

Remedies for an insurer's breach of good faith from a New Zealand perspective

**A paper delivered by the Hon Justice William Young KNZM¹
To
The 2010 New Zealand Insurance Law Association**

The language of good faith in insurance law

[1] The expression “good faith” and its related expressions (ie “utmost good faith” and “uberrimae fidei”) are used primarily in relation to the pre-contract disclosure obligations of an insured and, post-contract, in respect of the obligation of an insured not to make fraudulent claims. In both respects, language is being used loosely. For instance, disclosure obligations can be breached innocently by an insured who is acting in good faith. And an obligation of good faith which can only be breached by fraud might be thought to be ethically insipid.

[2] Since “good faith” is not particularly descriptive of the underlying law, I tend to think that the expression has been used not so much to define the relevant rules of law but rather to justify them (along with their sometimes harsh results). So I am doubtful whether concepts of good faith (in its usual sense) are of much direct assistance in determining whether a particular insured has, on specific facts, a case against an insurer (or vice versa) and I am suspicious of arguments which start with a broadly expressed obligation of good faith. But despite all my doubts and suspicions, reciprocal obligations of good faith are well-established features of the law of insurance and from time to time the courts are required to deal with good faith arguments in situations which go beyond the two situations I have mentioned; that is, pre-contract disclosure by an insured and fraudulent claims.

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[3] The usual remedy for non-disclosure is avoidance of the contract and, as I will discuss, arguably this is the only remedy available for breach of good faith obligations. Avoidance will usually (indeed almost always) be all that is required to meet the legitimate expectations of an insurer, but, in circumstances where the boot is on the other foot, avoidance will only occasionally,² and more commonly not, meet the legitimate requirements of an insured.

[4] This paper is addressed to the remedies available against an insurer for breach of good faith obligations, something which I will discuss directly towards the end of the paper. Before getting there, however, it is necessary to discuss in reasonable detail how the concept of good faith operates more generally in insurance law and to identify what I regard as the reasonably circumscribed situations in which an insured might claim that an insurer has breached the obligation of good faith.

In the beginning ...

[5] The logical starting point³ for any discussion of good faith in the insurance context is the decision of the Court of King's Bench delivered by Lord Mansfield CJ in 1766 in *Carter v Boehm*.⁴ There, in language addressed to the conduct of both the insured and the insurer, Lord Mansfield observed:⁵

First. Insurance is a contract upon speculation.

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

The keeping back [of] such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived, and the policy

² For cases where avoidance was an adequate remedy, see fn 7 and the discussion below at [41].

³ Those with a particularly historical turn of mind will find the earlier history reviewed by Howard Bennett "Mapping the doctrine of utmost good faith in insurance contract law" [1999] LMCLQ 165 at 185–192.

⁴ *Carter v Boehm* (1766) 3 Burr 1905, 97 ER 1162 (KB).

⁵ At 1164, [1909].

is void; because the risque run is really different from the risque understood and intended to be run, at the time of the agreement.

The policy would equally be void, against the under-writer, if he concealed; as, if he insured a ship on her voyage, which he privately knew to be arrived: and an action would lie to recover the premium.

[6] To understand the example given by Lord Mansfield of non-disclosure by an insurer, it is necessary to understand the, by contemporary standards, unusual facts of the case.

[7] The policy had been taken out by Roger Carter for the benefit of his brother, George Carter, who was the Governor of what was known as “Fort Marlborough” (but was more in the nature of a trading post) on the island of Sumatra. It was operated by the East India Company. The risk against which the Governor sought cover was the taking of the fort by a European enemy. The period of cover was from 16 October 1759 to 16 October 1760. Governor Carter had arranged the cover through his brother, to whom he wrote in 22 September 1759. Due to difficulties of travel and communication, these instructions were not acted on until 9 May 1760 when the contract of insurance was concluded. In the meantime, however, on 1 April 1760, a French expedition under Count D’Estaigne⁶ had, with the assistance of the Dutch, already attacked and taken Fort Malborough. So the contingency insured against had, unknown to Charles Boehm the underwriter, already crystallised by the time he accepted the risk. His complaints about all of this extended to the failure by the Carters to share with Mr Boehm Governor Carter’s bleak take on the relevant geo-political situation as conveyed (also in correspondence of September 1759) to his brother Roger and directors of the East India Company. Lord Mansfield’s view was that the Governor’s rather glum prognostications as to what lay ahead were simply his deductions based on circumstances that were well-known to everyone who was interested in the situation and that, as of May 1760, Mr Boehm in London was better situated to assess the relevant risks than the Governor had been in Sumatra during September 1759. The failure of George and Roger Carter to pass these prognostications on to Mr Boehm was therefore not a breach of the insured’s duty of disclosure.

⁶ Later executed (on 28 April 1794) during the French Revolution. It is said that before his execution he observed "After my head falls off, send it to the British, they will pay a good deal for it!"

[8] Lord Mansfield put it this way:

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 the fact, and his believing the contrary. But either party may be innocently silent, as to grounds open to both, to exercise their judgment upon.

As this passage suggests, Lord Mansfield saw good faith as applicable generally in the law of contracts and not confined to contracts of insurance (to which, for the reasons he gave, it had obvious relevance). This may conceivably be why he saw the disclosure obligations as reciprocal, that is, owed by the insurer as well as the insured. The law, of course, did not develop that way, ie along the lines of a general principle of good faith. But it has never been suggested that this negates Lord Mansfield's views as to the disclosure obligations of insurers.

[9] The problems of distance and communications which informed Lord Mansfield's judgment and provided the context for his example of non-disclosure by an insurer seem very remote and it is, in fact, not easy to find examples of cases where insurers have been required to return premiums as a result of their non-disclosure, although this has occurred in situations where an insurer has made an active misrepresentation to the insured.⁷

[10] There are of course countless cases in which the courts have addressed good faith arguments associated with pre-contract non-disclosure by the insured and the remedy of avoidance where such arguments have been made out. These cases, however, are of no particular relevance to the subject matter of this paper. On the other hand, as will become apparent, the case law as to post-contract good faith obligations of an insured are material, and it is to this body of law that I now turn.

