Chapter 2
Duty of Utmost Good Faith

Abstract The duty of utmost good faith forms the cornerstone of insurance law codified in s17 of the *Marine Insurance Act 1906* of the United Kingdom. It is a wide and all-encompassing duty that has arisen as a result of insurance contracts being *uberrimae fidei* in nature. This chapter examines the origin, meaning and juridical basis of the duty of utmost good faith; its applicability to non-marine insurance contracts in the United Kingdom, Malaysia and Australia; its scope or continuing nature with respect to the insurer's and insured's obligations; and the recent legislative reforms in the area in the jurisdictions examined.

2.1 Introduction

The duty of utmost good faith, which is the cornerstone of insurance law, has long been codified in s17 of the *Marine Insurance Act 1906* of the United Kingdom. The section provides that:

> 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 wide and all-encompassing duty has arisen as a result of insurance contracts being *uberrimae fidei* in nature. This chapter proposes to examine the origin, meaning and juridical basis of the duty of utmost good faith; its applicability to non-marine insurance contracts in the United Kingdom, Malaysia and Australia; its scope or continuing nature with respect to the insurer's and insured's obligations; and the recent amendments in the area in the jurisdictions examined.

It should be noted at this juncture, that there has been substantial reform in the area with respect to the United Kingdom following the enactment of the *Consumer Insurance (Disclosure and Representations) Act 2012* to regulate consumer

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insurance contracts and the *Insurance Act 2015* to primarily regulate non-consumer insurance contracts.[1] Malaysia has also followed suit with the introduction of its *Financial Services Act 2013* and *Islamic Financial Services Act 2013*, regulating insurance and *takaful* contracts respectively, with Australia having led the way, as far back as 1984 via its *Insurance Contracts Act 1984* (Cth). Nevertheless, this chapter traces the historical development of this important duty in order to effectively evaluate the adequacy of the recent amendments.

The duty of utmost good faith is essentially a broad duty existing in *uberrimae fidei* contracts, of which insurance contracts are a type. It requires both parties to the contract to disclose all material facts and act honestly towards each other without any underhanded behaviour. It is a positive duty imposed on the parties that goes beyond the obligation present in ordinary contracts, which merely requires parties to refrain from engaging in conduct that is fraudulent, misrepresentative or causes undue influence. Over and above this however, there has been some support for the view that it might also be wide enough to include conduct depicting fair play and co-operation as highlighted by Steyn J in *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd.*[2]

2.2 The Meaning of and Juridical Basis for the Duty

The question that arises when addressing the meaning that should be assigned to the concept of utmost good faith is whether it should receive a broad or narrow interpretation. As mentioned earlier, the duty of utmost good faith can generally be described as a positive requirement on both the insurer and insured to act honestly towards each other without deception, with 'utmost' merely serving to emphasize the duty.

As far as the English courts have been concerned, a rather conservative stance seems to have been taken. This is apparent from Slade LJ's concern voiced at the Court of Appeal in *Le Banque Financiere v Westgate Insurance Co Ltd*[3] in response to an indication by Steyn J in *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd*[4] that utmost good faith may be wide enough to include broad based notions such as fair dealing and co-operation:

> …in the case of commercial contracts, broad concepts of honesty and fair dealing, however laudable, are a somewhat uncertain guide when determining the existence or otherwise of an obligation which may arise even in the absence of any dishonest or unfair intent … More importantly, in our judgment, it would be too broad a proposition to state that any fact is

[1]The *Insurance Act 2015* (UK) is however, not exclusively applicable to non-consumer insurance contracts, in that it also contains provisions dealing with consumer insurance.

[2][1987] 1 Lloyd's Rep 69.

[3][1988] 2 Lloyd's Ll Rep 513.

[4][1987] 1 Lloyd's Rep 69.

> material if it is [in the language of the *Marine Insurance Act 1906*] calculated to influence the decision of the insured to conclude the contract of insurance. To give one example, it might well be that in a particular case proposed insurers would be aware of another reputable underwriter who would be prepared to underwrite the same risk at a substantially lower premium. In our judgment the mere existence of the relationship of insurers and insured would not place upon them the duty to inform the insured of this fact. …[The duty on the insurer, however] must 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 to place the risk for which he seeks cover with that insurer.[5] (Author's clarification added)

The Australian[6] and American courts on the other hand, have adopted a more liberal and progressive description of what amounts to utmost good faith, by ascribing to it the essential elements of fairness, reasonable conduct and propriety or honesty, although it is not necessary to show dishonesty for there to be a lack of utmost good faith. In fact, in as far back as 1933, it was held in the leading American case of *Kirk La Shelle Co v Paul Armstrong Co*[7] that:

> In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.[8]

Academics[9] in the area have generally had a consensus that utmost good faith in insurance contracts requires more than mere mechanical performance according to the letter of the contract. The question however, remains as to how much more.

Some help can be found in the foreword to Steven Burton's article where he argues that:

> …the duty to perform in good faith applies when one party exercises discretion in performance and thereby controls the other party's anticipated benefit. The discretion exercising party performs in good faith when it exercises discretion for any purpose within the reasonable contemplation of the parties, and in bad faith when discretion is used to recapture foregone opportunities.[10]

His analysis takes the concept of good faith far beyond that of a mere absence of bad faith but not so far as to secure the other party's expectations under the contract. His theory may well be relevant to insurance contracts because one party, namely the insurer, usually controls both the content (being contracts of adhesion) and administration of the insurance contract which includes the disposition of the

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[5] *Le Banque Financiere v Westgate Insurance Co. Ltd.* [1988] 2 Lloyd's L1 Rep 513, 544.

[6] See: Sutton (1999, pp. 157–158); *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1.

[7] 263 NY 79, 188 NE 163 (1933).

[8] Ibid. 167; Also, unlike other common law jurisdictions, the American *Uniform Commercial Code* defines 'good faith' as 'honesty in fact in the conduct or transaction concerned'.

[9] See: Finn (1989a, 1989b, p. 87), Tarr (1989).

[10] Burton (1980, p. 369).

benefits thereunder to the insured. In focusing on the conduct of the party having the principal discretion as to the time and manner of performance of the contract, he argues that the proper 'expectation interest' of one party to a contract is that the other will not take advantage of any discretion granted to it by the type of agreement, in order to avoid the sacrifice of economic opportunity necessitated by performance.

In this regard, it has been said that:

> …the rhetoric of 'utmost good faith' must never substitute for a careful consideration of what is good law in the particular and modern context…[and] the future development of the doctrine of utmost good faith must take place against an evaluation of the extent to which it continues to be appropriate for parties to insurance contracts.[11]

The juristic basis for the pre-contractual duty of utmost good faith has long been entrenched in s17 of the *Marine Insurance Act 1906* (UK). This is because s17 provides that insurance contracts are 'based upon' the utmost good faith which presupposes that it relates to the formation of the contract, and is supported by its positioning at the beginning of ss17–20 of the *Marine Insurance Act 1906* (UK) under the heading 'Disclosure and Representation', that relate to the formative process.[12] This coupled with the information imbalance that exists in favour of the insured justifies its imposition.[13] The remedy for its breach therefore, is that of avoidance of the contract ab initio under s17, which is a severe remedy that has retrospective effect and no right to damages.[14]

The justification for the post-contractual duty of utmost good faith on the other hand, is in response to the problem that unlike most other general contracts which have some device for policing unfair terms, there has been a 'remarkable lack of control in insurance contracts' in favour of insurers. Therefore, in addition to the *contra proferentum* rule, something along the lines of a post-contractual duty of utmost good faith was needed.[15]

The juristic basis for this post-contractual duty however, is less settled. First, since the words of s17 are wide enough to cover 'a continuing mutual duty of disclosure that runs throughout the duration of the contract of insurance,'[16] and unlike ss18–20 which are restricted to the pre-contractual stage, it would appear that

[11]Bennett (1999, p. 221).

[12]Bennet, above n 11, 219. Sections 18–20 of the *Marine Insurance Act 1906* (UK) have however, been repealed in recent times by s21 (2) of the *Insurance Act 2015* (UK).

[13]See: *Carter v Boehm* (1766) 3 Burr 1905 (Lord Mansfield); *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co* [1994] 3 All ER 581.

[14]This section draws on research appearing in: Thanasegaran (2011, p. 193). It is worth noting that this much criticized remedy of avoidance ab initio has been deleted from s17 by s14 of the *Insurance Act 2015* (UK).

[15]Hasson (1984, pp. 517–518); See: *The Mercandian Continent* [2001] EWCA Civ 1275 [11] (Longmore LJ).

[16]Naidoo and Oughton (2005, p. 347).

avoidance of the contract would be the drastic remedy for breach. Support for this reasoning can be found in Hirst J's judgment in *Black King Shipping v Massie (The Litsion Pride)*[17] where a post-contractual duty of good faith was clearly said to exist between both insurers and insureds.

On the other hand, the view in favour of detaching the post-contractual duty from s17 altogether as its juristic basis and fragmenting it into post-contractual terms and claims handling; and fraudulent claims has much to be said for it.[18] The former has been convincingly argued to be based on an implied term of the insurance contract but applicable in a more flexible manner than at the pre-contractual stage.[19] This would in turn give rise to the more equitable remedy of prospective avoidance of the relevant claim and/or damages.[20] As for the juristic basis for fraudulent claims in turn, it is founded on the public policy argument that no one should benefit from their wrong doing.[21]

Amongst the reasons for this view is that since the *Marine Insurance Act 1906* (UK) was a codifying statute, it would have been intended to retain the common law position prior to 1906, where such a wide post-contractual duty giving rise to avoidance as a remedy was in fact rejected at the time by Blackburn J in *Cory v Patton*.[22] Furthermore, as there is no longer an information imbalance between the parties post-contract, express contractual provisions can more than adequately regulate the rights and obligations of the parties concerned without the need for an overarching duty based on s17.[23] It would appear that this reasoning is more in line with the recent reforms that have taken place in insurance.

2.3 Continuing Nature of the Duty of Utmost Good Faith

The notion of good faith in insurance contracts as embodied in s17 of the *Marine Insurance Act 1906* (UK) was introduced in the landmark case of *Carter v Boehm*[24] where Lord Mansfield stated that:

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[17][1985] 1 Lloyd's Rep 437.

[18]See: Naidoo and Oughton, above n 16, 367–371; *Agapitos v Agnew (The Aegeon)* [2002] 2 Lloyd's Rep 42, [45] (Mance LJ).

[19]See: Australian Law Reform Commission (2001); Derrington (2002); *The Star Sea* [2001] 1 Lloyd's Rep 389 (Lord Hobhouse).

[20]See: Naidoo and Oughton, above n 16, 371.

