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THE CONCEPT OF UTMOST GOOD FAITH FAIRLY APPLIED IN ENGLISH INSURANCE LAW OR DOES IT CREATE AN UNFAIR RELATIONSHIP BETWEEN THE INSURE AND INSUREE?

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ABSTRACT

Introduction*: The term "bad faith" is commonly understood as a breach of the implied duty of good faith and fair dealing recognized in insurance contracts due to the "special relationship" between an insured and an insurer. Breach of this common law duty, although based in contract, is recognized as a tort under Texas law. Unfortunately, the implied duty of good faith and fair dealing is not reciprocal. However, there is another "good faith" doctrine to be aware of. The doctrine of Uberrimae fidei, or "utmost good faith." As set forth below, this heightened duty — which goes beyond the duty of disclosure — may be necessary given the difficulty in proving the insured had an "intent to deceive" when providing false statements on an insurance application. Uberrimae fidei's harsh penalty of voiding the policy should also deter insured's from withholding information from an insurance carrier or carelessly completing an insurance application.*

Objectives: *The objectives of the paper are to describe the utmost good faith before and under marine insurance act and to describe the Does Texas Recognize the Duty of Utmost Good Faith.*

Methodology: *To fulfill this objectives researcher adopted is a doctrinal form and the author has referred secondary sources in doing the research analysis.*

Conclusion: *It is clear, therefore, that whilst utmost good faith is making some contribution to fairness, the duty is not reaching its full or intended potential. It has served as a launching pad for industry-driven enunciations of best practice which are moving towards procedural fairness. However, utmost good faith has done little to improve substantive unfairness in policy terms. To a large extent, insurers are constricted in the exercise of their discretion regarding reinsurance, underwriting and out of date policy definitions in legacy products, and reform is needed to enable insurers to act in a way that delivers fair outcomes.*

Keywords: *utmost good faith, Insurance, law, Uberrimae fidei's*, Etc.

1. INTRODUCTION

The doctrine Uberrimae Fidei is originated from English law to the formation of insurance contract. Principle of Uberrimae fidei (a Latin phrase), or in simple English words, the Principle of Utmost Good Faith, is a very basic and first primary principle of insurance. Contract of Insurance is basically a contract for discharging indemnificatory liability by insurer for premium considered tendered by the insured to the insurer.[1]

According to this principle, the insurance contract must be signed by both parties (i.e. insurer and insured) in an absolute good faith or belief or trust. The person getting insured must willingly disclose and surrender to the insurer his complete true information regarding the subject matter of insurance. The insurer's liability gets void (i.e. legally revoked or cancelled) if any facts, about the subject matter of insurance are either omitted, hidden, falsified, distorted or presented in a wrong manner by the insured.

1.1 Concept of Utmost Good Faith in Insurance Contract

It is a general Common Law principle that, there is no duty of obligation on a party entering into a contract to disclose any material information.[2] Ordinarily, failure to disclose any material fact which might influence the mind of a prudent contractor does not give right to a party to avoid the contract; this is because the principle of 'cavet emptor' applies outside contracts of sales.[3] Nonetheless, some contracts are expressed by the law as one of utmost good faith, which requires the disclosure of material facts. Insurance Contract as a special contract is considered as a rare species of contract where both the proposer and the insurer are under a mutual duty of utmost good faith. That law of insurance emphatically revolves around the duty of utmost good faith. Etymological study points the origin of the term to the Latin expression 'uberrimaefidei'.[4] The principle in its ordinary sense means highest honesty, fair dealing and without any intention to defraud another person. The term as used in the law of insurance requires a contracting party to make full and true disclosure of any material facts which could guide a prudent insurer in

[1] Gopinath Vedula, *Uberrimae Fidei (Good Faith)*,(2019) *Available at* https://www.mondaq.com/india/insurance-laws-and-products/771934/uberrimae-fidei-good-faith

[2] *Bell v Lever Bros Ltd* (1932) AC 161 (HL)
[3] The Encyclopedia of forms and precedents, 1998, fifth Edition Para 128 p.68
[4] Birds, *Modern Insurance law*, 199 (9 th edn 2013).

determining whether to assume or take the risk and, if so at what premium and on what condition.[5] The classical origination of the duty to disclose material facts is traceable to Lord Mansfield in the earlier case of *Carter v Boehm* (1766) 3 Burr 1905.[6] The duty of utmost good faith is accorded a statutory codification under section 17 of the Marine Insurance Act 1906.[7] Section 17. Insurance is uberrimæ fidei; 'A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

