Therefore, it is suggested that a compromised approach is probably the best approach under which the reinsurer should return the premium with the deduction of its reasonable costs after the avoidance of the contract.

8.4.4.3 Non-dishonest breach of the duty of fair presentation

In contrast to the simplicity of the test where the reinsured makes dishonest non-disclosure, it becomes much more complicated where the reinsured’s failure to make a fair presentation is neither made deliberately nor recklessly. It was proposed that the reinsurer should not be entitled to avoid the policy, but should be given remedies which reflect what it would have done had a fair presentation of the risk was made. Here such complex remedy varies according to a range of different scenarios which reflect what reinsurer would have done had it received a fair presentation of the risk. It should be noted that the proportionate remedies regime would focus on the contract that the reinsurer would have entered into with the reinsured if the reinsured had complied with its duty of disclosure, so that the remedy will only indemnify the loss suffered by the reinsurer, namely the difference between his liabilities to pay the claims under the two contracts. This just reflects the rationale behind the proportionate approach that the nature and extent of the remedy depends on the nature and extent of the breach.
8.4.4.3.1 Where the reinsurer would not have entered into the contract at all

It is comparatively easier where the reinsurer would not have entered into the insurance contract at all. As there have been no real element of consensus of the parties at all, it is fair and appropriate to confer the reinsurer a remedy of avoidance of the policy so that it reflects the legitimate expectations of both parties to the contract at the time of entrance into the contract even if the failure of disclosure was not made deliberately or recklessly. This is the scenario in which the proposed resolution gains overwhelming support among the market responses. It is suggested that the burden of proof should rest with the reinsurer so that the avoidance is only available if the reinsurer is able to prove clearly that it would not have entered into the contract at all.

8.4.4.3.2 Where the reinsurer would have entered into the contract on different terms

If the reinsurer would have entered into the contract on different terms (excluding the premium element), the contract is to be treated as if it was concluded on those terms. Such proposed resolution in this scenario has got second highest support across the market, as it is commented that such resolution would best reflect the reality of what would have happened had disclosure been fully made. The reinsurer is liable only for the amount for which the reinsurer would have been liable for, if such term had been included in the reinsurance contract. However, it should be noticed that the remedies may vary as the additional terms those would have been included into the contract may result in various effects on the contract and the claims under it.

8.4.4.3.3 Where the reinsurer would have charged a higher premiums

If the reinsurer would have charged a higher premium, the reinsurer may reduce the amount of the payment of a claim under the policy in proportion to the additional premium it would have charged had a fair presentation of the risk been made. It provides that the reinsurer may “reduce proportionately” the amount to be paid on a claim.639 “Reduce proportionately” is defined as meaning that the reinsured need

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639 The Insurance Act 2015 Schedule Part 1 paragraph 6(1): In addition, if the insurer would have entered into the contract (whether the terms relating to matters other than the premium would have been the same or different),
only pay X% of claims under the relevant policy, where X = (premium actually charged / higher premium) x 100.\(^{640}\) This proposal has the same rationale as the Australian approach which in the *ICA 1984* s 28(3) stipulates that the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made. Such proposal received good support, although nearly one third of the responses from the London market disagreed. As it is clearly established that each renewal of contract of insurance is a brand new contract which triggers a fresh duty of utmost good faith. Therefore the reinsurer’s entitlement to set-off the higher part of premium must be limited to the claims made under the current contract period.

In fact, the calculation of premium and negotiation of contract terms should not be considered in isolation from each other. The changes to the contract terms affect limits and pricing. In practice, it is possible that the reinsurer would have both increased the premium level and included additional terms. Therefore, the default proportionate regime should be constructed in a one or more structure rather than one or the other structure. More than one remedy may be open to the insurers according to individual circumstances of the cases.

**8.4.4.3.4 The prospective effect of the contract**

As to the prospective effect of the contract, the law commissions are generally in the same attitude as the Australian legislation. In s 60(1) of the *ICA 1984*, an insurer can be allowed to cancel the contract for the future if there has been a failure to comply with the duty of the utmost good faith, whereas the law commissions proposed that both the insurer and the assured should be able to cancel contracts prospectively that no longer achieved the purposes of either party subject to a reasonable notice.\(^{641}\) Although such entitlement is regarded right, it is arguable whether it is

\(^{640}\) The Insurance Act 2015 Schedule Part 1 paragraph 6(2)"Reduce proportionately” means that the insurer need pay on the claim only X% of what it would otherwise have been under an obligation to pay under the terms of the contract (or, if applicable, under the different terms provided for by virtue of paragraph 6), where X=Premium actually charged/Higher premium x 100.

necessary to provide a specific statutory right to cancel in these circumstances. As the reinsurance contract often induced rights to cancel in any event. The proposal for cancellation rights did not receive that wide support like the other remedies mentioned above. Disagreement arises in two main aspects, whether it is necessary for the legislation to deal with such matter and who should be conferred such entitlement if a right of cancellation becomes a legislative right. Although majority of the responses agreed with the existence of the cancellation rights, the Insurance Act 2015 finally keeps silent on this issue. It is suggested that the position of this issue in the Insurance Act 2015 is applausible. Legislation should keep silence on such matters. It is a common industry practice to include into the contract such terms of cancellation rights agreed by the parities. It is hardly for reinsurance especially in a sophisticated and specialist market not containing such provisions. Consequently it is not necessary for the legislation to deal with such matters any more, but leave the right to the contract.

8.4.4.4 Summary of the proportionate remedy regime proposed by the Insurance Act 2015

The fact that the existing disproportionate all or nothing approach is outdated and divorced from commercial reality is beyond question. Since Australia enforced the ICA 1984 made such reform as a forerunner, proportionality approach can be considered as the mainstream standpoint of reform that introduces a concept of proportionality into the remedy regime. The Law Commissions have followed the forerunner’s step by proposing a new system of proportionate remedies for breach of the duty of fair presentation in non-consumer insurance area. It can be said that the Insurance Act 2015 has the same spirits as the Australian legislation in most significant aspects with some fine distinctions.

The core spirit of the concept of proportionality is that the availability of the remedy should be in proportion to severity of the breach. As a result, it is the nature and extent of the loss suffered through the reinsured’s non-disclosure or misrepresentation that decides the relevant extent of the remedies available to the reinsurers. So the reinsurer will not be permitted to avoid the policy for minor

Ibid.
breaches of the duty of utmost good faith any more. The contract will remain its enforceability unless the reinsurer can prove that the breach is so serious that the insurance could would not have been entered into at all had the proper disclosure been made. Two issues can be addressed as the core aspects of the proportionate remedies regime, namely the state of mind of the insured when committing the breach and what the insurer would have done had he known the true position.

1. Where the insured act dishonestly by making deliberate or reckless non-disclosure or misrepresentation of material facts, the insurer should be entitled to avoid the policy and retain the premium like the existing principle, at least entitled to retain its reasonable costs after the avoidance of the contract.

2. Where the insured’s failure to make a fair presentation is not made dishonestly, the insurer should not be entitled to avoid the policy, but should be given remedies which reflect what it would have done had a fair presentation of the risk was made.

(1) Where the insurer would have declined the risk altogether, the policy can still be avoided but the insurer should return the premium, different from the case of dishonest non-disclosure or misrepresentation.

(2) Where the insurer would have accepted the risk but included a certain contractual term, the contract should be treated as if it included that term.

(3) Where the insurer would have charged a higher premium, the claim should be reduced proportionately.

As to the prospective effect of the contract which is not avoided by the insurer, the legislation should keep silence on such matters. It is not necessary for the legislation to deal with such matters any more, but leave the right to the contract, especially in the context of reinsurance. Last but not least, it is believed that the parties to reinsurance contract should be allowed to contract out of the default regime, except contracting out of the basis of contract clauses or contracting out to make for a deliberate or reckless late payment the claims, provided that the transparency requirement is satisfied.
8.5 Problems of operation of the proportional remedies approach in reinsurance context

According to the core spirit of proportionate remedies regime discussed above, the reinsurer should only be indemnified of the loss proportionately to the nature and extent of the qualified breach. The reinsurer who has been induced by such breach should be restored to the position had the breach not been committed. So the proportionality of remedies available to the reinsurance parties are sorted in specific senses which reflect what the reinsurers would have done in deciding whether to accept the risk and to accept the risk on what terms or premium had it received a fair presentation of the risk, rather than attempting to ask what the ultimate position the reinsurance parties would have been in. Therefore, in the case of non-fraud misrepresentation or non-disclosure, after the threshold of test of inducement is passed, the issue comes to the test of proportionality where the difference between what the reinsurers would have done had it made a fair presentation and what actually occurred should be found out. However, there would be some problems of the test of proportionality in practice of reinsurance context which will be discussed in details in the following section.

8.5.1 Problems in reaching a hypothesis of what the reinsurer would have done

First of all, after successful establishment of objective material non-disclosure or misrepresentation qualifying a breach, to satisfy the test of proportionality, the court must accordingly arrive at a hypothesis as to what the reinsurer would have done had the information been truly disclosed or represented. As the draft Insurance Contracts Bill does not provide any further guidance of reaching the hypothesis, thus the courts are best placed to decide what evidence is admissible and sufficient so that it can establish the causation. So the question need to be asked is what would have happened absent the breach and subsequently form an estimate of the likelihood of the reinsurer acting in a particular way.