⁷ *Mutual Reserve Life Ins Co v Foster* (1904) 20 TLR 715 (HL); *Refuge Assurance Co Ltd v Kettlewell* [1909] AC 243 (HL).

The jurisprudence on the post-contract good faith obligations of an insured

The marine insurance legislation

[11] The good faith obligation is customarily referred to as involving “utmost good faith” or in Latin as “uberrimae fidei”. Although the provenance of the “utmost” is uncertain,⁸ it was well and truly embedded in the law by the time that the United Kingdom Parliament had enacted the Marine Insurance Act 1906.⁹ Section 17 of that Act provides:

DISCLOSURE AND REPRESENTATIONS

17. Insurance is uberrimae 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.

[12] Critically, s 17 not only declares that a contract of marine insurance contract is based upon the utmost good faith, which must be observed by both parties, but it also specifies the remedy for a breach – avoidance of the contract.¹⁰ It is fair to say that the language of the section (“a contract based upon ...”), the remedy provided (avoidance) and the family of sections to which it belongs (all of which deal with pre-contract conduct) rather suggest that obligations associated with “utmost good faith” do not necessarily persist after a contract of insurance has been entered into.¹¹ Despite these quibbles, however, the section has usually been seen as applying post-contract as well as pre-contract.

⁸ See the comments of Lord Clyde in *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd* [2001] 2 WLR 170 (HL) at [5].

⁹ It was for instance used by Romer LJ in *Seaton v Heath* [1899] 1 QB 782 (CA).

¹⁰ Similar to the UK Act, New Zealand’s Marine Insurance Act 1908 specifies avoidance as a remedy in cases of non-disclosure and misrepresentation at ss 18–20.

¹¹ See the similar views expressed in Neil Campbell “A Sceptical View of Good Faith in Insurance Law” in Duncan Webb and David Rowe (eds) *Insurance Law: Practice, Policy & Principles* (The Centre for Commercial and Corporate Law Inc, Christchurch, 2004) 205 at 207–208; Baris Soyer “Continuing duty of utmost good faith in insurance contracts: still alive?” [2003] LMCLQ 39 at 41-42; and Bennett Mapping the doctrine”, above n 3, at 166 who considers the section to be of “uncertain temporal scope”.

[13] The New Zealand equivalent of this Act, the Marine Insurance Act 1908, contains no provision corresponding to s 17 of the UK Act. There is scope for argument as to the significance of this. The existence of mutual duties of good faith was established in case-law prior to the 1906 Act, which is generally recognised as having codified existing principles of the law of utmost good faith.¹² Nor is s 17 the sole source of the obligation to act in good faith. In particular, it is clear that the mutual duties of good faith apply not only to marine insurance contracts, but to insurance contracts more generally.¹³ On the other hand, the language of s 17 has loomed large in the minds of English judges who have had to address the remedies available for post-contract breach of good faith obligations. It is well arguable that the absence of an equivalent of s 17 from the New Zealand statute book leaves the New Zealand courts with rather more flexibility than their UK counterparts.

The content of the insured's post-contract obligations of good faith

[14] The good faith obligations of an insured are often invoked to justify the rules as to fraudulent insurance claims, in particular the rule that a fraud by the insured defeats the claim.¹⁴ By fraudulently claiming,¹⁵ the insured breaches the “essential condition” of the good faith duty. An insurer may thus decline the entire claim, even though part of it was valid (eg, where the fraud was as to value) or if there was a

¹² See Bennett “Mapping the doctrine”, above n 3, at 165, and his exposition of the duty’s history at 186–192; Campbell “A Sceptical View”, above n 11, at 206.

¹³ Bennett “Mapping the doctrine”, above n 3, at 165, citing *Joel v Law Union Insurance Co* [1908] 2 KB 863; *Lambert v Co-operative Insurance Soc Ltd* [1975] 2 Lloyd’s Rep 485 (CA); *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501 (HL) at 518.

¹⁴ Malcolm Clarke *Policies and Perceptions of Insurance Law in the Twenty-First Century* (Oxford University Press, King’s Lynn, 2007) at 202.

¹⁵ What amounts to a fraudulent claim depends on whether the conduct falls within the rather tight definition of “fraud” applied in this area. “Merely” exaggerated claims may not amount to fraud. See Malcolm Clarke *The Law of Insurance Contracts* (5th ed Informa, London 2006) at [27-2B]; and in New Zealand and Australia, Kelly & Ball *Principles of Insurance Law* (looseleaf ed, LexisNexis) from [8.0060]. The approach to fraud is also discussed in Bennett “Mapping the doctrine”, above n 3, at 208 referring to *Derry v Peek* (1889) 14 App. Cas. 337 (HL); and Soyer “Continuing duty”, above n 11, at 44–45.

valid alternative basis for the claim.¹⁶ As I will indicate shortly, however, there are complexities with the application of the fraud rule in marginal cases, particularly once litigation has commenced, and also as to the nature of the remedy available where fraud is established. Judicial discomfort with resort to s 17 in this context has on occasion led to the English courts, to some extent, pushing back on the application of the fraud rule.

[15] There are a number of other areas where post-contract obligations of good faith have been invoked against the insured.

[16] In relation to third party insurance, an insured is obviously required to cooperate with the insurer in relation to any claim and the duty to do so has been linked to obligations of good faith.¹⁷ Such a duty could also, of course, be founded in express contractual provision and in any event implied given the subrogation rights of the insurer and what is necessary to enable them to be effectively exercised.