[21]See: *The Star Sea* [2001] 1 Lloyd's Rep 389 (Lord Hobhouse), *The Mercandian Continent* [2001] EWCA Civ 1275 (Longmore LJ), *Agapitos v Agnew (The Aegeon)* [2002] 2 Lloyd's Rep 42 (Mance LJ). This section draws on research appearing in: Thanasegaran, above n 14, 193.

[22](1872) LR 7 QB 304, 309.

[23]Soyer (2003, p. 42).

[24](1766) 3 Burr 1905.

> 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 risqué, as if it did not exist.
>
> The keeping back 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 is void; because the risqué run is really different from the risqué understood and intended to be run, at the time of the agreement … 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.[25]

Although the doctrine of utmost good faith is primarily associated with the pre-contractual stage of insurance contracts, aspects of it are also applicable post-contract, right up to the settlement of claims.[26] The scope of the duty and the remedies available for breach however, may vary with the stage, as observed by Leggatt LJ when expressing the view of the Court of Appeal in *Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd*:

> It was common ground between assured and underwriters that the duty of utmost good faith continues to subsist after the making of the contract. There is less common ground as to the content of the duty or as to the remedy for breach of the duty. Whatever its origin, there is force in the argument that the scope of the duty of utmost good faith will alter according to whether underwriters have to make a decision under the policy or the assured decides to make a claim, and may also be affected according to the stage of the relationship at which the scope of the duty becomes material.[27]

Since the pre-contractual duty is of a reciprocal nature (owing to the words of s17), it follows that the post-contractual duty should also reflect the same. This post-contractual duty can arise in relation to whether the insurer's decision to avoid the policy had been made in breach of good faith[28] or whether the insurer's conduct involving claims handling amounts to a breach.[29] 'Overall the application of the insurer's duty to avoid and the claims handling process represent an emerging principle of good faith in the way in which insurers handle claims.'[30] However, the remedies available in the event of breach should be prospective termination of the contract and/or damages based on the implied term theory, as explained above.

At this point it is necessary to take into account the debate on the scope of the continuing duty of good faith that was started by Hirst J's wide pronouncement that

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[25]Ibid. 1909, 1910.

[26]Bennet, above n 11, 197.

[27][1997] 1 Lloyd's Rep 360, 370.

[28]See: *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1994] 3 All ER 581, 623 (Lord Lloyd); *Drake Insurance plc v Provident Insurance plc* [2004] 1 Lloyd's Rep 268.

[29]See: Naidoo and Oughton, above n 16, 359.

[30]See: Naidoo (2005).

it arose 'whenever there is a contractual duty for the insured to give the underwriter information'.[31] This was followed by the House of Lords overruling *The Litsion Pride*[32] in *The Star Sea*[33] and a subsequent evaluation of the House of Lords' reasoning, undertaken by the Court of Appeal in *K/S Merc-Skandia xxxxii v Certain Lloyd's Underwriters*.[34] The Court of Appeal's[35] position on the matter, led by Longmore LJ, was that there is an inextricable link between the continuing duty of good faith and the terms of the insurance policy. This is because the insured's post contractual duty is mainly governed by the insurance contract itself, although the *Marine Insurance Act 1906* (UK) does in effect recognize the existence of such a continuing duty.

Based on this, the post-contractual duty of utmost good faith continues to exist but is limited in its application. It arises in the form of a pre-contractual obligation when renewals and variations of a policy are sought; and in claims settlement and management by the insurer, but does not apply to fraudulent claims.[36]

Further support for this limitation pertaining to fraudulent claims is apparent in cases like *Agapitos v Agnew (The Aegeon)*,[37] *Bonner v Cox Dedicated Corporate Member Ltd*[38] and *HLB Kidsons (A Firm) v Lloyd's Underwriters,*[39] which reinforce the juristic basis for fraudulent claims to be instead the public policy reasoning of not benefitting from your own fraud.[40] Once viewed in this manner, it becomes clear that there is a continuing duty of utmost good faith in insurance contracts but with different juristic basis accorded to it at the pre and post-contractual stages, giving rise to appropriate remedies in the event of breach. This, instead of the disproportionate all or nothing remedy of avoidance of the contract *ab initio* generally associated with s17 of the *Marine Insurance Act 1906* (UK).[41]

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[31]*Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437. This was followed by Evans J in *The Captain Panagos DP* [1986] 2 Lloyd's Rep 470.

[32]Ibid.

[33][2001] Lloyd's Rep IR 247.

[34](*The Mercandian Continent*) [2001] 2 Lloyd's Rep 563.

[35]Ibid.

[36]A useful account of this debate can be found in Merkin (2010, pp. 291–302).

[37][2002] Lloyd's Rep I R 573 (Mance LJ).

[38][2006] Lloyd's Rep I R 385 (Waller LJ).

[39][2008] EWCA Civ 1206 (Toulson LJ).

[40]Soyer, above n 23, 59 however argues that there is still a possibility that the treatment of fraudulent claims may be based on the implied term theory proposed by Hoffmann LJ in *Orakpo v Barclays Insurance Services* [1995] LRLR 443 (that has not been discredited) which might come in handy where an insurer incurs expenditure in investigating fraudulent claims.

[41]This distinction is of less importance in the United Kingdom in recent times, following the amendment to s17 brought about by s14 of the *Insurance Act 2015* (UK).

2.4 Application of the Duty of Utmost Good Faith

It has long been accepted in the United Kingdom that the *Marine Insurance Act 1906* (UK) which is essentially a codification of the common law, applied equally to marine and non-marine insurance contracts.[42] This pre-empted the need for a separate piece of legislation to govern non-marine insurance contracts in the United Kingdom. This approach has in fact been retained in recent times, with the *Consumer Insurance (Disclosure and Representations) Act 2012* (UK) applying to all types of consumer insurance contracts and the *Insurance Act 2015* (UK) applying primarily (but not exclusively) to non-consumer insurance contracts.

As far as Malaysia is concerned, the application of English common law with respect to insurance and mercantile matters is facilitated by s5 of the *Civil Law Act 1956* (Malaysia), as endorsed in decisions such as *Leong Brothers Industries Sdn Bhd v Jerneh Insurance Corporation Sdn Bhd.*[43] Section 5 (1) of the *Civil Law Act 1956* (Malaysia)[44] imports into the states of West Malaysia (other than Malacca and Penang), insurance and mercantile law administered in England in the like case as at 7 April 1956. As for the states of Penang, Malacca, Sabah and Sarawak however, s5 (2) provides for the application of insurance and mercantile law administered in England in the like case at the corresponding period.

The meaning of 'corresponding period' in s5 (2) has been interpreted to include English law up to the cut-off date of the advent of the *Federal Constitution of Malaysia* on 31 August 1957 following Malaysia's independence from Britain. This is because Article 44 of the *Federal Constitution of Malaysia* vests the legislative authority of the Federation in the Malaysian Parliament. Hence, any post-Constitution application of English law in Malaysia is at best only of persuasive value, provided there is no Malaysian law on point.[45]

The application of the *Marine Insurance Act 1906* (UK) and common law to marine insurance cases in Malaysia is well established, as there is no corresponding

[42] *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1987] 1 Lloyd's Rep 69, 93 (Steyn J); See also: *Britton v Royal Insurance Company* (1866) 4 F & F 905, 909 where Willes J voiced a similar sentiment in a case involving a fraudulent claim made under a fire insurance policy.

[43] [1991] 1 MLJ 102.

[44] Section 5 (1) provides:

In all matters pertaining to the law of marine insurance, average, life and fire insurance and mercantile law generally, to be decided in the States of West Malaysia other than Malacca and Penang, the law to be administered shall be the same as would be administered in England in the like case at the date of the coming into force of this Act (7 April 1956).

This section draws on research appearing in: Thanasegaran, above n 14, 192.

[45] See: Abu Bakar (2013, p. 19).

Malaysian statute addressing the same. As for non-marine insurance cases however, it has been the accepted practice for the *Marine Insurance Act 1906* (UK) and common law to apply in Malaysia, unless they are inconsistent with domestic insurance or *takaful* regulation, in which case the latter would prevail.[46] In this context, conventional insurance in Malaysia has been governed by the *Insurance Act 1996*[47] up until its repeal by the *Financial Services Act 2013* on 30th June 2013. Similarly, *takaful* in Malaysia is now governed by the *Islamic Financial Services Act 2013* which repealed the *Takaful Act 1984* on 30th June 2013.

A clear example of the continued application of the *Marine Insurance Act 1906* (UK) and common law in non-marine insurance and *takaful* contracts in Malaysia is the fact that the general principle of utmost good faith laid down in s17 of the *Marine Insurance Act 1906* (UK) has long been accepted as the foundation of insurance law in Malaysia. This has been the case although there was no corresponding provision to that effect in the *Insurance Act 1996* (Malaysia) or its predecessor, the *Insurance Act 1963* (Malaysia) or even the *Takaful Act 1984* (Malaysia) for that matter. The fact that Malaysian cases have repeatedly given effect to the principle of utmost good faith in both marine and non-marine insurance and *takaful* contracts indicates that the omission appears to be an oversight rather than deliberate.[48]

2.5 Reciprocal Duties

The words of s17 of the *Marine Insurance Act 1906* (UK) reflect the reciprocal application of the duty of utmost good faith to both insurers and insureds. However, this was only explicitly acknowledged as such by the English courts in the 1980s in *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd.*[49] Steyn J in the case, in holding that insurers like insureds, were under a duty to exercise utmost good faith in disclosing facts that were material to the insurance contract, said:

> I am of the opinion that it is established beyond doubt that the *uberrima fides* principle, as it is sometimes called, imposes reciprocal duties on the insured and insurer. … In other

[46]See: Mahmood (1992, p. 43).

[47]The *Insurance Act 1996* in turn repealed and succeeded the first insurance regulation in Malaysia, namely the *Insurance Act 1963*.

[48]See: *Kurnia Insurance (M) Bhd v Nik Mohd Faizul bin Nik Mustafa & Anor* [2013] 9 MLJ 675; *Leong Kum Whay v QBE Insurance (M) Sdn Bhd* [2006] 1 CLJ 1; *Cheong Heng Loong Goldsmiths (KL) Sdn Bhd v Capital Insurance Bhd* [2004] 1 MLJ 353; *Aetna Universal Insurance Sdn Bhd v Fanny Foo May Wan* [2001] 1 MLJ 227; *Seah Cheoh Wah v Malayan Banking Bhd & Anor* [2009] 7 CLJ 485 (*takaful*).

[49][1987] 1 Lloyd's Rep 69.

> words, reciprocal duties rest on both parties to an insurance contract not only to abstain from bad faith but to observe in a positive sense the utmost good faith by disclosing all material circumstances.[50]

Steyn J's view was subsequently endorsed on appeal by the Court of Appeal in *Banque Financiere v Westgate Insurance Co Ltd.*[51] It is interesting to note that Steyn J in the case, went on to award the plaintiffs damages for the insurer's failure to disclose the fraud. This was based on the alternative ground of breach of duty of care in the tort of negligence, as the remedy of avoidance of the contract provided for in s17 would have been totally inadequate for the plaintiff in the circumstances.