However, practical problems may exist in applying the proportionate remedies to reinsurance. Such subjective approach emphasises on a particular reinsurer's underwriting philosophy and requires evidence from individual underwriters. The
cases will be complicated and various as the reinsurance policies are more likely to be bespoke. It turns out what a reinsurer might have done had they known the true facts is speculative to certain extent, particularly in the cases of non-standard risks. Moreover, it even theoretically needs to expose all documentation that is relevant to a reinsurer’s approach to risk, negotiating the contractual terms or premium. But such evidence is not necessarily available to show the hypothesis. It is not even a minority concern pointing out that difficulties exist in establishing the hypothesis how a reinsurer would have acted if proper disclosure had been made. The proportionate remedy approach is not invulnerable as the hypothetic position in which the parties would have been is sometimes a mystery far from being obviously predictable. Even some of those who supported proportionate remedies thought it would be difficult to establish what a reinsurer would have done. Difficulties of proof of such mysterious hypothesis will be discussed in each scenario stipulated in Paragraphs 4 to 6 of the Schedule 1 of the *Insurance Act 2015*.

8.5.1.1 Where the reinsurer would have underwritten the risk but on different terms

Where the reinsurer would have underwritten the risk but on different terms, it is not easy to predict what terms the reinsurer would have finally inserted into the policy. The inclusion of certain terms into the policy may be subject to many special factors, such as the contemporaneous factors changing overtime, unique circumstances under particular policy or of particular risks, the underwriting manuals of the underwriter in that place and commercial reasons in specific market or between particular business participants, etc. Those reasons may lead to conclusion of reinsurance covering identical risk for different reinsured on different terms.

In addition to the difficulties arising from the potential inclusion of certain terms into the policy, there may be problems caused by the possibility that the reinsurer would have excluded any particular category of risk or imposed any additional terms which render the contract void or forfeit a claim under the contract later. For instance additional warranties or exclusions may be inserted into the contract which may affect the recoverability of claims. Although where the additional terms would have forfeited one claim, the rationale behind the proportionate approach will benefit the policyholder by preserving the insurance cover for other claims.
Moreover, there are some doubts as to whether there should be any procedural or substantive limits of the terms which a reinsurer can impose, as there may be possibility that the business’ interests would be impaired if the reinsurer would have imposed any unfair additional terms. The policyholder would have a chance to find better bargain from other underwriters or have any safeguard against such unfair terms in the policy if he had known such additional terms.

Actually it is suggested application of such approach of proportionate remedies will have little practical effect in a reinsurance contract which is placed on a back-to-back basis with the direct insurance where the reinsurer promises to pay when the reinsured is liable to pay, provided the reinsured’s liability is established satisfactorily. As it is the fundamental spirit of a facultative reinsurance contract that it is written on identical terms with the underlying contract. In such situation, the reinsurer is still liable to pay the agreed proportion of the claims to the reinsured on the identical terms and conditions of the underlying contract, by collecting that proportion of the premium as agreed before. It is pragmatically difficult for the facultative reinsurer to argue for proportionate remedies in the case of an innocent non-disclosure or misrepresentation.

8.5.1.2 Where the reinsurer would calculate the premium differently

Contrary to imposition of additional terms into the contract, in practice the reinsurer may also have charged the reinsured a higher premium, made the reinsured bear a higher excess or includes any restrictions on his liability if he had been disclosed all the true information. It would be difficult to prove that the reinsurer would have required increased premium, higher excess, limited liabilities as same as proving that it would have required additional terms.

Also difficulties may arise in considering what would happen if the both the insurer and reinsurer would have taken different approaches to the risk had both of them known the full facts. For example, if the insurer/reinsured charged £100,000 but would have increased the premium to £150,000 had all facts truly been known. According to the proportionate approach, the reinsured would be required to pay 67% of the claim. If the reinsured ceded 80% of the risk to the reinsurer as agreed under the reinsurance policy, the reinsured was supposed to pay 80% of the
reinsured’s liability; say in this case it would be 54% of the full claim. However, problems will be caused where the reinsurer might argue that it would have charged the reinsured an even higher level premium if he had known the information, for example an additional 60% premium rather than 50% as assessed by the reinsured. It is arguable whether the reinsurer is entitled to pay a smaller proportion of the full claim to the reinsured than the reinsured is required to pay to the policyholder. It is suggested application of such approach of proportionate remedies will have little practical effect in a reinsurance contract which is placed on a back-to-back basis with the direct insurance, or on a proportionate basis, i.e. the reinsured and the reinsurer share the risks and premium on a fixed proportion agreed advance. In such situation, the reinsurer is still liable to pay the agreed proportion of the claims to the reinsured, by collecting that proportion of the premium as agreed before. Whereas under the non-proportionate reinsurance contract where the reinsurer making his calculation the premium according to his own underwriting assessment, the reinsurance market practice is able to cope with such issues by developing its own ways. So the reinsurance parties should be feel free to reach their own agreement by contracting out of the default proportionate remedy regime, although the reinsurance market is able to accommodate the proportionate remedy regime.

In addition, it is suggested that an alternative approaches can also serve such purpose of reduction of the reinsurer’s liabilities of paying for the claims. The parties should be entitled to choose to pay the additional premium so that full payment of their claims can be protected from proportionate deduction, especially in the situation where the amount of the additional premium might be relatively small compared to the quantum of the claim. It is suggested here that the entitlement to elect whether to pay back the additional premium conferred on the insured who fails to fulfil its duty of disclosure does not seems to be an equitable resolution as it remains the reinsurer on the risk and in a passive position to pay for claims for which he would have not taken the liabilities on that quantum of premium. Even if an election can be made to preserve the full payment of the claims by charging additional premium, the entitlement should be conferred on the insurer rather than the insured. It should be the reinsurer who is empowered to set-off against any liability under the policy the loss suffered from the non-disclosure or misrepresentation. Thus, if the reinsurer would have charged a higher premium, he should be entitled to choose to reduce
from the reinsured’s claim the amount between the premium assessed and the higher premium.

8.5.2 Difficulties increased by the burden of proof

In fact, it is suggested that such new regime of remedies which effectively introduces a three-stage approach may increase the difficulties in getting the proposed remedies, so that it may fail to achieve the satisfied effect of the draft expected by the Law Commission. Before getting indemnified, the innocent party need to firstly evidence the qualified breach of duty, secondly satisfy the causation requirement, and then successfully apply the retrospective amendments to the reinsurance policy.

8.5.2.1 Controversial issue as to who should undertake the burden of proof

According to section 8(6) of the Insurance Act 2015, the burden of proving the qualifying breach sits on the reinsurers. So the reinsurers must show that the reinsured’s breach was deliberate or reckless. It should be noticed that here exists a complete difference in the test of the breach qualifying a remedy of avoidance between the Australian and new English approaches. The Australian law has preserved the ‘fraudulent’ test in proving a qualifying breach of avoidance of the contract. By contrast, the Insurance Act 2015 have lowered the standard of proof from fraudulent to ‘deliberate or reckless’, to response the insurer’s concerns that it is too difficult to prove fraud of the insured. Consequently, assertion of a policyholder’s deliberate or reckless breach would be a less difficult accusation, and therefore easier to prove. However, there is still opposite opinion of LMC proposing that the burden of proof should be reversed,⁶⁴³ that would mean it would be the insured to show that his breach was neither deliberate nor reckless, so that the insurer did not deserve such remedy of avoidance because the insured was innocent to breach the duty of fair presentation. It is suggested that it should not be right to make such reservation of burden of proof. It is a long established legal principle that it is the party who alleges the remedy to prove a qualifying breach. There seems no reason for the case of business insurance to be an exception of law. Such reversion of burden of proof may have been tantamount to setting up a presumption of fraud in

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⁶⁴³ See para. 34-36 of Written submissions of the Lloyd’s Market Association and the International Underwriting Association for the Special Public Bills Committee of the House of Lords, SPBC/14-14/8
the insured’s breach, unless the insured can prove that he committed the breach neither deliberately nor recklessly. So such shift was not in accordance with the spirit of legal principles of burden of proof. Moreover, although the reversion seemed to secure the insurer’s remedy of avoidance, it just jumped from one extreme to the other extreme. Notwithstanding there may be indeed certain circumstances where the insurer will be rarely able to know why the insured breached its duty, and then be unable to plead that the breach was deliberate or reckless. Consequently, in practice even where an insurer has good reasons to suspect that the breach was deliberate or reckless, he may be still precluded from pleading such a breach. However such shift of burden of proof would have provided the insurer a big advantage to just demonstrate relevant facts of the breach on the balance of probabilities, and then made the insurer’s life so easy.\textsuperscript{644} In fact, in the London market, many members of the LMA and the IUA,\textsuperscript{645} which represent a very significant constituency of London market buyers and sellers of reinsurance contracts to which English law is applicable, approach the Bill not only in the position as insurers, but also reinsured. Their dual capacities as both buyers and sellers of reinsurance make it a significant concern of them whether the changing positions tend to favour one side or the other.\textsuperscript{646} It had better for the Bill to restore a balance to the commercial relationship between the policyholder and the insurers, so that the proposed new regime could rectify current one-sided regime which is in an unduly favour of the insurer/reinsurer.\textsuperscript{647} However, such reversion of burden of proof would effectively retain the right of avoidance as the default remedy for breach of the duty of fair presentation, leaving the regime of proportionate remedies in a secondary position, unless the insured can prove that he is neither deliberate nor reckless. It can be said that such enhanced standard of burden of proof is not accordant with the spirit of the reform proposed by the Law Commissions. In conclusion, the burden of proof of