[17] The “ship’s papers” cases discussed by Lord Hobhouse in *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd*¹⁸ are sometime pointed to as exemplifying the operation in practice of post-contract obligations of good faith. These cases concerned a (now obsolete) court order “for ship’s papers” which was available in relation to marine insurance claims. The order required a wide disclosure (or a convincing explanation as to why such disclosure could not be made) of relevant documents. The documents did not have to be within the possession or power of the plaintiff. Compliance with the order was onerous and the sanction (staying the action until the order was complied with) effectively forced the insured either to comply or abandon the claim.

¹⁶ *Sampson v Gold Star Insurance Co Ltd* [1980] 2 NZLR 742 (HC); *Orakpo v Barclays Insurance Services* [1995] LRLR 443 (CA). However, see also *Kinred v State Insurance General Manager* 5 ANZ Insurance Cases 75,924; (1989) 2 NZBLC 103,589 (HC) and the discussion based on the Insurance Law Reform Act 1977, s 11.

¹⁷ Clarke *The Law of Insurance Contracts*, above n 15, at [27-4A].

¹⁸ *Manifest Shipping Co Ltd*, above n 8, at [58]–[60].

[18] But although the jurisdiction to require the production of ships' papers was justified on the basis of the insured's duty of good faith towards the underwriter,¹⁹ it plainly was not based on s 17 of the Marine Insurance Act. Failure to comply with the order could never be treated as providing a ground for the insurer to avoid the policy. As well, the requirement to provide ships' papers was dependent upon a court order being made.

[19] Good faith obligations on the part on an insured have also been invoked in the "held covered" cases.²⁰ "Held covered" clauses enable items to be "held covered" in situations where cover would otherwise be compromised or unavailable but subject to payment of an additional premium fixed by the insurer. When invoking a held covered clause, the insured must act in good faith, by making the same sort of disclosure as is required when a contract of insurance is entered into.²¹ This is unsurprising as the cases involve, in-substance, variations of the underlying contract and, associated with this, a reassessment of the risk by the insurer (associated with the fixing of the additional premium).²²

[20] In this context, *Black King Shipping Corporation v Massie (The Litsion Pride)*²³ not only provides an interesting factual situation but also represents the high water mark of the jurisprudence which supports broad post-contractual duties of good faith.

[21] Black King Shipping Corporation, acquired the *Litsion Pride* in January 1982. Black King was a one ship company but was part of a group of companies (the Macedonia Group) which owned a number of vessels. The *Litsion Pride* was mortgaged to Wayang (Panama) SA and under the security documents the owners were required to take out a war risks policy. The policy contemplated the owners paying additional premiums if the vessel entered areas where war risks were particularly acute. The mechanism by which this was to be achieved involved Black King notifying the insurers as soon as possible after the vessel sailed for, deviated

¹⁹ For example, *Boulton v Houlder Bros & Co* [1904] 1 KB 784 (CA), at 791–792 per Mathew LJ.

²⁰ Discussed by Bennett "Mapping the doctrine", above n 3, at 202–207.

²¹ *Overseas Commodities Ltd v Style* [1958] 1 Lloyd's Rep 546 (QB).

²² See Campbell "A Sceptical View", above n 11, at 208, analysing these clauses as "mini contracts" of insurance. See also Soyer "Continuing duty", above n 11, at 64–66.

²³ *Black King Shipping Corporation v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437 (QB).

towards, or was within the specified areas. Upon receipt of such a notice the insurer would fix an additional premium. Significantly, however, the policy did not provide that the obligations of the insurer were conditional upon notification having been made. In that respect it differed from the “held covered” cases already mentioned. The policy thus put pressure on the integrity of the owners as it provided an incentive not to disclose until after the event.

[22] In May 1982 (ie during the Iran/Iraq war) the vessel was chartered to make a voyage from Europe to a port in the Persian Gulf, which was later nominated (by 9 July, at the latest) to be Bandar Khoimeini. This port was the most dangerous port in the Gulf and the freight rates were correspondingly high. And, of course, also correspondingly high would have been the additional premiums which the insurer would have imposed if the appropriate notice had been given. The vessel entered the specified area on 2 August 1982. On 9 August the vessel was struck by a missile from an Iraqi helicopter and as a result it was lost. The owners did not comply with their notification obligations in a timely way. Instead, they notified the brokers of the entry of the *Litsion Pride* into the specified area by a letter which was dated 2 August but was not received until 12 August. The owners claimed that the letter had not been sent due to misadventures in their office and a secretary being away. The Judge, however, held that the letter had been back-dated and was not written until after the casualty. At the time, the Macedonia Group was under financial pressure and could not have paid the extra premium which the insurers would have imposed had timely notice been given.

[23] The claim on the insurance policy was, in the end, prosecuted by Wayang only. During the course of the proceedings the owners sought to play off the insurer and Wayang and generally behaved in a highly unusual, irregular and improper way. The judgment of Hirst J deals at very considerable length with the extraordinary conduct of the owners in relation to the litigation. Although this conduct was strictly irrelevant to the claim as between Wayang and the insurer, the Judge’s very adverse view of that conduct may have coloured his view of the bona fides of the owners in relation to events leading to, and in the immediate aftermath of, the sinking of the *Litsion Pride*.

[24] The Judge held, as a matter of construction, that the failure by the owners to notify the insurer as provided for by the policy did not discharge the liability of the insurers.

[25] This left in contention arguments based on fraud and breach of good faith.

[26] The Judge concluded that the owners had intended that the *Litsion Pride* should slip in and out of the Gulf in circumstances where they believed they remained covered under the war risks policy but could defer giving notice (and thus liability for an additional premium) until (and unless) the risk crystallised. Although the owners' relevant belief was consistent with the construction of the policy which the Judge adopted (namely that giving timely notice was not a pre-condition to liability), the Judge saw their overall conduct as fraudulent. The Judge also found that the back-dating of the 2 August notification tainted the whole claim with fraud. As well, and for good measure, he found that the conduct of the owner's broker in relation to initial discussions about the claim was fraudulent.

[27] Interestingly the insurers did not seek to avoid the policy but instead simply defended the claim (rather suggesting that s 17 was not being invoked). The Judge concluded that avoidance of the policy was not required and that the fraud provided a defence to the claim.