However, his Honour's decision on the point of recoverability of damages by the insured for the insurer's breach of its duty of disclosure was reversed on appeal. Although the Court of Appeal found Steyn J's reasoning to warrant some merit, they nevertheless, unequivocally held that the insured was entitled to only rescission of the contract and a refund of premiums paid without any right to damages, as the contract becomes void ab initio.[52]

Slade LJ[53] at the Court of Appeal cited several reasons for this. First, that the court has the power to grant rescission of the contract in cases of duress and undue influence as well as for bad faith, none of which carries any right to damages. Secondly, the words of the *Marine Insurance Act 1906* (UK) provide no indication that Parliament contemplated the remedy of damages; and lastly, it would also have to be reciprocal and therefore, result in causing greater hardship to the insured if the roles were reversed, since there is no need to prove fault.

This view was subsequently upheld by the House of Lords,[54] albeit from the point of view of causation rather than a breach of good faith, without a final view on the matter being expressed. Nevertheless, the House of Lord's decision has been followed in later cases through the operation of judicial precedent.[55]

Despite this, however, there has been a great deal of academic criticism levelled against the legal justification given by the Court of Appeal and the House of Lords in *Banque Financiere v Westgate Insurance Co Ltd,*[56] preferring instead Steyn J's

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[50]Ibid. 92–93. Further support for the proposition that the duty of good faith and the duty of disclosure are reciprocal in nature can be found in Lord Jauncey's restatement in *Banque Financiere v Skandia (UK) Insurance Co Ltd* [1990] 2 Lloyd's Rep 377of Lord Mansfield's dicta in *Carter v Boehm* (1766) Burr 1905, 1909.

[51][1988] 2 Lloyd's Rep 513.

[52]This section draws on research appearing in: Thanasegaran (2004, pp. 155–157).

[53]*Banque Financiere v Westgate Insurance Co Ltd* [1988] 2 Lloyd's Rep 513, 546, 550–551.

[54][1990] 2 All ER 947. Although the House of Lords did not specifically consider the issue of remedies, Lord Templeman agreed with the Court of Appeal that damages were not available for a breach of the duty of utmost good faith.

[55]See: *Aldrich v Norwich Union Life Insurance Co Ltd* [2000] Lloyd's Rep IR 1 where Evans LJ reluctantly decided that there was no duty on the insurer to disclose facts that could induce a proposer to enter into an insurance contract.

[56][1988] 2 Lloyd's Rep 513 (Court of Appeal); [1990] 2 All ER 947 (House of Lords).

view on the point.[57] The criticisms highlight how the *Marine Insurance Act 1906* (UK) which is a codification of the common law position as enunciated by Lord Mansfield in *Carter v Boehm*[58] could purportedly give rise to an equitable relief for failure to exercise good faith. On the point of Parliament's intention being limited to that which is reflected in ss17 and 18 of the *Marine Insurance Act 1906* (UK) alone, it is difficult to reconcile with the House of Lord's decision in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co*[59] where the element of 'the particular insurer having to be induced' was implied into the prudent insurers' test in s18 (2), although such a requirement is not apparent in the words of the section itself.

Finally, the suggestion that reciprocity of damages as a remedy would cause hardship to the insured is untenable, as it also applies to a breach of contract situation without any element of fault or blame having to be present. On the other hand, the reciprocity of damages as a remedy would do more justice to the insured in balancing the scales, than retaining the avoidance of contract as the sole remedy for the insurer's breach of good faith, would. This is because the latter does not adequately redress the loss suffered by the insured or exposure to risk. Meanwhile, a claim for damages by the insurer in the event of the insured's breach of utmost good faith should not significantly affect the insured's position, as the insurer's loss would in most cases be only that of opportunity cost.[60]

In fact, damages or a proportionate reduction of the policy monies paid out would be preferred over the long standing 'all or nothing' remedy of avoidance of the insurance contract by insurers for breach of the duty of utmost good faith by insureds.

Be that as it may, however, the position in the United Kingdom and Malaysia up until the recent amendments in 2012–2015 was that a breach of the duty of utmost good faith by the insurer would only avail the insured of a refund of premiums paid upon avoidance of the contract ab initio. Likewise, any breach of the said duty by the insured would entitle the insurer to do the same, thereby discharging the insurer of its payment obligations under the insurance contract.[61]

There were however, encouraging signs leading up to the major reform in this area that a distinction may be drawn between fraudulent conduct of the insured justifying avoidance of the claim by the insurer and lesser breaches of the duty; as well as the possible availability of damages for a breach of the post-contractual duty of utmost good faith by an insurer.

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[57]Birds (2013, pp. 157–158), Kelly (1989).

[58](1766) 3 Burr 1905.

[59][1994] 3 All ER 581.

[60]This section draws on research appearing in: Thanasegaran, above n 52, 157.

[61]Unless of course an award of damages is given based on a different ratio, as was the case in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd. (The Good Luck)* [1991] 2 Lloyd's Rep 191 where the insurer was held to be in breach of an express undertaking in the insurance policy to inform the insured of any information within the insurer's knowledge which was material to the risk insured.

Longmore LJ in *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent),*[62] which is widely regarded as a seminal case on the common law duty of utmost good faith in insurance contracts in the United Kingdom, succinctly set out the remedies available:

> The insurer can treat the insured as being in repudiation of what will normally be an innominate term of the contract if there is a serious breach or there is a breach with serious consequences for the insurer. Avoidance ab initio is an even more extreme form of contractual termination than an acceptance of repudiatory conduct and, for the extreme remedy of avoidance to be available, there must, in my view, be at least the same quality of conduct as a repudiation of the contract. It is only in this way that the requirement of inducement for pre-contract conduct resulting in avoidance can be made to tally with the post-contract conduct said to entitle the insurer to avoid the contract. It would not be just to the insured to enable the insurer to by-pass the rights and duties, imposed on the parties by the contract in order to enable him to claim the disproportionate remedy of avoidance, with the result that he can avoid liability for all other claims under the policy as well as the instant claim, without requiring that the conduct relied on be as serious as conduct which would be viewed as repudiatory. In this way the operation of Section 17 post-contract has the appropriate symmetry to the operation of the section pre-contract.[63]

Some commentators have also gone on to suggest that the duty of utmost good faith on the part of the insurer may operate to limit the insurer's ability to exercise its 'right' to avoid an insurance contract for breach of utmost good faith or non-disclosure by the insured.[64] Unanimous support for this view can be found in the Court of Appeal's judgment in *Drake Insurance plc v Provident Insurance plc*,[65] with Rix LJ saying (obiter) that:

> The doctrine of good faith should be capable of limiting the insurer's right to avoid in circumstances where that remedy…would operate unfairly…It may be necessary to give wider effect to the doctrine of good faith and recognize that its impact may demand that ultimately regard must be had to a concept of *proportionality implicit in fair dealing*. (Author's emphasis added)

The rationale for the limitation on good faith was likely as a result of concern that the law on non-disclosure in the United Kingdom operated unfairly at the time. In this context, it was recognized that any sensible law reform should make specific changes to aspects of non-disclosure like materiality and inducement, instead of adding 'an overarching and uncertain duty of good faith' to it.[66] Similarly, where

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[62][2001] 2 Lloyd's Rep 563.

[63]Ibid. 575. The subsequent cases of *Agapitos v Agnew (The Aegeon)* [2002] Lloyd's Rep I R 573 and *Axa General Insurance Ltd v Gottlieb* [2005] Lloyd's Rep I R 369 (Mance LJ) went on to endorse the view that the appropriate remedy for fraudulent claims by insureds was a matter derived from the terms of the insurance contract and the public policy reasoning that an insured should not be entitled to benefit from his or her own wrongdoing.

[64]Eggers (2003, pp. 262–271), Clarke (2003, p. 558).

[65][2004] QB 601, [87]–[89].

[66]Campbell (2005, p. 438).

the insurer fails to act in good faith towards the insured in the handling of a claim or any other post-contractual breach, it was clear that the insured's ability to only avail himself of avoidance of the policy and a refund of the premiums paid, was unfair and of little value.[67]

The law on utmost good faith in insurance and *takaful* contracts in Malaysia has operated in a similar manner, by virtue of s17 of the *Marine Insurance Act 1906* (UK) being applicable via s5 of the *Civil Law Act 1956* (Malaysia), where avoidance (and not damages) has been the only remedy available for breach of the duty.[68]

Before setting out the recent revamp of the law on utmost good faith and its ensuing remedies in the United Kingdom and Malaysia, it is worth noting that the Australian legislature had back in 1984 addressed this issue in a bold and progressive manner by incorporating the duty of utmost good faith as an implied term of contract in s13 of its *Insurance Contracts Act 1984* (Cth) whilst omitting the remedy of avoidance. In its place, more proportionate and innovative remedies were introduced, in ss14, 28 and 29 read together with ss31 and 33.[69] Section 13 provides that:

> 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.

Section 14 (1) goes on to provide that:

> If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision.

Central to this package of remedies in ensuring that the duty of utmost good faith is complied with, is that s13 makes the mutual obligation of utmost good faith an *implied term* of the insurance contract. This has paved the way for damages as a remedy for its breach to be assessed according to the contractual loss of profits principle rather than in tort.

It is worthwhile noting that the comprehensive provisions of the *Insurance Contracts Act 1984* (Cth) have been recently improved by the *Insurance Contracts Amendment Act 2013* (Cth). A new s13 (2)–(4) has been inserted to provide for a breach of utmost good faith to be a breach of the Act entitling the Australian Securities and Investments Commission (ASIC) to take action against the insurer; and also extends the good faith obligation to a third party beneficiary under the contract, from the time the contract is entered into. Section 14A inserted by the

[67] *Cox v Bankside Members' Agency Limited* [1995] 2 Lloyd's Rep 437.

[68] *Leong Kum Whay v QBE Insurance (M) Sdn Bhd* [2006] 1 CLJ 1; *Seah Cheoh Wah v Malayan Banking Bhd & Anor* [2009] 7 CLJ 485 (*takaful*).

[69] These provisions apply to the remedies for breach of the pre-contractual duty of utmost good faith which shall be examined in Chap. 3. Sections 54 and 56 that address the remedies for post-contractual breach of the same will in turn be examined in Chap. 4.

amendment goes on to provide that the ASIC may exercise its powers under the *Corporations Act 2001* (Cth) against the insurer for failure to comply with the duty of utmost good faith in the handling or settlement of a claim.