\textsuperscript{644} See para 17 in the Appendix of the written evidence from Law Commissioner David Hertzell SPBC/14-15/4; and para. 3 of the Written Evidence on the Insurance Bill from Insurance Law Research Group of University of Southampton;

\textsuperscript{645} The Lloyd’s Market Association (LMA) represents the interest of the 57 Lloyd’s managing agents underwriting on behalf of the 90 syndicates operating in the Lloyd’s market and 3 members’ agents which advise capital providers. http://www.lmalloyds.com. The International Underwriting Association of London (IUA) represents 42 international and wholesale insurance and reinsurance companies operation in or through London. http://www.iua.co.uk

\textsuperscript{646} See para. 1.4 of Written submissions of the Lloyd’s Market Association and the International Underwriting Association for the Special Public Bills Committee of the House of Lords, SPBC/14-14/8

\textsuperscript{647} See para.8 of written evidence from Willis Ltd, SPBC/14-15/10.
deliberate or reckless breach should remain upon the insurer to invoke a remedy of avoidance.

8.5.2.2 Difficulties arising by proof of the hypothesis

In practice, even the reinsurer successfully pass the first threshold, it is hard for him to discharge the burden of proof to evidence the causation on an objective basis. So it needs to be shown that the reinsurer would acted completely different had all true positions are known. Also it would be difficult for the reinsured to disprove that a particular reinsurer would have considered a certain breach so serious that makes it a qualifying breach i.e. that he would not have written the risk at all. It requires detailed retrospective analysis of what the relevant underwriter would have done. Normally in such proving process, witness evidence and documentation such as the relevant underwriting guides is highly likely needed. It will be an issue of credibility and consequently increase the possibility of even more disputes. However too much focus on those disputes will turn on investigation into the facts of each individual case and reduce the ability to rely on precedential case law.

In addition to the possibility of more disputes, retrospective analysis approach may also result in more claims and then increase of premium in practice. In order to prove that he would have reached a different underwriting decision had all information truly disclosed, the reinsurer may have to disclose any or all documentation that may be relevant to his underwriting approach to assess risks, set the terms or calculate the premium. It could lead to disclosure of an enormous amount of significant information, most of which will be commercially sensitive or even confidential. It is easy to imagine that the reinsurers must be reluctant and reticent to disclose such type of information. So alternatively, the reinsurer may even seek to avoid such disclosure so that no remedies can be relied on at all. It is commercially reasonable to say that it could eventually result in more claims which reinsurers have to pay and consequently increases the premiums that the reinsured have to pay. Those outcomes cannot be regarded as good for the business and reinsurance market.

Even if the hypothesis of what the reinsurer would have done can be clearly inferred, there is still a limitation of the test that it does not extend to consider what the business will react to the reinsurer's responses. For example, where the reinsurer
can prove that he would have imposed on the reinsured an obligation, a further hypothetical inquiry would arise as to what would have happened in response to the imposition of the obligation. It could still produce stalemate if the reinsured insists that it would have complied with any addition term such as a warranty so that the claim under the contract should remain valid now. In *McNeill v O’Kane*\(^{648}\) the insurers succeeded in established that they would have imposed an obligation to comply if the assured had not misrepresented that they had an operative alarm system on their hotel premises. However, the assured argued that in order to rely upon such misrepresentation, the insurer had to continue to show that the assured would have failed to comply with the obligation if such term was included in the contract. It was held by Holmes J that the insurer was not obliged to prove the assured’s failure to comply with the obligation, on the contrary the burden of proof rested on the assured to show that he would have been complied with the obligation that would have been imposed had the facts not been misstated and a policy would have been issued.\(^{649}\)

As a result, although the business’s reaction is crucial to place the final position where the parties would have been had all the true information been disclosed, the proposed proportional remedies regime is not able to go that further to find out the ultimate outcome. Certainly it will result in endless debates and always be a mystery. How far hypothetical inquiry can the law make into would be a pragmatic problem in modifying the proportionality remedy regime. After all the business who would like to recover their claims under the contract has to try their best to prove the hypothesis that he would have comply with all the obligations even if such terms had been imposed into the policy.

### 8.5.3 Difficulties in applying the new regime in specialised or complicated reinsurance market

In addition to the problems of inferring and proving the hypothesis position in reinsurance practice, difficulties may exist in applying the proportionate remedies approach in specialist or complex reinsurance context. First of all, it is doubtable whether the new regime applies to the reinsurance context. Also it is suggested that

\(^{648}\) (2003) 12 ANZ Ins Cas 61-554.

\(^{649}\) Applying Commercial Union v Ferrcom Pty Ltd (1991) 6 ANZ Ins Cas 61-042 at 77,009.
the effect of the proposed changes to the remedy regime may be diluted due to the particular character of special or complex reinsurance contract.

### 8.5.3.1 The issue as to whether the Act extends to reinsurance

As many of the written evidences to the Special Public Bills Committee shown, it is a widespread concern of many stakeholders that whether the *Insurance Act 2015* proposed should extend to reinsurance context. The Act does not expressly confirm its applicability to reinsurance context, but just mentioned reinsurance in defining who the person is connected with a contract of insurance in relevance of the knowledge of the insured. Therefore, it is worthy debating whether there is any room of uncertainty left by the bill on this issue, and whether the bill intends to apply to reinsurance context.

Rather than simple codification of the existing common law positions into a statute like what the MIA 1906 did, the *Insurance Act 2015* expressly intends to reform and replace many respects of the existing common law. In particular, the ss.18 to 20 of the 1906 Act which used to provide formulation of the most important two aspects of the duty of utmost good faith, i.e. the duty of disclosure and the duty to refrain from misrepresentation, are to be removed and replaced by a new duty of fair presentation in the act. In Chapter 6 it has been mentioned that actually many important aspects of formulation of the duty of disclosure and non-misrepresentation in ss.18 to 20 derive from reinsurance disputes, and the application of the duty of utmost good faith plays significant role in reinsurance contracts. So it is fair to say that it indeed leaves some room of uncertainty in the *Insurance Act 2015* by omitting the ss.18 to 20 which are precisely provisions most often applying to reinsurance contracts. However this does not mean that the reason why the act is silent in this regard is that it should not extend to reinsurance contract. It is just at least possible to argue that the new act has removed the provisions most often deriving from reinsurance contracts, and replaced the duty by a new doctrine which are not

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650 See the written evidences to Special Public Bill Committee House of Lords on the Insurance Contract Bill, para. 9 of Marsh; para.7 of Willis; para.3 of LIIBA; para.13 of BILA; para.8-10 of City of London Law Society.

651 Section 4(5) For the purposes of subsection (4) the persons connected with a contract of insurance are—
(a) the insured and any other persons for whom cover is provided by the contract, and
(b) if the contract re-insures risks covered by another contract, the persons who are (by virtue of this subsection) connected with that other contract.

652 Please refer to Chapter 6.
designed for reinsurance contracts. However, it is suggested that the act should be applicable to reinsurance context. First, as stipulated in the part 2 of the act, it states that the duty of fair representation should only apply to insurance contracts in the category of non-consumer insurance contracts. Therefore it is reasonable to presume that the act should extend to cover reinsurance contracts, which could not fall into the category of consumer insurance. Secondly, as the act is proposed to replace relevant provisions of the Marine Insurance Act 1906, it is not unreasonable to presume that the act follows the MIA 1906 to continue applying to reinsurance context. Moreover, the act introduced a default regime which has been trying to provide a fair balance of interest between commercial policyholders and insurers. It is fair to expand the scope to include the stakeholders in reinsurance market. Notwithstanding the reinsurance market often operates as a specialist and sophisticated end of insurance market, the act has already left a reasonable room entitling the specialised reinsurance parties to contract out of the default regime designed for the non-consumer insurance market, provided that such alternative contractual terms successfully serve their purpose. Accordingly, it is suggested that the act is highly desirable to clarify its scope of application that includes reinsurance and retrocession.