[28] The Judge's findings of fraud rendered academic an assessment of the extent to which good faith obligations apply post-contract but, undaunted by this, the Judge concluded that the owners were subject to a post-contract duty of utmost good faith which, in the context of a contractual requirement for notice, required disclosure of information material to any decision which the insurer might have to make (including, in the present case, the fixing of the additional premium and whether to obtain reinsurance). He also concluded that in relation to claims, the duty of good faith extended to what he called "culpable misrepresentation or non-disclosure".²⁴ Each of the three examples of the post-contractual duty discussed above, were relied upon to support this conclusion.

²⁴ *The Litsion Pride*, above n 23, at 512.

[29] The Judge's conclusion, albeit reached in a context where contractual notice was required, did not sit easily with the general principle that good faith obligations do not bite where the insured acts in a way which increases risk. So "[i]f a person who insures his life goes up in a balloon, that does not vitiate his policy ... A person who insures may light as many candles as he please in his house, though each candle increases the danger of setting the house on fire".²⁵ Indeed, it is well established that even where the insurer has the contractual right to cancel a policy, there is no continuing obligation on an insured to inform the insurer about circumstances which might induce an insurer to do so.²⁶

[30] Perhaps unsurprisingly, the broad approach to good faith obligations taken by Hirst J in the *Litsion Pride* was over-ruled by the House of Lords in *Manifest Shipping*.

[31] In this case, the primary and unsuccessful defence of the insurer to a claim associated with the loss of a ship caused by an engine room fire was that with the privity of the owner the vessel had been sent to sea in an unseaworthy state (cf s 39(5) of the Marine Insurance Act 1906 (UK)). A secondary defence, however was that there had been culpable misrepresentation or non-disclosure on the part of the owners in prosecuting the claim in that they had not made available all information in their possession, particularly two reports into earlier shipping casualties. Both these reports were privileged. One of them had been mislaid and only located after the trial had begun. The insurer went as far as to argue that it was a breach of the insured's s 17 duty of good faith to assert privilege in relation to a document which might assist the insurer to resist the claim. Given particularly that the insurer was unable to make good its s 39(5) defence despite eventually having access to the privileged reports, this argument was distinctly short on merit.

²⁵ *Baxendale v Harvey* (1849) 4 H & N 445 (Court of Exchequer) at 449, 452. See also Clarke *Policies and Perceptions*, above n 14, discussing the problem of aggravated risk at 161–164.

²⁶ See *Commercial Union Assurance Co v Niger Co* (1922) 13 Ll L Rep 75 (HL) and *New Hampshire Insurance Co v MGN Ltd* [1997] L.R.L.R. 24 (CA).

[32] The House of Lords concluded that there is a clear distinction to be made between the pre-contracting duty of disclosure and any duty of disclosure which applies after the contract is entered into. Lord Hobhouse put it this way:²⁷

[T]here is a clear distinction to be made between the pre-contract duty of disclosure and any duty of disclosure which may exist after the contract has been made. It is not right to reason, as the defendants submitted that your Lordships should, from the existence of an extensive duty pre-contract positively to disclose all material facts to the conclusion that post-contract there is a similarly extensive obligation to disclose all facts which the insurer has an interest in knowing and which might affect his conduct. The courts have consistently set their face against allowing the assured's duty of good faith to be used by the insurer as an instrument for enabling the insurer himself to act in bad faith. An inevitable consequence in the post-contract situation is that the remedy of avoidance of the contract is in practical terms wholly one-sided. It is a remedy of value to the insurer and, if the defendants' argument is accepted, of disproportionate benefit to him; it enables him to escape retrospectively the liability to indemnify which he has previously and (on this hypothesis) validly undertaken. Save possibly for some types of reinsurance treaty, it is hard to think of circumstances where an assured will stand to benefit from the avoidance of the policy for something that has occurred after the contract has been entered into; the hypothesis of continuing dealings with each other will normally postulate some claim having been made by the assured under the policy.

[33] Lord Hobhouse made it clear that in his view the reasons given by Hirst J in *The Litsion Pride* had not warranted dismissing the claim. In particular, he rejected the conclusion of Hirst J that non-fraudulent misrepresentation or non-disclosure would warrant avoidance under s 17.²⁸

[34] Since the *Manifest Shipping* judgment, the main English decisions in relation to the post-contract obligation of good faith have involved fraud. The law as it has developed is pretty complex, as the Law Commission of England and Wales and the Scottish Law Commission have recognised.²⁹ Although the detail of these developments is outside the scope of this paper, the issues which the courts have had to address are of relevance.

²⁷ *Manifest Shipping Ltd* (HL), above n 8, at [57].

²⁸ At [71].

²⁹ It is reviewed at length in a discussion paper issued on 9 July 2010 by the Law Commission (of England and Wales) and the Scottish Law Commission, *Reforming Insurance Contract Law Issues Paper 7: The Insured's Post-Contract Duty of Good Faith*.

[35] First and foremost there is the reality that the common law rules as to fraudulent claims treat dishonest plaintiffs in insurance cases far more harshly than plaintiffs in other litigious contexts. The fraudulent insurance claimant loses the good as well as the bad part of the claim. The policy reasons for this are not the same – or at least not precisely the same – as those which justify the pre-contract disclosure rules (which rest on the assumed information imbalance, pre-contract, between insured and insurer). An insurer in relation to an insured claimant is not obviously worse off than any other person on the receiving end of a claim. But fraud on the part of a claimant in other (ie non-insurance) circumstances does not result in claim forfeiture.³⁰ Fraud against an insurer on a claim on an insurance policy seems no worse than fraud in other litigious contexts. The only policy justification for a special rule must lie in what may well be the particular susceptibility of insurers to fraud.