The duty of disclosure is mutually shared among the parties to an insurance contract and they are by law bound to volunteer or share amongst each other information that is material before the contract is concluded.[8] Utmost good faith essentially provides the standard of judgment to distinguishes some classes of contracts (for insurance contracts which highly one of utmost good faith) from other contracts of which no duty of disclosure of material facts is placed on those entering into the contract at common law.[9] Lord Atkin has made this observation in the case of *Bell v Lever Bros Ltd*, (1932) AC 161 (HL) where he stated, "[T]here are certain contracts expressed by law to be contracts of the utmost good faith where material facts must be disclosed; if not the contract is voidable. Apart from special fiduciary relationships, contracts for partnership and contracts for insurance are the leading instances. In such cases, the duty does not arise out of contract: the duty of a person proposing insurance arises before a contract is made."[10] Lord Atkin's statement is of immense importance and significant endorsement and this is traceable to Lord Mansfield's decision in *Carta V Boehm* (1776) 3 Bur 1905.[11] The materiality of the facts or information to be disclosed is expressed as, essentially every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.[12] The development of this duty according to Channel J in Re Yager (1912) 108 L.T 35-40, is due to the unbalance in the bargaining power of the parties at the pre-contractual stage, namely the insurer's weaker position was one of the determining factors for the introduction of good faith.[13] This has received endorsement in the case of HIH Casualty and General Insurance Co v Chase Manhattan Bank [2003]Lloyds Rep 61(HL), where Lord Hobhouse observed: "the practical circumstance which has since been said to justify this special treatment of insurance contracts is a disparity between the knowledge of the proposer (and his agent) and the underwriter".[14] The duty of good faith is mutual and either party is stern from concealing what he privately knows to draw the other into a bargain from his ignorance of that fact and his believing the contrary.[15]

[5] *Guardian Assurance Co, Ltd v Osei* (1966) GLR 762
[6] *Carter v Boehm* (1766) 3 Burr 1905
[7] *Cabaret Club & Casino Ltd v London Assurance* [1975] 1 Lloyd's Rep 169. per May J The Act was intended to be declaratory of the common law.
[8] Birds J., *'Modern Insurance Law'*, 119(9th Edn, London Sweet and Maxwell 2013).
[9] John Lowry, Philip., *'Rawlings Insurance Law: Cases and Materials'*, (2004), 129
[10] *Ibid.*
[11] (1776) 3 Bur 1905
[12] Sections 18(2), Marine Insurance Act, 1906
[13] *Re Yager* (1912) 108 L T 35-40, Channel J
[14] [2003] Lloyds Rep 61(HL)
[15] *Carter v. Boehm* (1766) 3 Burr 1905

2. LITERATURE REVIEW

The Implied Term of Good Faith and Fair Dealing: Recent Development By Shannon Kathleen O'Byrne[16] in his article he describe the assists common law practitioners to predict when good faith obligations are owed in the context of contractual performance by organizing recent case law. The article concludes by advocating for express recognition of a common law rule that would mandate good faith as the governing, default standard out of which parties must expressly contract.

Does the Threat of Insurer Liability for "Bad Faith" Affect Insurance Settlements by Danial P. Asmat[17] In his article he explain the Economic reasoning predicts that policyholders in states that treat for insurer bad faith in settling claims as a tort should receive higher payments from insurers because of the greater potential damages insurers face in claims disputed in court. We test this hypothesis using data on automobile insurance claims for accidents occurring during 1972–1997, exploiting differences in states "laws and variation in timing of states" adoption of bad faith rules to identify the effects of tort liability. We find that the presence of tort liability for insurer bad faith increases settlement amounts and reduces the likelihood that a claim is underpaid.

3. OBJECTIVES

- To describe the utmost good faith before and under marine insurance act.
- To describe the Does Texas Recognize the Duty of Utmost Good Faith.

4. METHODOLOGY

The methodology used in achievement of this research paper is a doctrinal one.

5. ANALYSIS

5.1 Utmost good faith before marine insurance act

The earliest example of an insurance policy is according to Holdsworth to be found in Genoa, dating from 1347. This form of insurance policy was known by the Greeks expression 'polizza'. In the 1930's, special insurance courts were established to deal with marine policies. The Judgment of Lord Mansfield during the 18th century largely led to the development of English insurance law. The period under discussion is largely dominated by the common law. At common law, insurance contract is one of uberrimae fidei (that is, utmost good faith).[18] This form of contracts requires the exercise of utmost good faith (uberrima fidei) from both parties. The reasons for describing such contracts in this way are explained by Lord Mansfield in Carter v Boehm (1766) 3 Burr 1905 which is obviously the

[16] Shannon Kathleen O'Byrne, "The Implied Term of Good Faith and Fair Dealing: Recent Development", *The Canadian bar review* (2007).
[17] Danial P. Asmat, Does the Threat of Insurer Liability for "Bad Faith" Affect Insurance Settlements, 81 *Journal of Risk & Insurance* (2014).
[18] The Encyclopedia of forms and precedents, 68 (5th Edn Para 128 1998).

classical case on Insurance Contract.[19] It is noteworthy that Lord Mansfield's antecedents were Scottish who were inclined to requirement of good faith by contracting parties under the civilian tradition. As pointed out by lord Mustill in Pan Atlantic Insurance Co v Pine Top Insurance co. Lord Mansfeild was the time attempting to introduce into the English commercial law a general principle of good faith? This attempt was ultimately unsuccessful and only survived for limited classed of transactions, one which was insurance. The common law principle of utmost good faith requires a party to make full and true disclosure of the material facts which would guide a prudent insurer in determining whether to assume or take the risk and, if so at what premium and on what condition. The notion of materiality has acquired major significances in the common law system. In particular, an insurance company is entitled to cancel the insurance policy in the event of misrepresentation or concealment which is material to the risk. Often such material falsehoods and non-disclosures are identified at a fatal moment namely at the time of loss. Materiality is often defined as a contingency, state of affairs or event which has a 'fundamental' effect upon the insurance risk.[20] The justification of the test of materiality under the common law may not be equally convincing in the modern insurances world.