8.5.3.2 Situations where the proportionate approach may play little practical effect

First of all, the reinsurance which deals with risks in a wholesale mode in the London subscription market is often non-commoditised. The reinsurance risks are often large and complex in nature, requiring specialist and sophisticated skills to design bespoke policy for their particular commercial need. Even for the facultative reinsurance contract which can be considered as the simplest form of reinsurance agreement, there would still be problems for application of the proportionate regime. It is the fundamental spirit of a facultative reinsurance contract that it is written on a ‘back-to-back’ basis with the underlying contract. So under the policy the reinsurer undertakes to pay for an agreed proportion of the claims on the identical terms and conditions of the underlying contract for a fixed proportion of the premium of the direct insurance. Also it is suggested application of such approach of proportionate remedies will be difficult in a reinsurance contract which is placed on a proportionate
basis, i.e. the reinsured and the reinsurer share the risks and premium on a fixed proportion agreed advance. In such situation, the reinsurer is still liable to pay the agreed proportion of the claims to the reinsured, by collecting that proportion of the premium as agreed before. Consequently, it is pragmatically difficult for the reinsurer to argue for proportionate remedies under a facultative reinsurance contract or proportional reinsurance treaty in the case of an innocent non-disclosure or misrepresentation. Whereas under the non-proportionate reinsurance treaty, where the reinsurer making his calculation the premium according to his own underwriting assessment, the reinsurance market practice may be already able to deal with such issues by developing its own ways. As concerned by the Law commissions, there indeed exist many alternative ways for the reinsurer to refuse claims other than invoke a proportionate remedy for the breach in the case of an innocent non-disclosure or misrepresentation. For instance, provided necessary requirements are all satisfied, the reinsurer may refuse the reinsured’s claims by establishing that the reinsured has not been induced to the direct insurance; or the reinsurer can establish that the reinsured have impliedly waived the non-disclosure by asking limited questions or failing to make proper enquiry; or there exist difference between the two jurisdictions, say for example the reinsured underwrites the direct insurance under a civil law system which adopts proportionate approach, while the reinsurer sits in UK; or where the reinsured underwrites the direct insurance with a consumer, then the reinsured may be required to pay the claim by the FOS applying its fair and reasonable jurisdiction etc. Consequently, it is fair to say in certain situation discussed above, the proportionate approach may actually play little practice effect in reinsurance market. So the reinsurance parties should be feel free to reach their own agreement by contracting out of the default proportionate remedy regime, although the reinsurance market is able to accommodate the proportionate remedy regime.

8.5.3.3 Difficulties of applying the approach due to the specific placing process of reinsurance in subscription market

In addition underwriting mode of reinsurance agreement is also different from that of the consumer insurance in normal underwriting procedures. In the subscription market where signing down is a common practice, the risks are regularly signing up or down so that they will be under-or oversubscribed. Each underwriting subscription
could be considered as a separated contract between the reinsurer and the reinsured. For pragmatic reasons, it is extremely complicated to trace out the total effect on the claim of a change in line size by one reinsurer or a change of the terms of the reinsurance agreement, especially where such change was made by the leading underwriter whose decision may have the decisive effect upon those of the following market. If one reinsurer had successfully discharged the burden of proof that he would have to accept only a smaller line size whereas other reinsurers cannot show this, others may unexpectedly underwrite more percentage of the risk and forced to meet more of the claim. Such approach would still be harsh and arbitrary from other subscriber’s point of view. Or in the case where the leading underwriter can show that he would have entered into the reinsurance agreement on different terms then reduce its liabilities accordingly, it is far from obviously and extremely complicated to predict what the following market would have reacted if they had known the leading underwriter’s response. Therefore, it can be said that where there would be a change in the line size accepted by the subscriber or change of the reinsurance agreement terms, such proportionate remedies regime has many pragmatic difficulties in application so that the default regime cannot be considered as a suitable remedy for reinsurers in the subscription market.

8.5.3.4 No mention as to recovering payments of claims already made

For non-dishonest breach of the duty to make fair presentation, no prescription in the Bill has been made as to the remedies for the reinsurer to recover any payments of the claims already made prior to discovery of the material non-disclosure. For instance, in a declaration treaty, qualified claims are allocated into the treaty individually, normally in an account year. Upon discovery of a material non-disclosure, notwithstanding the reinsurer would be entitled to evidence that he would have excluded a certain type of loss consequently reject claims for that type of loss, or would have charged a higher premium consequently reduce a future claim payment proportionately to the difference of premium that would have been charged, such remedy is only prospectively from the discovery of the qualifying breach in the relevant account year. It is still not defined clearly whether such approach of remedy has a retrospective effect on the payment already made for previous declarations in this account year. The Act does not expressly include any right of recovery for
previous payments that would not have been made had a certain term been included, or a higher premium would have been charged. If a reinsurer is able to prove that the payments would otherwise have been excluded, then it is reasonable to regard the payments which have already been made by the reinsurer recoverable. Consequently it is suggested that such a right should be allowed in full accord with the core spirit of the proportionate remedy approach. So that the reinsurer should be allowed to recover all the payments of such attainted claims under the contract to the date that would not have otherwise been paid if the underwriters would have not accepted the risks or would have underwrites the risks on different terms, or entitled to claim the difference in the premiums payable in previous years during which the non-disclosure or misrepresentation was committed.

8.5.4 Entitlement of reinsurance parties to contract out of the regime of proportionate remedies

8.5.4.1 The new Act’s attitude towards the entitlement to contract out of the default regime

Besides proposing the default regime of proportionate remedies, the act regulates in part 5 concerning the entitlement of the parties to contract out. It believes that the parties to reinsurance contract should be allowed to contract out of the default regime. In contrast to a mandatory regime established for consumer insurance,

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653 Insurance Act 2015, section 15 Contracting out: non-consumer insurance contracts

(1) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects representations to which section 9 applies than the insured would be in by virtue of that section is to that extent of no effect.

(2) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects any of the other matters provided for in Part 2, 3 or 4 of this Act than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect, unless the requirements of section 16 have been satisfied in relation to the term.

(3) A term of a non-consumer insurance contract, or of any other contract, which would put any person referred to in section 12 as “C” in a worse position as respects the matters dealt with in that section than C would be in by virtue of section 12 is to that extent of no effect.

(4) In this section, references to a contract include a variation.

(5) This section does not apply in relation to a contract for the settlement of a claim arising under a non-consumer insurance contract.

654 Part 5 Good faith and contract out, section 14 Contracting out: consumer insurance contracts

(1) A term of a consumer insurance contract, or of any other contract, which would put the consumer in a worse position as respects any of the matters provided for in Part 3 or 4 of this Act than the consumer would be in by virtue of the provisions of those Parts (so far as relating to consumer insurance contracts) is to that extent of no effect.

(2) In subsection (1)—

(a) references to a contract include a variation,

(b) references to the consumer include any person referred to as “C” in section 12.
the new range of remedies proposed in the act is only default provisions reinsurance, entitling the commercial parties free to contract out of the reforms and substitute their own agreed terms, subject to the transparency requirements under the s.16. Therefore, it can be said that there is one general transparency requirement set out in s.16 and two exceptions set out in s.15 limiting the reinsurer’s entitlement to contract out under a non-consumer insurance contract. The parties of business insurance contract will neither be allowed to contract out of the rule prohibiting basis of contract clauses or similar clauses, nor to contract out of the liability for a deliberate or reckless breach of the implied duty to pay within a reasonable time stipulated under section 13(1). Any disadvantageous term that puts the reinsured in a worse position which they would be under the default regime, despite not falling into the two exceptions, will have no effect unless the reinsurer takes sufficient steps to draw the disadvantageous term into the reinsured’s attention before the contract is concluded and the term is clear and unambiguous drafted as to its effect. In determining whether the requirements of transparency have been met, the characteristics of reinsured persons of the kind in question, and the circumstances of the transaction, are to be taken into account.

8.5.4.2 Necessity of the entitlement of reinsurance parties to contract out of the default regime

Although the new range of remedies clauses proposed received major supportive response, contracting out was still a controversial issue of which the market’s opinions divided in whether there should be entitlement on the reinsurance parties to contract out of the proportionate remedies regime.

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(3) This section does not apply in relation to a contract for the settlement of a claim arising under a consumer insurance contract.

655 Insurance Contracts Bill Section16 The transparency requirements
(1) In this section, “the disadvantageous term” means such a term as is mentioned in section 15(2).
(2) The insurer must take sufficient steps to draw the disadvantageous term to the insured’s attention before the contract is entered into or the variation agreed.
(3) The disadvantageous term must be clear and unambiguous as to its effect.
(4) In determining whether the requirements of subsections (2) and (3) have been met, the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account.
(5) The insured may not rely on any failure on the part of the insurer to meet the requirements of subsection (2) if the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.
It can be said that the new remedy regime to certain degree complicates the remedies available to the reinsurance parties for qualifying breach. It is not necessary to leave the reinsurance context which is a significant type of business insurance alone outside the scope of reform. Nor is it possible for the legislation to design and draft universal provisions applying to the wide variety of forms of reinsurance contracts and specific provisions under them in practice. It is suggested that it is better for the legislation to take a compromised method by setting up only ground principles of reduction of the insurer’ liabilities proportionately and allowing the sophisticated and specialised reinsurance parties free to opt out of the default proportionate remedies regime to find a suitable solution for themselves.