Recent reforms in the United Kingdom have in turn, seen s2 (5) of the *Consumer Insurance (Disclosure and Representations) Act 2012* (UK) limiting the application of the duty of utmost good faith in s17 of the *Marine Insurance Act 1906* (UK) and subjecting it to the provisions of the former, which as the name suggests, deals with consumer insurance contracts. This has since been superseded and repealed by s14 (4) of the *Insurance Act 2015* (UK) which abolishes the remedy of avoidance of contract for a breach of utmost good faith in all types of insurance contracts. The result is that only the first part of s17 of the *Marine Insurance Act 1906* (UK) which provides that 'a contract of marine insurance is a contract based upon the utmost good faith,' is retained and deletes the rest, via ss14 (1) and 14 (3).

It should be noted that although the *Insurance Act 2015* (UK) primarily deals with non-consumer insurance contracts, some provisions especially those contained in Parts 5 and 6 of the Act, apply to consumer insurance contracts as well. This therefore, paves the way for more proportionate remedies like damages to be available to aggrieved parties. There are no specific provisions made for remedies with respect to a breach of utmost good faith as such in both the English statutes however, as the emphasis is on the insured's duty of fair presentation and the consequences of failure thereof. This aspect shall be set out in Chap. 3, that deals with pre-contractual non-disclosure and misrepresentation.

As for Malaysia, Paragraph 5 (9) of *Schedule 9* to the *Financial Services Act 2013* provides that both 'consumers' and insurers shall exercise the duty of utmost good faith in their dealings with each other, including the making and paying of a claim, after a contract has been entered into, varied or renewed. This explicit pronouncement of a general duty of utmost good faith that covers claims handling and renewals as well has been a long time coming. However, the provision should have been made applicable to **all** insurance contracts instead of just consumer contracts and should have also addressed the remedy available in the event of its breach by either party. This has resulted in some uncertainties in the law. For example, does the duty of utmost good faith which explicitly includes the insurers' conduct in claims handling apply to non-consumer insurance contracts as well? Also, in the event of a breach of the duty of utmost good faith by either party, would there be an opportunity for the common law remedy of avoidance to apply or has it been abolished?[70]

Having set out the reciprocal nature of the parties' duty of utmost good faith owed to each other, an examination will now be made of the scope of both the insured and insurer's respective obligations pertaining thereto.

[70]This section draws on research appearing in: Thanasegaran and Shaiban (2014, p. 338).

2.6 Scope of Insurer's Duty of Utmost Good Faith

Much of the emphasis has been with respect to what is expected of the insured in observing the duty of utmost good faith in insurance contracts. As a result, the ambit of the continuing duty of utmost good faith with respect to the insurer is less clear. Nevertheless, it has been shown that such a duty exists from the pre-contractual stage based on s17 of the *Marine Insurance Act 1906* (UK); right up to claims settlement, based instead on the implied term and public policy reasoning.[71] The various aspects of the insurer's duty of utmost good faith can be categorized as follows.

2.6.1 Clear Warning in Proposal Forms

The Malaysian legislature had by virtue of s149 (4) of the now repealed *Insurance Act 1996* (Malaysia) provided for the insurer to give a clear warning in proposal forms to prospective insureds, regarding the consequences that can ensue under the insurance contract as a result of pre-contractual non-disclosure. Section 149 (4) provided:

> A proposal form and, where no proposal form is used, a request for particulars by the licensed insurer shall prominently display a warning that if a proposer does not fully and faithfully give the facts as he knows them or ought to know them, the *policy may be invalidated*.[72] (Author's emphasis added)

The requirement for a statutory warning to be provided is an example of compliance with the duty of utmost good faith on the part of the insurer, and is a positive measure. However, the *Insurance Act 1996* (Malaysia) did not go on to explicitly provide for a remedy in the event of a breach of or non-compliance with s149 (4) by insurers. To compound matters, it retained the common law remedy of avoidance of the contract for pre-contractual non-disclosure and misrepresentation.

The new Paragraphs 5 (7) and 4 (4) of *Schedule 9* to the *Financial Services Act 2013* (Malaysia) have replaced s149 (4) by improving it to an extent. In referring to consumer and non-consumer insurance contracts respectively, they make no mention of avoidance as a remedy and require insurers *before* a contract is *entered into, varied or renewed*, to *clearly inform* the proposer or consumer/non-consumer *in*

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[71] Bennet, above n 11, 197.

[72] A similar provision existed previously under s16 (4) of the *Insurance Act 1963* (Malaysia) that was repealed upon the enactment of the *Insurance Act 1996* (Malaysia). By comparison, it should be noted that although the United Kingdom did not have a statutory equivalent before the recent amendments, Clause 4.3.2 (3) of the *Insurance Conduct of Business 2005* ('*ICOB*') (which is in substance similar to Clause 1 (c) of the previous *Statement of General Insurance Practice 1986* ('*SOGIP*') but since 14 January 2005 had been regulated by the Financial Services Authority instead of self-regulation as was the case since 1977, contained a similar provision.

writing of their pre-contractual duty of disclosure and of its continuing nature until the contract is entered into, varied or renewed. Although it is largely based on Australia's s22 (1) of the *Insurance Contracts Act 1984* (Cth), it still does not provide for a remedy against insurers for failing to provide such a statutory warning in the first place.[73]

This is unlike the position in Australia for instance, where s22 (3) of the *Insurance Contracts Act 1984* (Cth) clearly provides that non-compliance with s22 (1)[74] would result in the insurer not being entitled to exercise a right in respect of the proposer's failure to comply with the duty of disclosure, unless the failure was fraudulent.

Apart from this, the persistent problem due to the state of the law in Malaysia is the all or nothing remedy of avoidance of the insurance contract that has remained in the event of non-disclosure by the insured. However, there appears to be some improvement with reference to avoidance being omitted in the recent provisions giving rise to the statutory warning.

Another criticism that could still be levelled against the statutory warning is that although it is useful in reminding prospective insureds regarding the duty of disclosure, it may not be very effective otherwise. This is because it would only be truly effective if proposers of insurance (be it consumers or non-consumers) are able to 'understand and appreciate its significance'.[75] This sentiment is also prevalent in Singapore which has a similar provision, in that 'compliance with this section does not go anyway in explaining the substance of the warning, which is the common problem faced by befuddled insureds'.[76]

Furthermore, the widespread misconception that proposers only need to answer the questions posed, honestly and correctly, is compounded by the fact that insurance proposal forms are designed to contain numerous questions interspersed with sufficient space for proposers to insert their answers, without any additional space being provided for further material information to be provided that is not covered in the questions posed.[77]

On the contrary, this is far from what is expected, as reflected in the words of Whiteley JC of the Malaysian Supreme Court in *Teh Say Cheng v North British and Mercantile Insurance Co Ltd.*[78]

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[73]This section draws on research appearing in: Thanasegaran and Shaiban, above n 70, 341.

[74]Section 22 (1) of the *Insurance Contracts Act 1984* (Cth) provides that:

The insurer shall, before the contract of insurance is entered into, clearly inform the insured in writing of the general nature and effect of the duty of disclosure.

[75]This was a criticism that was levelled by Mahmood, above n 46, 49, with respect to the previous s16 (4) of the *Insurance Act 1963* (Malaysia) and is applicable to the *Insurance Act 1996* (Malaysia) as well.

[76]Lee (1997, p. 224).

[77]This section draws on research appearing in: Thanasegaran, above n 52, 149–150.

[78](1921) 2 FMSLR 248, 253.

> In order then, that the plaintiff may derive any benefit from this line of argument, it is necessary for him to establish the proposition that his duty of disclosure is limited to the subject matter of the question. There is an abundance of authority to contradict such a contention.

In order for the statutory warning to be more effective, however, it should *expressly* require the proposer to be under a positive duty to truthfully and accurately answer the questions posed in the proposal form *as well as* provide any other information which he or she knows *or* a reasonable person in the circumstances could be expected to know to be relevant to the insurer's decision on whether to accept the risk and the rates and terms to be applied. An expanded warning of this nature would effectively draw the standard of the pre-contractual duty of disclosure previously contained in s150 (1) of the *Insurance Act 1996* (Malaysia) to the proposers' attention. Anything short of this would only serve to exacerbate this widespread misconception on the part of proposers highlighted above.[79]

This rings true for Paragraph 4(1) of *Schedule 9* to the *Financial Services Act 2013* (Malaysia) as well, with respect to non-consumer insurance contracts which still requires voluntary disclosure by the proposer. This criticism however, does not apply to consumer insurance contracts in Malaysia and **all** insurance contracts in the United Kingdom, as they have adopted an inquiry based disclosure instead.

Although admittedly, in order for any statutory warning to be truly effective it would have to be appreciated as such by the proposers, a broader warning coupled with the provision of some conspicuous space in the proposal form below it for the proposer to volunteer information, would better serve its intended purpose. In addition, insureds should be provided with a copy of the proposal form filed with the insurer that contains a prominent warning requiring the proposer to keep a record of all information supplied to the insurer for the purpose of *entering into and renewing* the insurance contract. This would serve to further impress upon the insured regarding the existence and importance of the pre-contractual duty of disclosure at the inception of the contract as well as at renewals and variations,[80] thereby reinforcing the improvements introduced in the recent reforms which make explicit reference to the insurer's duty as also applying at renewals and variations.[81]

Having said this, the new and expanded statutory warnings in Paragraphs 5 (7) and 4 (4) of *Schedule 9* to the *Financial Services Act 2013* (Malaysia) are a welcome change, in that they would prevent a situation like that of *Leong Kum Whay v QBE Insurance (M) Sdn Bhd*[82] from recurring. The case was decided based

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[79]This section draws on research appearing in: Thanasegaran, above n 52, 150.

[80]Ibid. See: *CE Heath Underwriting & Insurance (Australia) Pty Ltd v Edwards Dunlop & Co Ltd* [1993] 176 CLR 535; *Lumley General Insurance Ltd v Delphin* (1990) 6 ANZ Ins Cas ¶60-986.

[81]See: Merkin, above n 36, 36–37: This takes cognizance of Merkin's criticisms leveled against the previous position, of insureds not being made aware of the duty at renewals and the remedy of avoidance for this being inadequate.

[82][2006] 1 CLJ 1.

on the old *Insurance Act 1963* (Malaysia) (repealed)[83] which was similar to s149 (4) of the recently repealed *Insurance Act 1996* (Malaysia), as the policies concerned were taken out in 1991 and 1992.