[36] Secondly while the English courts have not moved, at least explicitly, from the position that the only remedy for breach of the s 17 duty of good faith is avoidance, they have not seen avoidance as the appropriate remedy for post-contract misconduct. For instance, where there have been a number of separate claims made on a policy and only the last is fraudulent, does that retrospectively deny the insured cover in relation to the earlier honest claims? And if those claims have already been paid out, can the insurer recover from the insured what was properly paid on those claims? In light of such questions, the courts have recognised forfeiture of the claim, rather than avoidance of the policy, as appropriate albeit that the jurisprudential basis for this departure from s 17 is not entirely clear.

[37] Concerns broadly of the kind just mentioned have also led the courts to seek to restrict in various ways the operation of the fraud rule. For instance, since *Manifest Shipping*, the continuing obligation of good faith as to disclosure has been treated as terminating on the commencement of litigation with disclosure, and from that point, being subject to court rules.

³⁰ See *Shah v Ul-Haq* [2010] 1 All ER 73 (CA).

[38] The result of all of this is that the Law Commission of England and Wales and the Scottish Law Commission have recently categorised the law as complex and confused and have provisionally recommended the repeal of s 17.³¹

Circumstances in which an insurer might act in breach of good faith – pre-contract

[39] There are no conceptual difficulties with the imposition on an insurer, pre-contract, of a good faith disclosure obligation.

[40] As Lord Mansfield noted in *Carter v Boehm*, an insurer concealing that there was no risk to be insured against at the contract formation stage would breach the duty of good faith. Similar examples were given when the *Skandia* case³² (which I will shortly discuss in more detail) reached the House of Lords. Lord Bridge adopted the reasoning of the Court of Appeal which considered the insurer's duty at this pre-contract stage to be essentially the obverse of the insured's. The duty would "at least extend to disclosing all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer."³³ Lord Jauncey gave the example of an insurer concealing the fact that a house had already been demolished in relation to a proposed insurance against fire.³⁴

[41] In circumstances where the insured would not have entered into the contract of insurance at all if proper disclosure had been made, avoidance of the contract (and thus return of the unnecessarily paid premium) is entirely appropriate.³⁵ What is more problematic is what should happen where, as a result of non-disclosure or

³¹ Law Commission (of England and Wales) and the Scottish Law Commission, *Issues Paper 7*, above n 29, at Part 9.

³² *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665 (HC and CA) and *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1991] 2 AC 249 (HL) [*Skandia*].

³³ *Skandia* (HL) at 268 per Lord Bridge.

³⁴ *Skandia* (HL) at 282 per Lord Jauncey.

³⁵ Andrew McGee *The Modern Law of Insurance* (2nd ed LexisNexis Butterworths, Bath, 2006) at 180, gives the comparable example of an insurer who, after receiving premiums obtained fraudulently by its representative, was forced to refund all premiums paid with no deduction for cover provided,

misrepresentation, the insurance policy taken out is not right for the circumstances of the insured. Such an instance might be thought to have been contemplated by what Lord Bridge had to say in *Skandia*. Of course, where the insured's real complaint is that the policy taken out has not responded as expected to the contingency insured against, avoidance (and the recovery of the premium) is an inadequate remedy – assuming of course that proper disclosure by the insurer would have resulted in effective insurance being arranged. Despite this, as will already be apparent, an insurer faced with a claim in such circumstances has considerable scope to argue that, inadequate or not, the only remedy available to an insured is avoidance.

Circumstances in which an insurer might act in breach of good faith – post-contract

An overview

[42] Just as there is doubt as to the policy justification for imposing post-contract good faith obligations on an insured, there is considerable scope for argument whether – reciprocity and symmetry considerations aside – there is a need for similar post-contract obligations to apply to an insurer.³⁶ And given the very limited scope of the post-contract good faith obligations of an insured, reciprocity and symmetry considerations are, to my way of thinking, something of a makeweight in this context. Generally speaking I am reasonably sceptical of the utility of seeking to impose post-contract good faith obligations on insurers.

[43] This scepticism will become apparent as I discuss the general types of circumstance where arguments as to such obligations are deployed.

Handling of claims by third party insurers

³⁶ An argument which is well advanced by Campbell “A Sceptical View”, above n 11. The contrary view is advanced by Fred Hawke “Utmost Good Faith – What Does it Really Mean?” (1994) 6 ILJ 91; and A Naidoo & D Oughton, “The confused post-formation duty of good faith in insurance law: from refinement to fragmentation to elimination?” (2005) JBL 346, who at 370 consider that imposing restrictions on an insurer's post-contractual conduct will provide flexibility for the assured in light of the “draconian remedy of avoidance”.

[44] This is a frequent source of litigation in North America, for instance in circumstances where the third party insurer has foregone an opportunity to settle a claim at or near the indemnity limit with the result that the case has gone to trial, a more substantial award results with the insured liable for the uninsured portion.³⁷

[45] Although I am not aware of New Zealand cases directly on point, I have no doubt that New Zealand courts would be slow to afford a third party insurer complete autonomy in relation to the defence and or settlement of proceedings against the insured.³⁸

[46] In this respect I think that the New Zealand courts would follow, at least broadly, the approach taken in *Groom v Crocker*³⁹ towards restricting the insurer in its exercise of discretion. The plaintiff was the driver, and his brother Aubrey Groom was the passenger, in a car which was struck by a truck. Both were injured, Aubrey Groom seriously so. Sole blame for the accident rested with the truck driver. Mr Groom's insurers and the insurers of the owner of the truck considered that in the case of Aubrey Groom's claim for damages, the "better" defendant (in terms of the likely perception of the jury) was Mr Groom. Both sets of insurers were also involved in relation to another accident where their roles were reversed, that is the truck owner's insurer had the more sympathetic defendant. So they entered into an arrangement under which in the Groom case, liability would be admitted by Mr Groom but denied by the truck driver and that similar steps should be taken in the other case. Part of the implementation of this plan involved the solicitors (Messrs Crockers) appointed by Mr Groom's insurers writing to his brother's solicitors confirming that Mr Groom admitted liability. Aubrey Groom went to trial (of course only as to damages) on the basis of that admission and the jury awarded him £900. Then Mr Groom sued Crockers for, inter alia, defamation for which he was

³⁷ See the discussion in Craig Brown "Damages for Bad Faith Denials of Insurance Claims in Canada; Continuing a Tradition of Judicial Restraint" [2002] NZ Law Rev 453; and Hawke "Utmost Good Faith", above n 36.