In last chapter it was concluded that parties should be allowed to contract of the doctrine provided certain requirements are satisfied. Just as it is possible for the parties to exclude, limit or restrict the duty of utmost good faith by substitutional agreements, it is suggested that it should also be open for the parties to contract out of the default proportionate remedies regime by agreements for the similar reasons. The reasons for supporting contracting out are easy to understand. It is a fundamental principle of commercial law that the parties in business insurance have freedom of contract. Generally speaking, the parties, who have the balanced negotiation powers and ability to negotiate suitable substitutional arrangements, should be allowed to work out their own detailed terms on how proportionate remedies would apply to these contracts of insurance concluded under the framework concluded by each declaration, notwithstanding the entitlement to contract out may be subject to certain limits. For instance a kind of clause can be inserted into the insurance contract, providing that the only remedy available will be the additional premium which the insurer would have charged had all the true positions been known. In addition, it is already a common industry practice especially in sophisticated reinsurance markets for parties to contract out the default routine so that there should not be any legislative intervention restricting their business free will. The market does have some practical countermeasures deal with the defect of the current remedy approach. For example, it is a common practice in the present market for policies to be sold on a combined basis that covers for different risks are designed to be granted by divisible parts of the policy, so that the parties will
preserve undisputed claims instead of sinking into avoidance of the whole policy.\textsuperscript{656} As shown in the evidence to the Special Public Bill Committee on the Act,\textsuperscript{657} s.15 received general welcome. The parties to a reinsurance contract should be allowed to consider from their own standing points whether contracting out of the default routine is appropriate in their particular circumstances.

However, there do exist opposite opinions which disagree with opt-out entitlement. For instance, there are concerns that such freedom to contract out could render the proposed remedy regime undermined. Also there is some concern that contracting out would become the insurance market norm so that a standard opt-out clause would be devised in the market and consequently imperil the interest of the policyholders.\textsuperscript{658} Also some concern is expressed that the policyholders who are in a weaker bargaining position may be left exposed due to such opt-out entitlement.\textsuperscript{659} There is even strong opposition alleging that the contracting out provisions are inappropriate for reinsurance under which the parties will in principle be of equal commercial strength.\textsuperscript{660}

However, even if the parties are not allowed to contract out the default proportionate regime, the proposed test of proportionality still entirely depends on the parties’ subjective choice. This is similar to the situations under current all or nothing regime, it is not in all the cases that the parties would routinely seek for the remedy of avoidance in either consumer insurance or business insurance. It is not easy for the reinsured to disprove that the particular reinsurer would have taken his breach of the duty of disclosure so seriously that he would not have underwritten the risk at all. After all, the proposed proportionate approach is only a default regime and the parties’ subjective choice had the all the true information disclosed should have been the decisive element in determining the final remedies. From this point of view, the effect of the proposed changes to the remedy regime will be diluted by the test of

\textsuperscript{657}See para.6 of the letter from Marsh to the Special Public Bill Committee on the Insurance Bill APBC/14-15/5; and para.19 of the evidence from AIRMIC to the Special Public Bill Committee on the Insurance Bill, SPBC/14-15/12
\textsuperscript{658}See para.19 of the evidence from AIRMIC to the Special Public Bill Committee on the Insurance Bill, SPBC/14-15/12
\textsuperscript{659}See para.7 of Aon UK limited response to the Special Public Bill Committee on the Insurance Bill.
\textsuperscript{660}See para.11 of the City of London Law Society (CLLS) response to the HL SPBC call for evidence on the Insurance Bill.
proportionality, so that it is a just and reasonable choice to entitle the parties to contract out freely provided that all the requirements are satisfied.

8.5.4.3 Limitation or restriction of the entitlement of contracting out

Even though entitlement of contracting out is basically agreed by majority of the market, some concerns had been expressed that there might be general limits or restrictions to which the default regime can be altered or excluded by the contract, so that contracting out is only allowed in limited circumstances in specialist risks.661

In fact, such need for introducing some limits upon the entitlement of contracting out has shown the same concerns behind the disagreement with the contracting out. There may be possibility that the insurers may use their bargaining power or take advantage of the insured’s lack of understanding to impose non-negotiable contracting out policy terms on business insured,662 so that the proportionate remedies regime which intended to achieve “neutrality” between the parties would be undermined. Moreover, it was significantly concerned that entitlement to contract out would introduce contract uncertainty that made the parties find it difficult to know whether they could rely upon terms altering the default position and stipulating their own duties and obligations until the effect of such terms had been tested in the court.

As a result the generous clauses of contracting out could have a negative impact on the business insurance market and lead to even greater uncertainty and more disputes, conflicting with the aims and objectives of the reform.

In contrast to the Australian legislation that provides the provisions are exclusive remedies which are open to the insurers against the therefore no other greater remedies are available to the insurer in the case of breach of the duty, the Insurance Act 2015 barely propose to place any general restrictions on the extent to which the regime can be altered or excluded by the contract but just clarified two exceptions to the entitlement and one general transparency requirement.663 Therefore parties may

661 See para.20 of the evidence from AIRMIC to the Special Public Bill Committee on the Insurance Bill, SPBC /14-15/12

662 para.7 of Aon UK limited response to the Special Public Bil Committee on the Insurance Bill.

663 Clause 16 The transparency requirements
(1) In this section, “the disadvantageous term” means such a term as is mentioned in section 15(2).
(2) The insurer must take sufficient steps to draw the disadvantageous term to the insured’s attention before the contract is entered into or the variation agreed.
(3) The disadvantageous term must be clear and unambiguous as to its effect.
be allowed to contract out of the default regime entirely, provided all the necessary requirements are met. It is suggested that such approach of barely any limitation imposed upon the entitlement of contracting out should be given applause, despite the negative impact of the right to contract out shown by the market concerns discussed above. Consequently, the courts will have discretion to determine the effect of the terms in different scenarios. Also it gives the parties freedom to consider whether it is necessary and appropriate to opt out of the default regime in their particular situation, so the parties can make an informed decision as to whether to stay within the default regime or to negotiate for the alternative position. Notwithstanding such approach may sacrifice contractual certainty for flexibility to some extent, for instance in subscription placements involving more than one reinsurer, it could cause problems if some reinsurers contract out the default regime while others do not, leaving the reinsured with a gap in cover in the same claim.\textsuperscript{664}

The parties in a sophisticated insurance market are believed to have the ability to draft their contracts appropriately to satisfy the requirements for contracting out which can be considered as the last safeguard in the default regime.

Although no general limitation was imposed upon the parties’ right to contract out of the default regime, it is enunciated that, to be valid, a term which purports to contract out of the default regime to the detriment of the policyholder must be clear, unambiguous and sufficiently brought to the attention of the other party. That means to serve the contracting out purpose successfully, the term must satisfy two procedural requirements. First the insurer must take sufficient steps to draw the term into the insured’s attention before conclusion of the contract. Then the opt-out clause must be clear, unambiguous as to its effect. Whether a clause has such effect depends upon its true construction in particular cases according to the parties’ true intentions. As a result, to serve the purpose of contracting out, the parties must draft the terms clearly and ambiguously, in case a narrow and restricted construction might be adopted before the court. The parties need to negotiate their position, and

\begin{itemize}
\item[(4)] \textit{In determining whether the requirements of subsections (2) and (3) have been met, the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account.}
\item[(5)] \textit{The insured may not rely on any failure on the part of the insurer to meet the requirements of subsection (2) if the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.}
\end{itemize}

\textsuperscript{664} See para. 10 of the letter of Marsh to the Special Public Bill Committee on the Insurance Bill APBC/14-15/5; para.9 of the evidence from London & International Insurnace brokers’ Association to SPBC on Insurance Bill; and para.14 of the evidence from the British Insurance Broker’s Association (BIBA) to SPBC on Insurance Bill.
finally make an informed decision to agree with the alternative position with knowledge of all the facts and consequences of contracting out. In addition the clauses must be drafted appropriately and indicate their expectation explicitly to alert commercial parties sufficiently to such extraordinary bargain, considering individual parties’ statutes and abilities. Generally speaking, the more sophisticated and professional the parties are, the less attention needs to be addressed by the provisions.

CONCLUSION

Reinsurance contract as a contract of uberrimae fidei, in contrast to ordinary commercial contracts, attracts a duty of utmost good faith. There are various forms of reinsurance which adopt different ceding methods. Each of them has specific characters in the placing progress. The unique placing process in London subscription market of such complex and complicated reinsurance contracts by specialist brokers has to certain degree modified the operation of the doctrine of utmost good faith in reinsurance context. Moreover, from partial codification by the MIA 1906 to significant changed by the Insurance Act 2015, it is fair to that the doctrine of utmost good faith has experienced one hundred years long revolution. Development of the doctrine itself has important affect upon its operation in reinsurance context too.