The appellant insured in the case sought a reversal of the High Court of Malaya's decision refusing to set aside an arbitrator's award relating to claims made by the appellant against various insurance companies on personal accident policies he had taken out with each of them. The appellant had made a claim on the policies following an accident on 26 June 1992. The insurers in the case were however, permitted to avoid the insured's personal accident insurance contracts and refuse payment on the basis of non-disclosure of a material fact, which was the acquisition of two life insurance policies by the insured prior to the renewal of the personal accident policies, despite the fact that no statutory warning was given to the insured at renewal.[84]

The recent Malaysian reforms take cognisance of their Australian counterpart in s22 (1) of the *Insurance Contracts Act 1984* (Cth) which requires insurers to 'clearly inform' the insured in writing of the general nature and effect of the duty of disclosure, before the 'contract of insurance' is entered into, and take it a step further to encompass the renewal stage as well.[85] In fact, in Australia, the recurrent issue has been whether (save for fraudulent non-disclosure) the written warning or information given by the insurer in fact amounted to 'clearly informing' the insured,[86] for otherwise, the insurer would not be able to rely on non-disclosure by the insured.[87]

This arose in *Suncorp General Insurance Ltd v Cheihk*,[88] where the New South Wales Court of Appeal had to consider whether the insured had been 'clearly informed' of the duty of disclosure by the insurer in the case. The insurer had sent three documents to the insured in renewing the policy. The duty of disclosure only appeared on the back of a Certificate of Insurance without any reference being made to it either on the front of the said document or anywhere in the other two

[83]The said Act also contained a similar obligation on the insurer's part to provide a statutory warning in proposal forms (making no mention of renewals) in s16 (4):

No insurer shall use in Malaysia a form of proposal which does not have prominently displayed therein a warning that if a proposer does not fully and faithfully give the facts as he knows them or ought to know them, he may receive nothing from the policy.

[84]This section draws on research appearing in: Thanasegaran (2007, pp. clii–cliii).

[85]The Australian courts have nevertheless, applied it to renewals as well, as a matter of course. See: *Lumley General Insurance Ltd v Delphin* (1990) 6 ANZ Ins Cas ¶60-986; *Alexander Stenhouse Ltd v Austcan Investments Pty Ltd* (1993) 7 ANZ Ins Cas ¶61-166. Also see: Section 11 (10) of the *Insurance Contracts Act 1984* (Cth) which was retrospectively introduced in 1986 to cover the insurer's duty at renewals as well.

[86]See: *GIO General Ltd v Wallace* (2001) 11 ANZ Ins Cas ¶61-506; *Suncorp General Insurance Ltd v Cheihk* (1999) 10 ANZ Ins Cas ¶61-442.

[87]Section 22 (3) of the *Insurance Contracts Act 1984* (Cth).

[88](1999) 10 ANZ Ins Cas ¶61-442; This section draws on research appearing in: Thanasegaran, above n 84, cliv.

documents. The insurer was in the circumstances held not to have 'clearly informed' the insured, as the requirement of clarity not only applied to the contents of the documents but also the way in which the contents were brought to the insured's attention. Giles JA went on to say:

> It will always be a question of fact and degree, but the purpose of s22 is to ensure that the insured is informed of the *significance and important matters of his duty of disclosure* and the *consequences of failure to comply* with the duty of disclosure, so that his insurance cover will not be imperilled by ignorance of those matters. The insured is to be *informed clearly*. Both the purpose of s22 and its terms call for insistence *on a proper standard of information giving*.[89] (Author's emphasis added)

2.6.2 Unduly Strict Construction of Policies and Exclusions

Another aspect of the insurer's duty of good faith and disclosure would be with respect to the enforceability and meaning of the insurance contract itself. This was pointed out by Lord Lloyd at the House of Lords in *Pan Atlantic Insurance Co. Ltd. v Pine Top Insurance Co Ltd*[90] where his Lordship said that'…there may be circumstances in which an insurer, by asserting a right to avoid for non-disclosure, would himself be guilty of want of utmost good faith'.[91]

Such a duty would likely cover situations where insurers seek to construe policy terms in an unduly strict manner or rely on technical exclusions to defeat or reduce otherwise valid claims put forward by insureds. It is indeed ironic that such practices still occur today, when the English courts almost a century ago recognised that good faith warranted insurance policies to be drawn up in clear and unambiguous terms, according to the proposal forms 'so as not to deceive and entrap the unwary'.[92] This aspect shall be developed further in Chap. 4 of this book under the post-contractual duty of good faith.

2.6.3 Good Faith in Claims Settlement

As for good faith in claims settlement, the courts seem to have given precedence to clear words contained in insurance policies even though they may fly in the face of good faith. This is apparent from cases such as *Lambert v Cooperative Insurance Society Ltd*[93] and *Chiew Swee Chai v British American Insurance Co Sdn Bhd*[94]

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[89]Ibid. 75–024.

[90][1994] 2 All ER 581.

[91]Ibid. 623.

[92]*Re Bradley and Essex and Suffolk Accident Indemnity Society* (1912) 1 KB 415, 433 (Farwell J).

[93][1975] 2 Lloyd's Rep 485.

[94][1987] 1 MLJ 53.

which has led to the frequent contesting of claims by insurers, and resulting in a rejection of claims and reduction of policy monies paid out. As a result, it has given rise to a growing trend amongst insureds to make exaggerated claims as a counter measure, in order to facilitate 'price haggling' between insurers and insureds, which has become commonplace.

On the issue of fraudulent claims, insureds typically put forward an inflated claim with the intention to defraud the insurer. Such a claim can be defeated by the insurer on the basis of the insured's failure to act in good faith.[95] It is however, a question of fact to be inferred from surrounding circumstances, as to whether a particular claim is tainted with fraud.

Section 17 of the *Contracts Act 1950* (Malaysia) may be of assistance in this regard, as it contains a general definition for 'fraud'. Section 17 provides that:

> "Fraud" includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract: (a) the suggestion, as to a fact, of that which is not true by one who does not believe it to be true; (b) the active concealment of a fact by one having knowledge or belief of the fact; (c) a promise made without any intention of performing it; (d) any other act fitted to deceive; and (e) any such act or omission as the law specially declares to be fraudulent.

The Explanation (or proviso) to s17 goes on to provide that:

> Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silent to speak, or unless his silence is, in itself, equivalent to speech.

This reinforces the fact that in *uberrimae fidei* contracts such as insurance, a failure to disclose material facts with intent to deceive would amount to fraud, the consequence of which (along with misrepresentation or coercion) makes the contract voidable at the option of the innocent party, by virtue of s19 (1) of the *Contracts Act 1950* (Malaysia).[96]

Alternatively, s19 (2) provides that 'a party to a contract, whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representation had been true'.

In this regard, the Court of Appeal in *Galloway v Guardian Royal Exchange (UK) Ltd*[97] held that the insurer was entitled to avoid the entire policy due to the insured's fraudulent claim put forward for an exaggerated sum. Fraud on the part of the insured was clear in this case, as he sought to claim an additional loss of £2000

[95] *Tuong Aik (Sarawak) Sdn Bhd v Arab-Malaysian Eagle Assurance Bhd* [1996] 1 AMR 871; *Britton v Royal Insurance Company* (1866) 4 F & F 905.

[96] Unless of course the party whose consent was vitiated had the means of discovering the truth with ordinary diligence or was in fact not induced by the fraud (or misrepresentation) to consent to the contract: proviso to s19 (2).

[97] [1999] Lloyd's Rep IR 209.

by submitting a forged receipt relating to the purchase of a computer. The court's position on the matter was succinctly set out by Millett LJ as follows:

> The result of a breach of this duty leaves the insured without cover. In the present case the insured took advantage of the happening of an insured event to make a dishonest claim for the loss of goods worth £2,000 which to his knowledge had not occurred…The making of dishonest insurance claims has become all too common. There seems to be a widespread belief that insurance companies are fair game, and that defrauding them is not morally reprehensible. The rule which we are asked to enforce today may appear to some to be harsh, but it is in my opinion a necessary and salutary rule which deserves to be better known by the public. I for my part would be most unwilling to dilute it in any way.[98]

Where the insured puts forward an inflated claim without any express act of fraud or forgery on the other hand, the position becomes less clear. The inflated claim in this case, would give rise to a *prima facie* presumption that the insured is not acting in good faith. This is however, merely a presumption and therefore, not conclusive. The insured would still be entitled to succeed in making the claim, if the presumption could be rebutted, in which case, the insurer would have failed to prove fraud.[99]

In *Norton v Royal Fire and Life Assurance Co*,[100] the insured who had presented an exaggerated claim was held not to have intended to defraud the insurers, as he had worked out the claim based on his recollection and had subsequently reduced it. If however, the claim is grossly exaggerated as to the amount and/or the quantity of goods lost, an inference of fraud would be more likely to be drawn and harder to rebut.[101]

The true question in an exaggerated claim presented by an insured, however, is whether the insured intended to deceive the insurer by it.[102] This is a recurrent problem in the insurance industry today, where inflating the claim to some degree is seen to be the norm as a means to commence bargaining. The inflated claim is merely seen as a bargaining figure, without any real intention to defraud the insurer. This practice appears to have emerged as a means to counter the insurers' general reluctance to award claims put forward without strict scrutiny and frequent contesting and reduction wherever possible.

This has in fact been acknowledged by MacKinnon J in *Ewer v National Employers' Mutual General Insurance Association Ltd.*[103] Here, an insured who had put forward an exaggerated claim for items lost in a fire based on the cost price of the said items even though they were at the time no longer new, was held to have

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[98]Ibid. 21.

[99]*Globe Trawlers Pte Ltd. v National Employers' Mutual General Insurance Association Ltd* [1989] 1 MLJ 463; This section draws on research appearing in: Thanasegaran, above n 52, 153.

[100](1885) 1 TLR 460.

[101]*Chapman v Pole P O* (1870) 22 L T 306.

[102]The requisite mental element is therefore, whether a representation was made either 'knowingly without belief in its truth or recklessly without caring whether it is true or false': *Derry v Peek* (1889) 14 App Cas 337 (HL).

[103][1937] 2 All ER 193, 203.

done so not to defraud the insurers but merely as a bargaining figure. A similar view acknowledging the commercial phenomenon of 'price haggling' is apparent in Vincent Ng J's judgment in *Wong Cheong Kong Sdn Bhd v Prudential Assurance Sdn Bhd*[104] where his Honour said:

> Even so, concerning exaggerated claims, the practice in business to exaggerate demands in order to accommodate the commercial phenomenon of "price haggling", ought not to be ignored by the court in its deliberation, as it is quite prevalent and hence not necessarily an *ipso facto* fatal element in an insurance claim.[105]

Despite the fact that an exaggerated claim may give rise to a presumption of fraud by the insured (which may in turn be rebutted), the burden of proving the allegation that the insured intended to defraud the insurer rests with the insurer. The standard of proving fraud in such an instance in the United Kingdom and Australia is on the balance of probabilities for civil cases, with strong evidence of intention to defraud having to be adduced in practice but not so high as to be proof beyond a reasonable doubt.[106] With respect to Malaysia however, the Federal Court decisions of *Yong Tim v Hoo Kok Chong*[107] and *Asean Securities Paper Mills Sdn Bhd v CGU Insurance Bhd*[108] have settled the standard of proof to be that of beyond reasonable doubt.[109]

On the issue of good faith in claims settlement, Paragraph 5 (9) of *Schedule 9* to the *Financial Services Act 2013* (Malaysia) is an improvement with respect to *consumer* insurance contracts as it requires the duty of utmost good faith to be exercised by a consumer and insurer in their dealings with each other 'including the making and paying of a claim.' The uncertainty remaining, however, is with respect to the status of non-consumer insurance contracts and the remedy available in the event of breach.