³⁸ See *Royal Insurance Fire & General (New Zealand) Ltd v Mainfreight Transport Ltd* 7 ANZ Insurance Cases 77,972 (CA) which forced the insurer, who had initially denied liability, to accept a settlement reasonably made by the insured.

³⁹ *Groom v Crocker* [1939] 1 KB 194 (CA).

awarded £1,000 damages, despite the publication (of the letter just referred to) being confined to his brother's solicitors. In his judgment in the Court of Appeal MacKinnon LJ postulated a discussion in which Aubrey said to the plaintiff, "You have all the luck. I had my skull fractured and I only got £900. But because someone said you fractured it you get £1,000. And it was only said to my solicitors who would not believe it for a minute." The Court of Appeal, however, had no difficulty upholding the award.

[47] Although this was a defamation case against the solicitors it turned largely on whether the plaintiff's insurers were entitled, as they claimed, to handle the claim as they chose; a claimed entitlement which the Court of Appeal rejected.

[48] It is well open to question whether the result (ie broadly that a third party insurer must act reasonably and take into account the interests of the insured and not act for collateral purposes) turns on a broad duty of good faith,⁴⁰ or rather, just reflects a pragmatic judicial response to a situation in which the third party insurer is acting, at least partly, on behalf of the insured.

Not meeting a valid claim.

[49] In England, the law is that an insurer is not required to pay damages for non-payment of a valid claim, based on a characterisation of an insurance payment as a secondary obligation to pay damages.⁴¹ And there is no help to be gained (in aid of damages) by contending that this was done in breach of the good faith duty. This situation is currently being examined by the Law Commission and the Scottish Law Commission.

⁴⁰ See also *Distillers Co Biochemicals (Australia) Pty Ltd v Ajax Insurance Co Ltd* (1974) 130 CLR 1 at 31.

⁴¹ This issue is discussed by the Law Commission (of England and Wales) and the Scottish Law Commission, *Issues Paper 7*, above n 29, citing *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep IR 111 (CA) as emblematic of the problematic nature of this approach.

[50] In New Zealand, the situation is rather different. Losses caused by an insurer's breach of contract in such a manner are able to sound in ordinary contractual damages.⁴²

[51] Good faith arguments are sometimes deployed in this context. For instance, in *Cedenco Foods Ltd v State Insurance Ltd*,⁴³ the insurer had failed to promptly pay an established valid claim and the High Court judge awarded exemplary damages on the basis that there was no excuse for the lateness of the payment. This award was later set-aside by the Court of Appeal which, however, left open the question of whether or not damages could be awarded for breach of the duty of good faith.

[52] I confess to difficulty in discerning a role for good faith arguments where the only complaint is that the claim was not promptly met. The insurance policy will set out the payment obligations of the insurer. This means that the obligation to pay is provided for contractually without any need to resort to good faith arguments. In most circumstances, interest will provide appropriate compensation for lateness of payment and in circumstances where particular losses have been suffered for which damages are appropriate, New Zealand common law principles might be thought to be adequate to ensure that such damages are recovered.⁴⁴

[53] Rather more doubtful is whether the New Zealand courts would go down the path taken by the Supreme Court of Canada in *Whiten v Pilot Insurance Co*⁴⁵ The insurers declined liability in relation to a house fire alleging arson. The jury at trial took the view that the arson allegation was contrived and not made in good faith. So the plaintiff recovered \$340,000 for her direct claim on the policy along with punitive damages of \$1,000,000 for breach of the insurer's duty of good faith. The punitive damages award was reduced to \$100,000 in the Ontario Court of Appeal but restored by the Supreme Court. The following passage from the head note gives a fair summary of the case:

⁴² See *New Zealand Insurance Co Ltd v Harris* [1990] 1 NZLR 10 (CA); *Stuart v Guardian Royal Exchange Assurance of New Zealand Ltd* (1988) 5 ANZ IC 60-884 (HC). Compare also *Clifton-Mogg v National Bank of New Zealand* (2001) 10 TCLR 213 (HC) discussed below at [64].

⁴³ *Cedenco Foods Ltd v State Insurance Ltd* (1997) 6 NZBLC 102 (CA).

⁴⁴ Although for issues relating to damages for failure to pay money, see John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (3rd ed, LexisNexis, 2007) at 706.

⁴⁵ *Whiten v Pilot Insurance Co* [2002] 1 S.C.R. 595.

The jury's award of punitive damages, though high, was within rational limits. The respondent insurer's conduct towards the appellant was exceptionally reprehensible. It forced her to put at risk her only remaining asset (the \$345,000 insurance claim) plus \$320,000 in costs that she did not have. The denial of the claim was designed to force her to make an unfair settlement for less than she was entitled to. The conduct was planned and deliberate and continued for over two years, while the financial situation of the appellant grew increasingly desperate. The jury evidently believed that the respondent knew from the outset that its arson defence was contrived and unsustainable. Insurance contracts are sold by the insurance industry and purchased by members of the public for peace of mind. The more devastating the loss, the more the insured may be at the financial mercy of the insurer, and the more difficult it may be to challenge a wrongful refusal to pay the claim.

The jury decided a powerful message of denunciation, retribution and deterrence had to be sent to the respondent and they sent it. The obligation of good faith dealing means that the appellant's peace of mind should have been the respondent's objective, and her vulnerability ought not to have been aggravated as a negotiating tactic. It is this relationship of reliance and vulnerability that was outrageously exploited by the respondent in this case.