Modification of the doctrine in reinsurance occurs due to several reasons. First, the special placing process in London subscription market affects the formation procedure of reinsurance contracts, consequently reshapes operation of the doctrine. Secondly, the characters of reinsurance contracts distinguished from underlying insurance would have some impact on operation of the doctrine in reinsurance context. In addition, other significant common law rules such as the principle of waiver, which is in extensive use in the reinsurance market practice, will also modify the operation of the doctrine in reinsurance context. Moreover, evolution of the duty itself, from an absolutely strict duty to a duty only requiring fair presentation, and a proposal of a new proportionate regime of remedies brings potential problems of its operation in reinsurance context. Consequently, notwithstanding there has been a long history of the doctrine and clarification of many aspects of the doctrine comes from a reinsurance cases, difficulties and problems still exist in operating such duty in reinsurance context. Such problems extend to every specific aspect of operation of the duty in reinsurance context, from the formation to performance, and then remedies for qualifying breach of the duty in claim stage.

First of all difficulties and problems exist in reinsurance broker’s placing process at the contract formation stage. According to the current legal status, s.19 of MIA1906 which imposes a separate duty of disclosure on agent to insure only applies to the placing broker who is the last tache in the chain to deal with reinsurer directly. But for
those underwriting agency who holds the cover and underwriting pen on behalf of the reinsurers or brokers who effect a binding authority on behalf of a coverholder, they are exercising judgment on behalf of the reinsurer, therefore do not have a duty of disclosure for the purpose of s.19 (b) at all. There may be more than one producing brokers involved in the process of effecting reinsurance. No matter appointing a sub-broker or dealing with the reinsurer directly, he is supposed to pass his possessed material information down. The placing broker is deemed to know such information in his ordinary course of business then disclose it to the reinsurer under s.19 (b). Also s.19 (a) should be able to cover the gap and protect reinsurers from situations where material information does not reach placing broker. However, such seemingly settled positions are significantly changed by the *Insurance Act 2015* under which the approach switches from the separate duty route to the imputation route. Consequently the duty of fair presentation is solely imposed upon the reinsured by attributing all the disclosable knowledge of the agent to insure into the reinsured’s. At a face value, it appears more simplified and clearer in the position of the new insurance act that integrates the current two separate duties of disclosure into one, and then technically makes the test rules and scope of duty easier to understand. No matter how many intermediates are involved in the placing process and no matter what their capacities are, all their relevant information material to the prudent insurer’s underwriting assessment are attributed into the reinsured’s, therefore disclosable by the reinsured for the purpose of the duty of fair presentation. However, it is suggested that such imputation approach may cause difficulties in practice. It is harsh to deem the reinsured to know all the material facts possessed by the placing brokers who are at the end of the intermediate chain, as the reinsured may even not know the existence of such agent to insure. Neither is it easy for the reinsured to know or ought to know all the material information processed by the brokers, nor is it practical for the reinsured to make reasonable search to reveal such information. Moreover, attribution of agent to insure’s knowledge into the reinsured’s is inconsistent with current common law rules.

Difficulties may also arise as to the scope of knowledge for the purpose of disclosure by the reinsurance brokers. It’s not uncommon practice that reinsurance brokers play multiple roles in the operation of the business involving in some other processes with the reinsurer or the reinsured, and even in a dual agency of both parties. It may give
rise to the potential for conflicts of interest, enlarge the ambit of knowledge of the broker accessed in multi capacities, and then affect the scope of the duty of disclosure. The broad wording of s.19 (a) of the *MIA 1906* makes ambit of disclosure controversial. As it is not easy to reconcile the conflicting common law authorities, the proposition that broker’s duty of disclosure is merely confined to facts known in capacity of the reinsured’s agent in effecting reinsurance contract is still not convincing. Consequently, before any suitable case comes to the court, it is suggested that the placing broker should disclose all material circumstances known to him; even he has acquired or held such knowledge in a different capacity, including his capacity as broker in different levels of the placement chain of reinsurance. In the situation of dual agency, even when the broker offers the firm indication from the proposed reinsurer to his original principal, he is still acting on behalf of his principal, the reinsured. Therefore, the broker should take his intending principal’s interest as priority above all other clients, even though he may not know its identity. The *Insurance Act 2015* reflecting the latest legal spirit supports such proposition too. But the ambit and test of the knowledge of the reinsured for the purpose of duty of fair presentation is still complex, involving new legal and factual test to be established and clarified. It is yet unknown whether the new tests can serve the market practice better than the current existing rules. It will take some time and judicial decisions, like the current settled rules, to show whether the prescriptive approach of attribution of knowledge route will successfully eliminate current unfairness or uncertainty in existing legislation and common law cases.

In addition, in the broker’s placing process, sometimes problems may arise where the broker may do wrongs or even commit fraudulent conduct against the reinsurer or his principal, i.e. the reinsured. It is unsettled whether there are any common law or public policy exceptions undermining the broker’s duty of disclosure besides circumstances expressly excluded from the scope of the duty in legislation. It is suggested that s.19 does operate subject to a fraud exception that brokers are not required to disclose their fraud against their principals to reinsurers, although different from the Re Hampshire Land principle which is through the imputation of knowledge route. Although the imputation of knowledge approach adopted by the *Insurance Act 2015* may cause problems discussed above, it indeed eliminates difficulties in justification of fraud exception to the broker’s disclosure. The Re
Hampshire Land principle can apply to the duty of fair presentation directly beyond questions then. Any fraud conducted against the reinsured's interest is not material information that can be imputed into the reinsured's knowledge. Therefore the broker is not obliged to present such information to the reinsurer. However, it is doubtful whether there exists any wider exception beyond fraud to the broker's duty. Although there are some authorities supporting a gloss on it, the reasoning is still unconvincing. Therefore the reinsured still needs to make a fair presentation of all the material circumstances possessed by his brokers, no matter producing brokers or placing brokers, no matter in what capacities, as long as such circumstances are known or ought to be known by the him for the purpose under s.3. While brokers are advised on the behalf of the reinsured to disclose all material information within his knowledge received in all capacities before a suitable case reaches the court.

After clarifying the difficult issues in reinsurance broker's role in placing process, it proceeds to problems arising from modification of the duty of utmost good faith by specific formation procedures of placing reinsurance contracts in London subscription market. Difficulties exist because the duty of utmost good faith cannot attach reinsurance contracts straightward because of the formation procedures. A reinsurance contract is concluded when the reinsurer scratches the MRC as an acceptance of the broker's offer on behalf of his principal, i.e. the reinsured. Each of the reinsurers has an individual contract of reinsurance with the reinsured on the same risk and only liable for his own subscribing proportion of the risks, and each contract of reinsurance attracts a separate duty of utmost good faith between the parties involved. As a result, the reinsured and broker owes separate duty of disclosure and duty of refraining from misrepresentation in the scratching process to individual reinsurers. Each reinsurer, not only the leader but also the following reinsurers, deserves a full disclosure of all material information concerning the underwritten risks so that an information underwriting decision can be made by him. Once the reinsurer scratches the slip after an underwriting decision is made, a reinsurance contract is concluded. Thus terminates the operation of duty of utmost good faith. No more duty of disclosure of material facts is required by the broker to the reinsurer even if the underwritten risk is not fully subscribed yet. If a loss had occurred between the date which the slip became fully subscribed and the date which the policy is issued, the reinsured would still be covered. As to the
circumstances where the reinsurance comes into existence before the direct insurance, it is suggested that initialing the MRC is just functioning as a binding promise to provide reinsurance for whatever person who subsequently write a line on the primary insurance and desire to cede the risks to the reinsurer. Once the reinsurance had been accepted by the original underwriter, the reinsurance contract is concluded binding the parties. Even without a communication of that acceptance made to the reinsurers by the broker, a binding contract comes into existence on strict contractual analysis. As a result, the duty of utmost good faith has attaches the reinsurance contract since the broker starts to approach the reinsurer at the beginning of the scratching process. The broker must anticipate the placement request of a potential reinsured in respect of a proper reinsurance protection and then make a full disclosure of all material facts and information concerning the underlying risks and the reinsurance agreement itself to individual proposed reinsurers during the scratching process. The duty of disclosure continues after the reinsurer has put down his line on the MRC. Any material information comes into the broker’s knowledge after the reinsurer has made the scratching must be disclosed by the broker to the proposed reinsurer. As a result, in contrary to normal situation, the broker remains under a duty of disclosure until the underwriter of the underlying cover has accepted the offer to conclude a binding contract.

From the problems discussed above, it can be said that a gap is created between the rules of law and the market practice. Rather than going through the contractual negotiation with the broker, the following underwriters subscribe the contract simply and largely by considering who the leading underwriter is and what proportion he has subscribed the risks. As a result, in case where a misrepresentation or non-disclosure is made to the leading underwriter, the gap between the rule of law and the market practice will cause difficulties as to whether the following underwriters would have the same defense as the leading underwriter does to avoid their individual insurance contracts. Solutions are found to cover the gap in both common law and market practice aspects, instead of the flaw deemed communication rule, a supposed rule was proposed by the common law authorities. So if a custom or usage of such supposed rule can be proven in the particular market, or it imported an implied term into the contracts between the reinsured and the following underwriters, or an implied representation had been made to following underwriters.
that all material circumstances had been accurately provided to the leading underwriter, then the deemed communication rule should be valid. In addition to this supposed rule, an alternative solution on different ground also becomes popular, suggesting that the fact that a misrepresentation or non-disclosure of material fact has been made to the leading underwriter is on its own a material fact which should be disclosed to the following underwriters. However, it is suggested that the reasoning that each of the underwriters was induced by the misrepresentation including the following underwriters who relied upon the presentation to the leading underwriter and the leader’s judgment in respect of the risk is more attractive. Therefore, if a reliance or expectation can be established, the following market should be entitled the same defense as the leading underwriters. In practice such using of deemed communication rule, supposed rule or other alternative solutions can be avoided by inserting a leading underwriter clause into the reinsurance contracts. So the leading underwriter can be regarded as the representative on behalf of the following market in respect of any disputes between the parties under reinsurance contracts within his authorities.