As for the United Kingdom on the other hand, it is interesting to note that the draft *Insurance Contracts Bill 2014* that was tabled in Parliament, contained a s14 (1) which *implied* a term into *every* contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time. The implications of the proposed duty being an implied term of contract, was that damages would have been an available remedy in the event of breach. This proposal would have been in line with s13 of the *Insurance*

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[104][1998] 3 MLJ 724.

[105]Ibid. 737–738.

[106]*Danepoint Limited v Allied Underwriting Insurance Limited* [2005] EWHC 2318; *Von Braun v Australian Associated Motor Insurers Ltd.* (1999) 10 ANZ Ins Cas 61-419.

[107][2005] 3 CLJ 229.

[108][2007] 2 MLJ 301.

[109]There was however, some doubt raised by Gopal Sri Ram JCA at the Court of Appeal in *CGU Insurance Bhd v Asean Security Paper Mills Sdn Bhd* [2006] 3 MLJ 1, 33 as to the standard of proof for fraud in civil cases in Malaysia being on a balance of probabilities, but was rejected by the Federal Court on appeal. This section draws on research appearing in: Thanasegaran, above n 14, 195.

Contracts Act 1984 (Cth) of Australia. However, when the *Insurance Act 2015* (UK) was eventually passed on 12 February 2015, this provision was dropped owing to a lack of consensual support by all the market players, which made it unsuitable to be passed though the Law Commission's uncontroversial bill procedure. This aspect of good faith in claims settlement and the recent reforms shall be examined further in Chap. 4 under the post-contractual duty of good faith.

2.6.4 Tort of Bad Faith

It is worth noting however, that in the United States the aspect of good faith on the insurer's part has been taken much further where it is viewed as a tortuous obligation. This tort of bad faith is essentially described as follows:

> In every contract (not just insurance policies) there is implied by law a covenant of good faith and fair dealing which provides that neither party will do anything which will injure the right of the other to receive the benefits of the agreement. The violation of this duty is a tort, which may give rise to liability over and above that for breach of contract. In a proper case, general damages (such as those for mental distress) and punitive damages may be recovered.[110]

The American position is motivated by the need to prevent insurers from acting unreasonably in claims settlement, although not necessarily limited to this.

The Australian Law Reform Commission[111] had in 1982, considered the possibility of introducing the same into Australian law but decided against it in favour of contractual damages instead. This decision was made based on the sentiment that it would not substantially add to the contractual remedies already available to the insured and compounded by the fact that Australian courts are not generally in the habit of awarding punitive damages.

Although the tort of bad faith does not apply to contracts of insurance governed by the Australian *Insurance Contracts Act 1984* (Cth), the possibility that such a tortuous obligation may exist with respect to insurance contracts not governed by the Act has been left open by the judgments of Badgery-Parker J in *Gibson v Parkes District Hospital*[112] and McDonald J in *Gimson v Victorian Workcover Authority*,[113] although this has remained an increasingly academic issue with the passing of time.

A duty of good faith founded on tort is in fact not a common feature in the United Kingdom, Malaysia and Australia, as the awarding of punitive damages by the judiciary is uncommon in these jurisdictions. Australia by virtue of ss13–14 of

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[110]Parkes and Heil (1973, p. 63).

[111]Report No 20, *Insurance Contracts* (1982) [328].

[112](1991) 26 NSWLR 9.

[113][1995] 1 VR 209; This section draws on research appearing in: Thanasegaran, above n 52, 157–158.

the *Insurance Contracts Act 1984* (Cth) has clearly adopted a *contractual* duty of utmost good faith and although the Malaysian provisions for utmost good faith under the *Financial Services Act 2013* (Malaysia) and *Islamic Financial Services Act 2013* (Malaysia) and that of the United Kingdom under the *Insurance Act 2015* (UK) have not explicitly provided so, there is nothing to indicate a wider reaching tortuous duty being envisaged. Nevertheless, some clarification on this would prove useful.

2.7 Scope of Insured's Duty of Utmost Good Faith

The scope of the duty of utmost good faith with respect to the insured on the other hand, has been the focal point of and therefore, fairly clearly addressed by the legislatures of the United Kingdom, Malaysia and Australia. It also spans from the pre-contractual stage of negotiations between the parties right up to the submission and settlement of claims there under.

2.7.1 Pre-contractual Duty of Disclosure

The common law pre-contractual duty of disclosure imposes a positive duty on the insured to make disclosure of all material information as well as any material change in the risk to be insured[114] right up to the moment the insurance contract is concluded. Failure to do so would entitle the insurer to avoid the contract ab initio. This right to avoid the contract is available to the insurer before or after a loss occurs and the insurance contract remains in force until and unless the insurer exercises the option to avoid.

The justification for this duty is broadly based on insurance contracts being *uberrimae fidei* in nature and more specifically on the information imbalance existing at that stage of the transaction. This information imbalance is in favour of the insured who possesses knowledge of his own circumstances, vis-à-vis the insurer who does not but nevertheless, needs to assess the viability of the risk to be undertaken. It has however, been argued that claims of this information imbalance placing the insured in a position of strength over the insurer may be more of a perception than reality. This is because the insured is often unaware as to which parts of the information the insurer wishes to have and is as a result in a weaker position.[115]

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[114] *Allis-Chalmers Co v Fidelity & Deposit Co of Maryland* (1916) 114 LT 433; *Looker v Law Union and Rock Insurance Co Ltd* [1928] 1 KB 554.

[115] Hasson (1969, p. 633).

In fact, the pre-contractual duty of disclosure has been viewed at common law as arising as a matter of law in all *uberrimae fidei* contracts (of which insurance is a type),[116] as opposed to being an implied term of contract like in Australia, for instance.[117]

This 'all or nothing' common law remedy of avoidance or affirmation of the contract however, has the potential for injustice in situations where the insurer avoids a policy on grounds of non-disclosure of information that has only a marginal effect on the premium. To compound matters, the remedy of proportionate recovery for the insured that commensurate with the premium actually paid based on the non-disclosure, which has been adopted by other European jurisdictions and Australia,[118] was also not available in the United Kingdom and Malaysia until recently.

Section 18 (1) of the *Marine Insurance Act 1906* (UK), which laid down this pre-contractual duty of disclosure, provided that:

> Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance that is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.

The burden of proving non-disclosure of a material fact by the insured, in accordance with general legal principle, rests with the insurer,[119] which may be further justified by the fact that the issuance of the insurance policy would have raised the presumption that everything was in order.[120]

In this regard, a circumstance was described in s18 (2) as being material if it

> …would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk.

And whether an undisclosed circumstance is in fact material is essentially a question of fact, according to s18 (4).

The pre-contractual duty of disclosure comes to an end upon the conclusion of the insurance contract and although the duty of utmost good faith continues thereafter,[121] the insured is no longer under a duty to disclose any changes in the

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[116]This is apparent from *March Cabaret Club & Casino Ltd v London Assurance Ltd* [1975] 1 Lloyd's Rep 169, 175 (May J).

[117]See: Section 13 of the *Insurance Contracts Act 1984* (Cth) (Australia).

[118]This is available by virtue of the Australian remedy of common law damages for non-disclosure in general insurance contracts (s28 of the *Insurance Contracts Act 1984* (Cth)) and proportionate recovery in life insurance contracts (s29 of the *Insurance Contracts Act 1984* (Cth)).

[119]*Joel v Law Union and Crown Insurance Company* [1908] 2 KB 863; *Lee Bee Soon v Malaysia National Insurance Sdn Bhd* [1980] 2 MLJ 252.

[120]*Elkin v Janson* (1845) 13 M & W 655.

[121]*Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd* [1997] 1 Lloyd's Rep 360.

risk insured which may occur during the subsistence of the contract.[122] The House of Lords in *Niger Co Ltd v Guardian Assurance Co Ltd*[123] in fact rejected an attempt made by the insurer to extend the insured's duty of disclosure concerning the risk insured beyond the conclusion of the insurance contract. In deciding so, Lord Sumner was mindful of the potential threat to the insured if insurers were allowed to extend the pre-contractual duty of disclosure, when his Lordship said:

> There remains the question of non-disclosure. The object of disclosure being to inform the underwriter's mind on matters immediately under his consideration, with reference to the taking or refusing of a risk then offered to him, I think it would be going beyond the principle to say that each and every change in an insurance contract creates an occasion on which a general disclosure becomes obligatory, merely because the altered contract is not the unaltered contract, and therefore the alteration is a transaction as the result of which a new contract of insurance comes into existence. This would turn what is an indispensable shield for the underwriter into an engine of oppression against the assured.[124]

The position has been largely the same with respect to Malaysia until the recent reforms introduced in both countries, as can be seen from the decision of Yusoff J in *Lee Bee Soonv Malaysia National Insurance Sdn Bhd*,[125] a case involving marine insurance. Here, s21 of the *Marine Insurance Act 1906* (UK)[126] was applied with respect to when a contract of marine insurance was deemed to be concluded, connoting the end of the insured's duty of disclosure pertaining to the risk insured.

It may be worthwhile to note that the duty of disclosure continues to apply to the period between when an insured applies for a policy and the time the policy is issued, should the insured come into possession of material information. As Hasson points out, this obligation should be clearly stipulated in the proposal form or application, as lay applicants for insurance often think that the contract is concluded when the application is submitted and hence inadvertently open themselves up to a breach of the duty.[127]

This duty of disclosure arises again whenever the insurance policy is renewed, whereby the insured is required to disclose to the insurer all material changes that

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[122]It should be noted that certain insurance contracts like fire insurance, in practice impose a duty on the insured to disclose facts which occur during the subsistence of the contract that materially increase the risk insured. This is done usually by inserting a promissory warranty in the contract, providing that the insurer is discharged from liability in the event of failure by the insured to make such disclosure.

[123](1922) 13 Ll L Rep 75.

[124]Ibid. 82.

[125][1980] 2 MLJ 252.

[126]Section 21 provides that:

A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract, although it be unstamped.