An award of punitive damages in a contract case, though rare, is obtainable. It requires an "actionable wrong" in addition to the breach sued upon. Here, in addition to the contractual obligation to pay the claim, the respondent was under a distinct and separate obligation to deal with its policyholders in good faith. A breach of the contractual duty of good faith was thus independent of and in addition to the breach of contractual duty to pay the loss. The plaintiff specifically asked for punitive damages in her statement of claim and if the respondent was in any doubt about the facts giving rise to the claim, it ought to have applied for particulars.

[54] It is never satisfactory when a deep-pocketed defendant seeks to burn off a meritorious but impecunious plaintiff. But I confess to reservations whether gaming behaviour of this type by an insurer is more reprehensible than the same sort of behaviour by a litigant in non-insurance litigation. I accept that peace of mind (and similar benefits) may be part of what an insured is bargaining for, but to the extent that the insured's contractual expectations are disappointed by the conduct of the insurer, compensatory damages seem to me to be the appropriate response.

Some concluding observations

[55] I am inclined to see the cases in which post-contract good faith obligations on the part of an insurer have been invoked as primarily turning on either what is implicit in particular circumstances (such as the exercise of rights of subrogation) or alternatively on the peace of mind (or similar) expectations of the insured which

form the basis of the particular contract of insurance. While I do not want to be taken as dismissing the possibility of an insured being able to sue an insurer on a free-standing claim based directly on breach of good faith, I am yet to be convinced that such a free-standing claim is sustainable.

What remedies are available for breach by an insurer of the obligation of good faith?

[56] I am very conscious of the reality that so far I have avoided confronting the critical issue which this paper's title suggests is to be addressed. It is, however, an issue which can hardly be sensibly dealt with in the absence of a reasonable understanding of the broader insurance law context. In particular, for the reasons which I have just given, I think it unrealistic to explore the question except in relation to pre-contract good faith obligations.

[57] The leading case is *Skandia*,⁴⁶ which I have already mentioned, a case which involved two concurrent but independent series of frauds.

[58] The primary fraudster obtained very large sums of money from a syndicate of international banks. In the end, the case as determined in the Court of Appeal and House of Lords focussed on what were referred to in the judgments as "the first Ultron loan" and "the second Ultron loan" and the claim which remained in play was confined to the second of these loans. The security the fraudster offered consisted of gemstones, "baubles of little value" which had been fraudulently over-valued. In due course, the fraudster disappeared with the money. The banks had

⁴⁶ *Skandia*, above n 32.

not relied solely on the security provided but also on credit insurance. In relation to this, a separate series of frauds was perpetrated by their insurance broker, Mr Lee. His frauds consisted of over-stating to the banks the level of insurance that he had arranged. In relation to the first Ultron loan, there was for some months a gap between the level of insurance which had been obtained and what he represented had been obtained. After the first Ultron loan had been advanced but before the second, Mr Dugate (who was the insurer's representative) came to appreciate that Mr Lee had misrepresented to the banks the insurance in relation to the first Ultron loan, albeit that he had eventually managed to fill the gap (ie made good on the required level of cover). Mr Dugate took no steps to alert the banks to the fraud of their broker. Before the second Ultron loan was advanced, Mr Lee, unbeknown to Mr Dugate, again misrepresented to the banks the extent of the cover obtained. If the banks had known of his fraud they would not have advanced the second Ultron loan. But conversely, if Mr Lee's representations to the banks had been true, they would have been no better off because of fraud exclusions in the cover which (on this hypothesis) would have been triggered by the fraud of the primary fraudster.

[59] The banks claimed against the insurers on a number of bases including a free-standing claim for breach of an obligation of good faith based on the failure of Mr Dugate to tell the banks about Mr Lee's fraud in relation to the first Ultron loan. As the case went through the courts, the approach to this claim became narrower. In the High Court, Steyn J accepted that there had been a breach of duty and awarded damages. The Court of Appeal agreed that the duty of good faith had been breached but concluded that the only remedy for this was avoidance. And then in the House of Lords, it was held that there had been no breach of the duty. This was on the basis that because the broker's fraud on the banks would not have triggered the fraud exclusion clause (ie would not have permitted the insurers to decline cover) it was not sufficiently connected to the risk to require disclosure. It is fair to say that this involves a very limited view of the extent of the disclosure obligations of an insurer.

[60] For good measure the House of Lords considered the remedies available for breach of the duty, and confirmed the Court of Appeal's finding that at the pre-

contract stage, the only remedy available is avoidance.⁴⁷ Further, the law lords concluded that Mr Lee's fraud in relation to the second Ultron loan (and thus any antecedent breach of duty by the insurers) in effect merely provided the occasion for the loss which was suffered rather than relevantly causing it.

[61] In *Skandia*, the Court of Appeal, addressed the question whether the insurer's non-disclosure of Mr Lee's conduct could amount to a misrepresentation under the Misrepresentation Act 1967 (UK) (which relevantly corresponds to the Contractual Remedies Act 1979). The argument was that the banks were entitled to treat Mr Dungate's silence about Mr Lee as an implied representation that he knew of nothing materially reflecting on Mr Lee's probity. This argument was not a great fit for the statutory test, which requires misrepresentations to be "made".⁴⁸ It was also not established that Mr Dungate had led banks to believe that he was making any representation as to Mr. Lee's honesty. Nor was there any evidence that he intended such an implied representation to be relied on by the banks. And any reliance by the banks on the alleged implicit representation was itself at best implicit. Further, on the basis of the House of Lords approach to causation, an implied representation as to Mr Lee's probity was of no assistance to the banks, because the relevant counterfactual, in terms of assessing damages, would have been based on the required level of insurance having been obtained. This would not have assisted the banks because such insurance, if obtained, would not have responded to the claim because it would have had a fraud exception.