Besides the problems discussed above, the characters of reinsurance contracts distinguished from underlying insurance would also have some impact on operation of the duty of utmost good faith in reinsurance context. Notwithstanding reinsurance is recognised as insurance for insurer, not all reinsurance contracts can be categorised as contract of insurance to attract the duty of utmost good faith straightforward. Where the duty is indeed attracted by the reinsurance contract, it may still not apply to the contract straightforward. Difficulties may arise as the duty is modified in respect of the applicability, duration, and the extent of material facts subject to disclosure in the reinsurance context. The attachment and duration of the duty may vary according to various placing methods. And the specific nature and characters of the reinsurance contract will also have some impact on what material facts need to be disclosed, different from those under underlying insurance contracts.

It is long established under common law that the doctrine of utmost good faith applies to all form of contract of insurance, therefore the reinsurance contracts should be subject to the same test of materiality like all direct insurance contracts. However, in reinsurance market practice the duty of disclosure under the MIA 1906
has become onerous to a certain degree, especially for large size, complicated nature and complex business. To minimise the difficulties and the deficiency of enforcing the law, the reinsurers commonly follow the current reinsurance market practice by designing particular standards and formal procedure of disclosure and inserting a specially draft clause in the reinsurance contracts overriding the current legal rules set out in the MIA1906, rather than seeking enforcement of the full requirements of the act. It is significant for the reinsured and reinsurer to identify various disclosure roles and allocate responsibilities, and the nature of the material facts and information in advance, so that it can facilitate a suitable and sufficient disclosure of material facts. Material facts subject to duty of disclosure differ between the direct insurance and reinsurance contracts, determined by the nature of the insurance contract and the placing method by which the contract is concluded. As to material facts to be disclosed in placing reinsurance contract, in addition to the material facts relating to the underlying risks, any information relating to the manner in which the reinsureds run his business and operation of the reinsurance agreement itself may be material to be disclosed to the reinsurers. Generally speaking, placing information material to facultative agreement will normally be material the treaties too. In addition to those, other information may also be material to the reinsurer, depending on particular features of the treaty, the method taken by the treaty, and the nature of business in original insurance to be ceded. It suffices to say that, being different from material facts in direct insurance, material facts to be disclosed in placing reinsurance agreements mainly relate to two aspects, compromising of operation of the treaty itself such as information about previous declarations to the treaty falling outside the treaty scope at renewal of the treaty; and the manner in which the reinsureds run their business under the direct insurance, make underwriting assessment and handle claims, rather than the circumstances relating to the underlying risks. Normally, the reinsured’s retention, the reinsured’s potential exposure under the direct insurance, the reinsured’s loss experience in respect of direct insurance, estimated premium income, the reinsured’s claim handling philosophy would be material facts which the reinsurers would be interest to know in most cases. Some other relevant circumstances such as estimated premium income, retrocession protection offered to the reinsurer, refusal of another reinsurer to accept or renew the risk, identity of other co-reinsureds if any, or existence of other reinsurance cover and retention level etc may also influence the reinsurers’
underwriting assessment. Although the types of material information may be different between direct insurance and reinsurance agreements, there is a similar fact under both direct insurance and reinsurance context, i.e. there is no hard and fast rule that what circumstances can be material in placing insurance agreements. The reinsured and his broker acting on his behalf face most exposure of the reinsurer’s potential allegation of materiality of a particular representation or non-disclosure. There are always inevitable disputes between the parties; even the market expert witnesses may put forward conflicting advices. Therefore the assessment of the materiality in respect of a particular circumstance is a question of fact in individual cases.

In practice, reinsurance contracts which have large size, complex nature are usually placed in various complicated methods. Such different placing methods result in distinct nature of the reinsurance contracts, and then modified the applicability and duration of the duty of utmost good faith in reinsurance. No matter what method is adopted to place the risks proposed, there are always three significant timing in deciding the applicability and duration of the duty, i.e. setting up a facility under which risks are ceded by the reinsured, the reinsurers' underwriting assessment of the risks proposed and conclusion of contract of insurance to cede the risks proposed. In direct insurance and facultative reinsurance contract which is similarly placed in practice, it is normally easy and simple to coordinate the three timing together in the negotiation of the contract. However, as to the treaties, especially where business is ceded to the reinsurer for example by use of bordereau under the treaties in future, it is more complicated than the direct insurance as there may exist gaps between the three timing according to the placing procedure in practice. As a result, applicability and duration of the doctrine is modified and varies under different types of reinsurance treaties. The determinative criterion is that whether the reinsurance agreement is a contract of insurance in nature synonymous to the direct insurance, as the incidence of the disclosure and representation obligation may arise only when the contract of insurance is made. If the reinsurance contract is in essence a contract for insurance which works more like a contract of agency between the parties rather creating a partnership, then the question to be answered should be when the reinsurers make underwriting assessment and when a contract of insurance is concluded according to the facility, then the attachment point of the duty to the policy is reallocated to the stage of each individual declaration which
appears to be the case if the policy is facultative in that the reinsurers can refuse any individual declaration. Consequently, it is the nature of the reinsurance contract that determines whether the duty of utmost good faith attracted in a reinsurance contract. Such nature is also critical to any consideration of the role which declarations were intended to play in the reinsurance agreement. Therefore the duty of utmost good faith is only attracted when underwriting assessment is made to conclude a contract of insurance between the parties. All other features of the agreement, such as the form or the words used to describe it by the parties, are not determinative.

In conclusion, the application and duration of the duty of utmost good faith in reinsurance agreements could be summarised as following. As to facultative reinsurance agreements which are in essence contracts of insurance between reinsureds and reinsurers, the doctrine of utmost good faith as a principle of law is equally applicable to facultative agreements as it is to original insurances. As to reinsurance treaties, it can general be separated into three categories. The crucial criterion is when the contract of reinsurance is concluded. Under an obligatory treaty, the treaty itself in effect operates as a contract of reinsurance, as the reinsurer is bound to accept the risks ceded by the reinsured automatically. Accordingly, a duty of utmost good faith applies to the obligatory treaty itself. Declarations to an obligatory treaty in later stage do not attract duty of utmost good faith any more. Under a facultative obligatory treaty, the treaty itself is a standing offer only binding the reinsurer to offer cover in the future. No contractual obligations arise until declarations are made to the treaty in later stage. Consequently, the duty should apply to the contracts of insurance concluded by declarations rather than to the fac/oblig treaty itself. According to the general rule of duration, it supposes to last from parties’ negotiation of the fac/oblig treaty to their conclusion of the contracts of insurance by future declarations. However, as the reinsurer waiver the duty of disclosure at declaration stage by automatic acceptance of the reinsured’s cessions, the duration of the duty is modified as if it only attach to the first stage, i.e. conclusion of the fac/oblig treaty just like the practice in an obligatory treaty. Under non-obligatory treaties which are best categorised as contracts for reinsurance, a duty of utmost good does not apply to such framework facility which does not bring any contract of reinsurance into existence. When the reinsurer decides to accept a declaration by the reinsured, a contract of reinsurance is concluded between the
parties. Then the duty of utmost good faith arises in the declaration stage. Where the reinsured fails to make a fair presentation in relation to the risks ceded, only the declaration relating to the particular risks is avoided, leaving the non-obligatory treaty and other declarations under it untainted.

In addition to the difficulties and problems caused by reinsurance contracts nature characters and placing process discussed above, other significant common law rules, such as the principle of waiver which is in extensive use in the reinsurance market practice, will also modify the operation of the doctrine in reinsurance context. The doctrine of waiver becomes a practical method used by the reinsurance market to reshape the scope of the duty of utmost good faith. The parties are free to tail the strict statutory duty of utmost good faith, as long as the terms make commercial senses for them and such contracting out is permitted by the common law and public policy. The parties can curtail the duty by waiving duty of disclosure of a particular type of information as the parties treat such information not material; or waiving the duty itself so that the reinsured or his brokers need not to burden such a duty at all; or the remedies for qualifying breaches; also the reinsured should be entitled by clear contract wording to limit the authority of brokers to make a pre-contract representation. Whether there has been a waiver depends on the reinsurer’s intention construed under the whole policy terms, no matter it is expressly incorporated into the contract or implied from the representation or conduct of the reinsurer. However difficulties exist in clarifying the permissible scope of contracting out provisions in reinsurance contract. Whether a contract term extends to waiver of the remedies or liabilities for a negligent misrepresentation is a question of construction depending the meaning of the language used by the parties construed in the context of the whole instrument and against the admissible background. Absence of the word ‘negligence’ is irrelevant, as long as the wording is literally wide enough to cover negligence. However, it may be problematic as to the fraudulent presentation, as a matter of public policy or a settled rule of law would come into play. Therefore the reinsured could not exclude liability for his own personal fraudulent misrepresentation which had induced the contract in question. But it is suggested that it is to be conceptually possible in law to have an express clause in the contract that excludes liability of the reinsured for fraudulent misrepresentation of his brokers, only if such clause is clearly, suitably and effectively worded to achieve such effect. It
is consistent with current market practice by inserting a clause of waiver into the reinsurance contract to exclude the reinsured’s liability for the fraud of his agent to insure, subject to a precondition that the reinsured is in no way implicated in the agent’s fraud. There are two alternative approaches supporting such agreement, namely such waiver can be deemed to remove the broker’s authority to speak on behalf of the reinsured or to treat the broker as the agent of the reinsurers. Both of the approaches can give a justifiable effect for the assured to discharge the liabilities for the broker’s non-disclosure or misrepresentation as to the material facts.