[127]Hasson, above n 115, 635–636.

have taken place since the last renewal. Such was the case in *Lambert v Co-operative Insurance Society Ltd*[128] where the English Court of Appeal held that the insurer was entitled to avoid the 'all risks' insurance policy taken out by the insured on jewellery belonging to herself and her husband. This was on the basis that she had failed to disclose at the time of renewal of the policy that her husband had been convicted of two offences involving dishonesty and was sentenced to fifteen months' imprisonment.[129]

This is also the position in Malaysia where in the Supreme Court decision of *Syarikat Pembinaan Lida Sdn Bhd v Talasco Insurance Sdn Bhd*,[130] the appellant was not entitled to claim under the fire insurance policy, for failure to inform the insurers that part of the risk insured had been damaged by fire the day before the policy was renewed. A similar decision was reached by the Court of Appeal in *Leong Kum Whay v QBE Insurance (M) Sdn Bhd*[131] where the insured was not entitled to claim under a personal accident insurance policy for failing to inform the insurer of two life insurance policies taken out prior to renewal of the policy in question.

This surfacing of the duty of disclosure whenever an insurance policy is renewed however, does not apply to life insurance policies as they are intended to provide insurance coverage for the entire duration of the insured's life. Most life insurance policies therefore, expressly provide for such an automatic right to renewal and even when they do not, such a term may be implied into the contract, so as not to defeat the essential objective of life policies.[132]

Besides renewals, the duty of disclosure also arises in the case of variations and reinstatements of insurance policies when the same tantamount to entering into a new contract, although most likely limited to the variation itself.[133]

Although it is trite law that the duty of utmost good faith and the duty of disclosure are reciprocal in nature, ss18 (1) and (2) of the *Marine Insurance Act 1906* (UK) and s150 (1) of the *Insurance Act 1996* (Malaysia) nevertheless made specific mention of only the insured's pre-contractual duty of disclosure. This is because the insured is in possession of information or facts peculiar to him or herself that is not known to the insurer.[134] It is this information or facts that would

[128][1975] 2 Lloyd's Rep 485.

[129]Ibid. 487. See also: *Sharp and Roarer Investments Ltd v Sphere Drake Insurance Plc (The Moonacre)* [1992] 2 Lloyd's Rep 501.

[130][1993] 2 MLJ 121.

[131][2006] 1 CLJ 1.

[132]Poh (2005, p. 377).

[133]See: Section 11 (9) of the *Insurance Contracts Act 1984* (Cth) (Australia) which provides some guidance by including renewals, variations and extensions of insurance contracts as giving rise to 'entering into an insurance contract' which would in turn give rise to the duty of disclosure.

[134]This does not however, mean that there is no such duty on the insurer at the pre-contractual stage, although presumably governed by the general duty of utmost good faith as opposed to s18. See: *Banque Financiere v Skandia (UK) Insurance Co Ltd* [1990] 2 Lloyd's Rep 377, 389 (Lord Jauncey).

be likely to influence the prudent insurer in deciding on the amount of premium to fix or whether to accept the risk and provide coverage at all. Hence, it would appear to be fair to place such an obligation on the insured.[135]

It should be noted however, that both s18 of the *Marine Insurance Act 1906* (UK) and s150 (1) of the *Insurance Act 1996* (Malaysia) have been repealed by s21 (2) of the *Insurance Act 2015* (UK) and s283 of the *Financial Services Act 2013* (Malaysia) respectively, and shall be addressed in Chap. 3 of this book.

On the flipside, however, an insurance company with its vast experience and industry knowledge would most likely know exactly what sort of information it would require, pertaining to the risk to be underwritten. Furthermore, most insurance companies today are multinational corporations with huge resources, dealing in turn, with insureds who are often taking out their first insurance policy. Therefore, any previous justification for a strict application of the pre-contractual duty of disclosure may be placed in doubt, as the insured who is often inexperienced in the matter, would be totally unfamiliar with what sort of facts the insurance company would like to be informed of, in order to assess the viability of the risk to be underwritten.

As a result, insureds may often act in good faith and yet fall short of the duty of disclosure required by law, either due to failure to realise that certain facts are material in law or not realising that the duty encompassed more than having to truthfully answer the questions posed on a proposal form.[136] As Hasson pointed out in his critique of the duty of good faith[137] this imbalance between the insurer and insured in favour of the insurer, was largely due to the assignment of a wider interpretation of a 1766 decision[138] by later English courts, whereas American courts have read the case as stating a much narrower duty.

Despite this, however, the strict position of the common law remained unwavering up until the recent reforms in the United Kingdom in 2012–2015 and Malaysia in 2013. Scrutton LJ in *Rozanes v Bowen*[139] had in fact dismissed any notion of the pre-contractual duty of disclosure on the part of the insured as being limited to questions put forward by the insurer.

This rigid attitude of the courts is also apparent in the Malaysian case of *Teh Say Cheng v North British and Mercantile Insurance Co Ltd*,[140] where Whiteley JC categorically rejected the insured's argument (under a fire policy) that he was justified in assuming that the insurer only required no more information than that which was asked by the questions in the proposal form.

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[135]See: Romer LJ's comment on the rationale for the rule in *Seaton v Heath* [1899] 1 QB 782, 793.

[136]It should be noted that numerous calls for reform of this position were made by the Law Reform Committee back (1957), the Law Commission (1980) and the Insurance Ombudsman in the United Kingdom.

[137]Hasson, above n 115, 632–633.

[138]Lord Mansfield's dicta in *Carter v Boehm* (1766) 3 Burr 1905, 1909, 1910.

[139](1928) 32 Ll L Rep 98, 102.

[140](1921) FMSLR 248, 255.

In *March Cabaret Club & Casino Ltd v London Assurance Ltd*[141] May J clearly stated the position with respect to questions posed to the insured in proposal forms as '…whereas there is a presumption that matters dealt with in a proposal form are material, there is no corresponding presumption that matters not so dealt with are not material'.[142]

The justification for this has always been that the insured's duty to disclose material information to the insurer existed independently and irrespective of any proposal form.[143] It would appear that since insurers in Malaysia were not up until the enactment of the *Financial Services Act 2013* (Malaysia), obliged to issue proposal forms to begin with, they should not as a result be prejudiced by it should the questions posed be incomplete. Therefore, the proposal form although a common feature in the Malaysian insurance industry, was seen as a mere guide as to the type of information that may be material to the insurer and by no means an avenue to relieve the insured of the duty to disclose, in the event that it was not comprehensive.[144] Such is no longer the case however, by virtue of Paragraphs 4 (4) and 5 (7) of *Schedule 9* to the *Financial Services Act 2013* (Malaysia).

Based on this reasoning, it was held in *Arterial Caravans Ltd v Yorkshire Insurance Co Ltd*[145] that the insurer's acceptance of a proposal form in which the insured had omitted to answer certain questions, did not give rise to an inference of waiver or estoppel against the insurer as to the insured's duty of disclosure with respect to the information omitted. In this respect, the insured's conduct of giving a blank answer may also amount to a misrepresentation of fact, where the blank answer is taken as a negative reply and it turns out to be untrue.[146] That which seems more logical and consistent an approach however, is that whatever the inference, the overriding consideration should be whether the incomplete proposal form ought to have put the insurer on guard.[147]

In fact, the English Court of Appeal in *Roberts v Plaisted*[148] did accept that the way in which a question was framed in a proposal form could in certain circumstances have the effect of limiting the insured's pre-contractual duty of disclosure. In this case, the plaintiff obtained insurance coverage for a motel that had a function room, a lounge bar and a discotheque. The proposal form inquired as to whether the premises were occupied as a hotel or an inn, whether it had any other purposes and if there was a casino in any part of the building. The insured correctly answered the latter two questions in the negative.

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[141][1975] 1 Lloyd's Rep 169.

[142]Ibid. 176; This was reiterated in *United Oriental Assurance Sdn Bhd v WM Mazzarol (The Melanie)* [1984] 1 MLJ 260, 262 (Salleh Abbas CJ).

[143]*Asia Insurance Co Ltd v Tat Hong Plant Leasing Pte Ltd* [1992] 1 CLJ 330.

[144]*Schoolman v Hall* [1951] 1 Lloyd's Rep 139.

[145][1973] 1 Lloyd's Rep 169.

[146]*Roberts v Avon Insurance* [1956] 2 Lloyd's Rep 240.

[147]Legh-Jones et al. (2003, p. 447).

[148][1989] 2 Lloyd's Rep 341.

During the currency of the policy, the motel was destroyed by fire and the insurers refused to indemnify the insured for the loss on the grounds that the insured had failed to disclose that the motel had a discotheque. The Court of Appeal held that the way in which the questions in the proposal form were framed, in particular that pertaining to the existence of a casino, had the effect of waiving the insured's duty to disclose the presence of a discotheque on the premises, even though such a fact may have otherwise been material. Furthermore, it was reasonable for an insurer to assume that a motel that provided public entertainment would also have a discotheque.

The courts were therefore only willing to accept questions posed in proposal forms as giving rise to the defence of waiver or estoppel in the insured's favour, in clear and limited situations as above. There has however, been a substantial change in this area in Australia and Malaysia in favour of the insured, by virtue of s21 (3) of the *Insurance Contracts Act 1984* (Cth) (Australia) and Paragraphs 4 (3) and 5 (6) of *Schedule 9* to the *Financial Services Act 2013* (Malaysia) (based on s150 (3) of the now repealed *Insurance Act 1996* (Malaysia)) respectively, that will be addressed in Chap. 3.

Another alternative may be where questions asked in a proposal form are ambiguous in which case the courts have been inclined to provide a fair and reasonable construction in construing them *contra proferentum*, which is against the party seeking to rely on them.[149] It should be noted however, that where the insured is seeking to rely on the ambiguity of the questions posed in the proposal form as a means to defeat an allegation of non-disclosure or misrepresentation, the courts in construing the ambiguity have been mindful of any inconsistency in the answers to other questions in the proposal form which leaned towards an indication that the insured was in fact not misled by the ambiguity.[150]

The *contra proferentum* rule, albeit a fair and useful tool of construction protecting insureds against their understandable ignorance of technical insurance provisions, can however, only be deployed in cases of ambiguity and does not quite address the imbalance in information and understanding existing at the pre-contractual stage, like it does with respect to resolving post-contractual disputes.[151]

A detailed analysis of the application of the pre-contractual duty of disclosure in the United Kingdom, Malaysia and Australia, along with its exceptions and concepts such as 'materiality' and the 'prudent insurer test' reflected in the now repealed s18 (2) of the *Marine Insurance Act 1906* (UK), as well as the recent amendments in the United Kingdom and Malaysia that incorporate an enquiry based disclosure for consumer insurance contracts and voluntary disclosure for non-consumer contracts, will be made in Chap. 3 of this book.

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[149] *Sweeney v Kennedy* (1948) 82 Ll L Rep 294.

[150] *Asia Hotel Sdn Bhd v Malayan Insurance (M) Sdn Bhd* [1992] 2 MLJ 615.

[151] Tarr (2001).