[62] I rather think that the very tenuous causation argument of the banks in the *Skandia* case meant that this litigation provided a very inauspicious context for consideration of whether the courts might go beyond avoidance as the remedy available in the case of a free-standing claim based on breach of good faith. Before discussing this point further, however, I think it necessary to note that because of the Fair Trading Act 1986, the general New Zealand legal context is very different from that of the United Kingdom. Applying to "misleading or deceptive conduct" in trade, s 9 of that Act is not subject to the same constraints as the statutory claim for

⁴⁷ Compare *Cedenco*, above n 43, where this point was not decided.

⁴⁸ *Skandia* (CA), above n 32, at 790. See also the discussion in Kelly & Ball as to non-disclosure and misrepresentation in *Principles of Insurance Law*, above n 15, summarising commentators' views at [2.0270].

misrepresentation. And where there is a duty to speak, silence might be thought to be within the section.⁴⁹

[63] Unsurprisingly, s 9 of the Fair Trading Act has often been invoked in insurance cases.

[64] A reasonably apposite example is a case I heard, *Clifton-Mogg v National Bank of New Zealand*.⁵⁰ Mrs Clifton-Mogg and her partner Craig Hamilton had been required to take out life insurance associated with a mortgage from the bank. The bank arranged this insurance through an associated insurer for whom the bank acted as agent. During discussions with the bank officer who was dealing with the insurance proposal, Mr Hamilton gave a fair account of his reasonably substantial alcohol consumption and discussed his occupation as a truck driver including that fact that he drove for up to 12 hours a day. The bank officer told Mrs Clifton-Mogg and Mr Hamilton that the policy only excluded cover for suicide. In fact, the policy that he entered into contained wide-ranging exclusions relating to being under the influence of alcohol as well as criminal activities. This latter exception could arguably exclude cover if any death was related to motor vehicle infractions. As it turned out Mr Hamilton died four months later while driving with an excess level of alcohol in his blood, and the insurer refused to pay out.

[65] The litigation was against the bank rather than its associated insurer and was based on the Fair Trading Act 1986 and not the Contractual Remedies Act 1979. I did rather think that expectations damages which Mrs Clifton-Mogg sought (in effect the benefit which would have been received if the policy had responded) would have been rather more obviously recoverable under the Contractual Remedies Act than under the Fair Trading Act. As it turned out, I did in the end conclude that the appropriate measure of damages assessed on a reliance basis was the same as expectations damages; this because I found that if the policy had not been misrepresented, she and Mr Hamilton would have taken out a policy which would

⁴⁹ See *Des Forges v Wright* [1996] 2 NZLR 758 (HC) at 764; *Unilever NZ Ltd v Cerebos Greggs Ltd* (1994) 6 TCLR 187 (CA) at 192 per Gault J; and *Hieber v Barfoot & Thompson Ltd* (1996) 5 NZBLC 104,179 (HC) per Kerr J.

⁵⁰ *Clifton-Mogg*, above n 42.

have responded to his death. So in the end, Mrs Clifton-Mogg wound up in the same position as she would have been in if more appropriate insurance had been taken out.

[66] Unaddressed in the *Clifton-Mogg* case is whether the same result would have been achieved if the claim had simply proceeded on the basis that there had been an obligation on the part of the insurer and/or its bank agent to disclose the extent of the exclusion clause or the inappropriateness of that policy for mortgage protection purposes. Such a claim would plainly have been rather more difficult to establish not only legally but also factually, particularly in terms of showing that but for the non-disclosure a more appropriate mortgage protection policy would have been taken out. I would, however, be slow to conclude that such a claim would have been unsustainable.

[67] It is well established that the insurer is not under a common law duty to warn the insured about the scope of an insured's duty of disclosure.⁵¹ It is likewise clear that such failure does not amount to misleading conduct under the Fair Trading Act.⁵² Richardson J, however, has expressed the view that based on mutual good-faith obligations, it is "at least arguable that ... those insurers concerned about moral risk should put all their cards on the table and signal that fair and accurate answers to all questions in a proposal may not discharge the proponent's disclosure obligations."⁵³

[68] Also material in this context is *Dome v State Insurance General Manager*.⁵⁴ Faced with Mr Dome's incomplete command of the English language, a clerk in the insurance office completed the relevant form for him. The Court found that in doing so, the clerk had misunderstood Mr Dome's disclosure ("in his own limited way") of the fact that there had been a previous fire at the property he wished to insure. After discussing the utmost duty of good faith as it applied to a proposer's duty of

⁵¹ See Kelly & Ball *Principles of Insurance Law*, above n 15, at [2.0050], which considers this surprising given the scope of disclosure expected from an insured.

⁵² *Quinby Enterprises Ltd (in liq) v General Accident Fire and Life Assurance Corp plc* [1995] 1 NZLR 736 (HC).

⁵³ *Gate v Sun Alliance* (1995) 8 ANZ Ins Cas 75.806. See also Law Commission *Some Insurance Law Problems* (NZLC R46, 1998) from 11.

⁵⁴ *Dome v State Insurance General Manager* (1988) 2 NZBLC 102,988 (HC).

disclosure, the Court held that there was a duty on the insurer to ensure that what the insured was trying to disclose was taken on-board.

[69] For obvious reasons, I am reluctant to express a firm view one way or the other on whether a strict “avoidance only” approach would be taken by New Zealand courts where an insurer had breached its obligations of good faith. That said, there are some reasonably obvious and substantial arguments which are available to support a broader approach. Such arguments might, inter alia, be based on:

- (a) The reality that in circumstances analogous to those in *Clifton-Mogg*, avoidance is an inadequate remedy;
- (b) The absence from the New Zealand statute book of an equivalent to s 17 of the Marine Insurance Act 1906 which has acted as such a fetter on the English courts and is now likely to be repealed.
- (c) The significance of the Fair Trading Act and its impact on the general New Zealand legal landscape.⁵⁵

⁵⁵ Cf the comments in *Body Corporate 202254 v Taylor* [2009] 2 NZLR 17 (CA) at [95]–[96].