Although it is affirmative that the reinsurance parties should be allowed to contract out the default legal framework, it is possible to cause difficulties in draft and construction of the clause in reinsurance context. In order to avoid the uncertainty to the reinsurance contracts and make sure the reinsurance market running well without interference by onerous contracting out clauses, it is suggested that a narrow and restricted approach should be taken in construction of such terms with the assistance of the reinsurance market practice. Such approach receives support from the Insurance Act 2015 that expressly enunciates a requirement of transparency. Consequently, to achieve the purpose of exclusion of specific rights or remedy, the term must be drafted in a clear and unambiguous way, and appropriately indicate their expectation explicitly to alert reinsurance contract parties sufficiently to such extraordinary bargain considering individual parties’ statutes and abilities. If the meaning of the term is unclear due to its ambiguity, or it is capable of more than one conflicting or alternative interpretation of the clause, then the rule of contra proferentem should be relied upon to construe the term against the interest of the party who benefits from the intended modification.

As revolution of the test in common law authorities and the scope of duty of utmost good faith in legislation, the test of implied waiver of the duty evolutes too. Difficulties may arise in clarifying the requirements to establish an implied waiver of duty of utmost good faith. It is suggested that Rix L.J’s approach which emphasises a mutual fairness of both parties in the placing process to make all the relevant material information disclosed should be given applause. Such rationale receives supports from the Insurance Act 2015 that balances the parties’ interest in performing the duty and requires the reinsurer to become more active in making
enquiries to get the material information put on his notice fairly disclosed and represented. Consequently, when a reasonable reinsurer has been put on notice of any further material information, and obvious questions would reveal such material information prompted by the reinsured’s presentation, failure to make such appropriate enquiries would imply a waiver of disclosure of relevant information. However, there is still not a general assumption that a failure to ask an express question by the reinsurer will be construed as a waiver of further information by the reinsurers on the balance of the existing authorities. Once the reinsurer did put forward enquiries about any further information prompted by the reinsured’s representation, the limited questions asked by the reinsurer will not be assumed as a waiver of the information that falls outside the scope of the questions. Whether the reinsurer has the intention to waive any relevant information not covered by his specific or limited questions depends on the questions he asked under the whole picture of the policy, leaving the courts to use his discretion to construe the facts of each case and take the particular type of insurance business into consideration.

At last but not least, the evolution of the duty itself, from an absolutely strict duty to a duty only requiring fair presentation and a proposal of a new regime of remedies for qualifying breaches also brings potential difficulties in operating the duty in reinsurance context. Neither the current remedies regime nor the new proportionate regime proposed by the *Insurance Act 2015* can be said to function perfectly in reinsurance context. It is fair to say that the right to rescind is firmly established as the primary remedy for breach of the duty of utmost good faith under current English law. Although alternative formulations to recover damages for actionable breach can be established in certain situations, it is suggested to only exist in theory. In fact, in practice the right to damages appears to have fewer practicalities in reinsurance context, leaving the right to rescind as the only actionable remedy in reinsurance market. Although the current all or nothing regime of remedies is in fact not as draconian and inconsequential like it is generally assumed to be, the disproportionate approach does have some deficiencies, namely depriving the reinsured of all coverage, causing great injustice, disproportionate, being lack of consequence, irrelevant of the state of mind of the wrongdoer when committing the breach, and one-side favorable to the reinsurers etc.
By comparison between the regimes under the *ICA 1984* in Australian law, the current English law regime, and the new proportionate regime proposed by the Law commissions, it can be said that the new proportionate regime of remedies for qualifying breaches introduced by the *Insurance Act 2015* should be supported and welcomed. The core spirit of the concept of proportionality is that the availability of the remedy should be in proportion to severity of the breach. The most important change in the new regime is to divide the regime into two parts according to the state of mind of the wrongdoer in committing the breach. It is the seriousness of the breach and extent of the loss suffered due to the breach that determines the relevant extent of the remedies available to the reinsurers. Therefore, the parties should be and only be restored to positions according to what the reinsurer would have responded, had the information been truly disclosed and represented. Notwithstanding the new regime can overcome the deficiencies of current regime, there are still difficulties in applying such regime in reinsurance. Difficulties will arise in drawing a hypothetic picture of what the contract would have been. The scope of the parties’ contractual obligations and duties must be defined first, namely what contractual terms the parties should perform. It is suggested that it is impossible for the law to keep digging in pursuit of the hypothesis of ultimate position where the parties would have been in, but just need to pursue the reinsurer’s hypothetic response to the disclosure of the true information had the duty of utmost good faith been performed successfully.

Even the above problem can be solved, it will still raise practical difficulties in applying the proportionate remedy approach in reinsurance context. First of all, difficulties will arise in the applicability of the new regime to specialist and complicated reinsurance context. Moreover it is still not easy to go through the test of proportionality where the difference between what the reinsurers would have done had it made a fair presentation and what actually occurred should be found out. It is problematic in referring and proving a hypothesis of what the reinsurers would have been done had all material information been truly represented. In fact the hypothetic position in which the reinsurance parties would have been is sometimes a mystery far from being obviously predictable, and speculative to certain extent. In addition, the detailed retrospective analysis of what the relevant underwriter would have done will normally requires witness evidence and highly likely needs documentation such
as the relevant underwriting guides. It will be an issue of credibility and consequently increase the possibility of even more disputes. Too much focus on those disputes will turn on investigation into the facts of each individual case and reduce the ability to rely on precedential case law. Moreover, the retrospective analysis approach may also result in more claims and then increase of premium in practice. Furthermore as to the controversial issue of burden of proof, it is suggested that the burden of proof of deliberate or reckless breach should remain upon the insurer to invoke a remedy of avoidance. Reinsurance risks are often large and complex in nature, requiring specialist and sophisticated skills to design bespoke policy for their particular commercial need. It is extremely complicated to trace out the total effect on the claim of a change in line size by one reinsurer or a change of the terms of the reinsurance agreement, especially where such change was made by the leading underwriter whose decision may have the decisive effect upon those of the following market. It is far from obviously and extremely complicated to predict what the following market would have reacted if they had known the leading underwriter’s response. Therefore, it can be said that where there would be a change in the line size accepted by the subscriber or change of the reinsurance agreement terms, such proportionate remedies regime has many pragmatic difficulties in application so that the default regime cannot be considered as a suitable remedy for reinsurers in the subscription market. Moreover, it is suggested application of proportionate approach will be difficult in a reinsurance contract which is placed on a proportionate basis, i.e. the reinsured and the reinsurer share the risks and premium on a fixed proportion agreed advance. In such situation, especially in a back-to-back cover, the reinsurer is still liable to pay the agreed proportion of the claims to the reinsured, by collecting that proportion of the premium as agreed before. Consequently, it is pragmatically difficult for the reinsurer to argue for proportionate remedies under a facultative reinsurance contract or proportional reinsurance treaty in the case of an innocent non-disclosure or misrepresentation. Whereas under the non-proportionate reinsurance treaty, where the reinsurer making his calculation the premium according to his own underwriting assessment, the reinsurance market practice may be already able to deal with such issues by developing its own ways. As concerned by the Law commissions, there indeed exist many alternative ways for the reinsurer to refuse claims other than invoke a proportionate remedy for the breach in the case of an innocent non-disclosure or misrepresentation. Consequently, it is fair to say in
certain situation discussed above, the proportionate approach may actually play little practice effect in reinsurance market. So the reinsurance parties should be feel free to reach their own agreement by contracting out of the default proportionate remedy regime, although the reinsurance market is able to accommodate the proportionate remedy regime, provided that all the limitation and requirements are satisfied.

Despite the problems mentioned above, it is suggested that the proportionate regime in the *Insurance Act 2015* that significantly changes the current common law positions should be welcomed. Notwithstanding it to certain degree complicates the remedies available to the reinsurance parties for qualifying breach and creates new practical problems, it basically resolves the difficulties and problems caused by the deficiencies and difficulties caused by current remedy regime. It is better for the legislation to set up only default principles of proportionality and then allow the sophisticated and specialist reinsurance parties free to opt out of the default regime to find a suitable solution for themselves.
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