2.7.2 Misrepresentation

Another aspect of the insured's pre-contractual duty of utmost good faith towards the insurer is the duty to refrain from making material misrepresentation. Misrepresentation in the general law of contract is a vitiating factor, resulting in the contract being voidable at the option of the innocent party.[152] It is divided into three categories, namely, fraudulent, negligent and innocent misrepresentation. Fraudulent misrepresentation is where one knowingly makes a false statement without belief in its truth or recklessly as to whether it is true or false.[153] Negligent and innocent misrepresentation on the other hand which lack the intent to deceive on the part of the maker of the statement, are defined by s18 of the *Contracts Act 1950* (Malaysia).[154]

Misrepresentation as a vitiating factor in the general law of contract addressed in ss17–19 of the *Contracts Act 1950* (Malaysia) necessarily envisages pre-contractual misrepresentation. This is because unlike *uberrimae fidei* contracts like insurance, there is no continuing post-contractual duty of good faith in general contracts.

As far as the law of insurance is concerned, the corresponding provision to the pre-contractual duty of disclosure with respect to the duty to abstain from material misrepresentation at the pre-contractual stage was contained in s20 of the *Marine Insurance Act 1906* (UK) which provided as follows:

> Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract.

Like s18 (2), a representation would be material if it influenced the judgment of a prudent insurer in fixing the premium or determining whether to take the risk and offer coverage,[155] with the materiality of a particular representation essentially being a question of fact.[156] Such a representation may either be as to a matter of fact or expectation or belief,[157] with a representation of fact being true if it is

[152]See: Section 19 (1) of the *Contracts Act 1950* (Malaysia).

[153]*Derry v Peek* (1889) 14 App Cas 337; Section 17 of the *Contracts Act 1950* (Malaysia) covers this in its definition of fraud.

[154]Section 18 of the *Contracts Act 1950* (Malaysia) provides that:

Misrepresentation includes: (a) the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true; (b) any breach of duty which, without an intent to deceive, gives an advantage to the person committing it, or anyone claiming under him, by misleading another to his prejudice, or to the prejudice of anyone claiming under him; and (c) causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

[155]Section 20 (2) of the *Marine Insurance Act 1906* (UK).

[156]Section 20 (7).

[157]Section 20 (3).

substantially correct[158] and a representation of belief or expectation being true if it is made in good faith.[159]

Section 20 (6) completed the provision on pre-contractual representations by providing that a representation may be withdrawn or corrected before the contract is concluded, without affecting the validity of the ensuing contract. Section 20 has however, been repealed by s21 (2) of the *Insurance Act 2015* (UK) and replaced by a duty of *fair presentation* on the insured's part, which shall be examined in Chap. 3.

It should be noted at this juncture, that there was no corresponding provision to s20 of the *Marine Insurance Act 1906* (UK) on pre-contractual misrepresentation in the now repealed *Insurance Act 1996* (Malaysia), resulting in the position with respect thereto being governed by s20. This was the case up until the enactment of the *Financial Services Act 2013* (Malaysia). Paragraphs 4 and 5 of *Schedule 9* to the *Financial Services Act 2013* (Malaysia) now provide for a voluntary disclosure mechanism similar to Australia, with respect to non-consumer insurance contracts; and an inquiry based disclosure mechanism similar to that of the United Kingdom and eligible contracts in Australia, with respect to consumer insurance contracts, respectively. The details of these and the corresponding remedies available in the event of breach shall be addressed in Chap. 3.

As far as post-contractual misrepresentation is concerned, it is presumably on the same footing as that of the general duty of utmost good faith, which is based on the implied term of contract reasoning.

It is worth noting that misrepresentation in the insurance context has always played second fiddle to the duty of disclosure, largely due to the wide scope of the latter. The fact that insurers in bringing an action for avoidance of contract in the past, have often pleaded both non-disclosure and misrepresentation as their defence, has added to the blurring of the two principles. The rationale for this seems to have been that the insured's duty to correctly answer questions posed in a proposal form, in essence forms part of the insured's duty of good faith and disclosure. There have however, been instances in cases like *Economides v Commercial Assurance Co Plc*[160] where the insured's conduct in underinsuring the contents of his house as a result of not realizing the actual value of the items subsequently brought in by his parents from Cyprus, was held to be an innocent misrepresentation as opposed to material non-disclosure warranting avoidance.

It should be noted that there is a distinction between innocent misrepresentation of belief or expectation which would not entitle the insurer to avoid the contract and innocent non-disclosure on the other hand, which would, as the latter is a situation

[158]Section 20 (4). It goes on to stipulate that a representation of fact would be substantially correct if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer. This goes to show that a representation must be considered in its entirety and in the context in which it was made. See: *Morrison v Muspratt* (1827) 4 Bing 60, 63 (Burrough J).

[159]Section 20 (5).

[160][1997] 3 WLR 1066.

where the insured knows the truth but does not appreciate the fact that it is material and should therefore, be disclosed.

By virtue of s20 (1) of the *Marine Insurance Act 1906* (UK), the insurer was entitled to the remedy of avoidance of contract for material misrepresentation at the pre-contractual stage, irrespective of whether such misrepresentation by the insured was negligent or fraudulent. Although s20 (1) failed to make a distinction on the remedy available for different types of misrepresentation, the insurer was under common law entitled to the additional remedy of damages in the tort of deceit and could retain any premium paid, in the face of fraudulent misrepresentation by the insured.

Where the misrepresentation was innocent however, the insurer was entitled to avoid the contract only if it was with respect to a statement of fact and not expectation or belief. This was because s20 (5) provided that a representation of belief or expectation was true if it was made in good faith, as was the case in *Economides v Commercial Assurance Co Plc.*[161]

Most cases involving avoidance of insurance contracts by insurers for material misrepresentation however, tend to involve incorrect answers given by insureds to questions posed in proposal forms. This is apparent from cases like *Goh Chooi Leong v Public Life Assurance Co Ltd,*[162] *National Insurance Co Ltd v S Joseph*[163] and *Taylor v Eagle Star Insurance Co Ltd.*[164] Although this need not necessarily be the case always, as can be seen in *St Paul Fire & Marine Insurance Co (UK) Ltd v McConnell Dowell Constructors Ltd.*[165] Here the insurers were entitled to avoid the Contractors All Risks policy in response to the appellant contractors' submission on their own accord of drawings and plans for the projected buildings as having piled foundations when in actual fact, spread foundations were subsequently used, resulting in subsidence damage to the buildings.

Albeit different provisions of the *Marine Insurance Act 1906* (UK) dealt with the issue of pre-contractual non-disclosure and misrepresentation, the consequence of a breach of both was the same, namely avoidance of the contract by the insurer.

It would appear that damages as a remedy in addition to avoidance of the contract would be available where there was fraud or negligent misrepresentation involved.[166] This being in line with s76 of the *Contracts Act 1950* (Malaysia) read together with s19 of the same Act, whereby, should a contract be avoided on the basis that it was obtained by coercion, fraud or misrepresentation, the party rightfully avoiding the contract would be entitled to compensation for any damage sustained thereby.

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[161]Ibid.

[162][1964] MLJ 5.

[163][1973] 2 MLJ 195.

[164](1940) 67 Ll L Rep 136.

[165][1995] 2 Lloyd's Rep 116.

[166]*Toomey v Eagle Star Insurance Co. Ltd. (No 2)* [1995] 2 Lloyd's Rep 88.

It is interesting to note however, that prior to the recent amendments in the United Kingdom and Malaysia which shall be examined in Chap. 3, English judges like Steyn J and Rix J in *Highlands Insurance Co. v Continental Insurance Co.*[167] and *HIH Casualty and General v Chase Manhattan Bank,*[168] as well as the Insurance Ombudsman in the United Kingdom[169] had indicated the possible application of s2 (2) of the *Misrepresentation Act 1967* (UK) as a restriction on the insurer's right to avoid contracts for misrepresentation. Especially so, in consumer or non-commercial insurance contracts, thereby, permitting damages instead to be awarded in lieu thereof.

2.7.3 Fraudulent Claims

The final aspect of the insured's duty of utmost good faith is at the claims settlement stage, where the insured is required to put forward a genuine claim to the insurer within the contractual time limit prescribed. In this regard, the submission of a fraudulent claim would by virtue of public policy be a breach of utmost good faith, entitling the insurer to avoid the claim and forfeit the premiums paid.[170] An allegation of fraud by the insured would however, have to be pleaded and proven by the insurer.[171] In this context, the submission of exaggerated claims by insureds would not in itself necessarily amount to fraud. The courts would be mindful of the possibility of such exaggeration as merely being a means to facilitate the now common phenomenon of 'price-haggling' between the parties.[172]

2.8 Remedies for Breach of the Duty of Utmost Good Faith

Since it is well established that the duty of utmost good faith is reciprocal in nature, it is therefore necessary to evaluate the suitability of the remedies available to both insurers and insureds alike, in the event of breach by the other.

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[167][1987] 1 Lloyd's Rep 109.

[168][2001] Lloyd's Rep IR 702.

[169]Financial Ombudsman Service (1991, pp. 7–8).

[170]See: *The Star Sea* [2001] 1 Lloyd's Rep 389 (Lord Hobhouse), *The Mercandian Continent* [2001] EWCA Civ 1275 (Longmore LJ), *Agapitos v Agnew (The Aegeon)* [2002] 2 Lloyd's Rep 42 (Mance LJ).

[171]*Hornal v Neuberger Products Ltd* [1957] 1 QB 347.

[172]*Ewer v National Employers' Mutual General Insurance Association Ltd.* [1937] 2 All ER 193; *Wong Cheong Kong Sdn Bhd v Prudential Assurance Sdn Bhd* [1998] 3 MLJ 724; This aspect has been addressed earlier in this chapter under the insurer's duty of good faith in claims settlement.

As far as breach of the duty of utmost good faith by the insurer is concerned, the United Kingdom and Malaysia were up until the recent amendments in the *Insurance Act 2015* (UK) and *Financial Services Act 2013* (Malaysia) still bound by the shackles of s17 of the *Marine Insurance Act 1906* (UK) and its solitary remedy of avoidance of the insurance contract by the insured with a refund of premium paid, without any right to damages.[173]

The effect of these recent amendments in the United Kingdom and Malaysia, as well as the position in Australia, as to the remedies available in the event of breach, shall be broadly divided into the pre-contractual and post-contractual stages and examined in Chaps. 3 and 4.

2.9 Conclusion

In view of the wide scope of the insurers' and insureds' duties of utmost good faith highlighted above, which span from the pre-contractual stage of negotiating an insurance contract right up to claims settlement, the following Chaps. 3 and 4 will be dedicated to a detailed analysis of the reforms undertaken thus far and still required, at the pre and post-contractual stages. This will then be followed by an evaluation of the position pertaining to *takaful* in Chap. 5.

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