5.2 Utmost good faith under marine insurance act

The period from 1906 saw the codification of Insurance policy by the Marine Insurance Act, 1906. The Marine Insurance Act, 1906 of England incorporates the principle of utmost good faith ranging from disclosure by assured and the agent effecting insurance down to representation pending negotiation of contract. According to the Marine Insurance Act of England, a Contract of Marine Insurance is one of utmost good faith, failure to observe by either party, the contract may be avoided.[21] Potential parties to insurance contract are under a duty to volunteer to each other any material information that is, every circumstances or facts that would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk or not before the conclusion of the contract .[22] The insured's duty of disclosure is spelled out in section 18 of the Marin Insurance Act 1906. This has been established in various judicial opinions which have largely contributed to its development. The Act codifies the common law principles and renders same applicable to non-marine insurance contracts. It is noteworthy to say that the classic formulation of the duty to disclose material facts by Lord Mansfield in the case of Carta v Boehm[23] and as subsumed in the concept of uberrimae fidei, is accorded a statutory codification, specifically sections 17 and 18 of the Marine Insurance Act 1906. This duty has long been strictly applied to all types of insurance contracts; whether on ships, houses lives etc. The underwriter should be informed of every material circumstance within the knowledge of the assured.[24] It is important to note that Section17 of the Act does not limit the principle of utmost good faith to marine Insurance contracts only. In Lindenau v Deborough is was observed that, the principle should apply in all cases of insurance, whether on ships, houses, or lives, the underwriter should be informed of every material

[19] Hodgin n(6)
[20] Trakman L.E., *'Mysteries surrounding the material disclosure in insurance law'*, (1984)
[21] Section 17, Marine Insurance Act 1906
[22] Section 18(2) of the Marine Insurance Act 1906
[23] *Carter v. Boehm* (1766) 3 Burr 1905
[24] *Lindenau v Desborough* (1828) 8 Barn & C 586

circumstance within the knowledge of the assured.[25] Thus, section 18 of the Act codifies the common principle of utmost good faith and places the application of the principle beyond Marine Insurance into all forms of insurance contracts. Lord Mansfield's formation of the duty of disclosure is given statutory recognition under section 18 of the Marine Insurance Act 1906. The incidental questions on the test of materiality or what ordinarily would amount to material information, were frequently answered by Section 18(2) of the Marine Insurance Act 1906. Under the section, every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk. Also in Rivez v Gerussi, [26] it was held that a material fact is the one which would affect the judgment of a prudent and rational underwriter in considering whether he will enter into a contract at all or at one rate or another. To determine whether or not a non-disclosed fact is material is under section 18(2) is one that would influence the judgment of the prudent insurer. Although the Act does not go on to define these requirements, the courts have laid down the requisite tests for determining whether they are satisfied to have any influence on the contract. The "Prudent insurer test" by Blackburn J. in Lonides v Pender (1874) LR 9QB 531 in helpful in determining the materiality of facts under this law. Accordingly, every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.[27] Under the Act, it is worthwhile to draw attention to the useful point that generally the disclosure of material facts as embedded in the principle of utmost good faith works at the pre-contractual or the negotiation stage and the claims process but not during the time that the contract subsists. A closer look at section 18(1) of the Marine Insurance Act 1906 reveals this position.

5.3 Does Texas Recognize the Duty of Utmost Good Faith?

Texas does not recognize the doctrine of *uberrimae fidei*, but does permit an insurer to deny a claim or cancel a policy on the basis of the insured's misrepresentation (including an insured's failure to advise the insurer of the changes in his prior answers to an insurance application) if the insurer pleads and proves, among other things, the insured's intent to deceive in making the representation at the time it was made. *Mayes v. Massachusetts Mutual Life Insurance Co*.[28] An insured's false statements which are made because of negligence, mistake and/or carelessness are not sufficient to invalidate an insurance policy on the basis of an insured's misrepresentation of a material fact. *Adams v. John Hancock Mutual Life Insurance Co*.[29], 797 F.Supp. 563, 566 (W.D. Tex. 1992).

As set forth below, the key difference between *uberrimae fidei* and Texas law is the "intent to deceive" requirement -a difference which is likely outcome determinative in most instances.

[25] (1828) 8 Bam & C586
[26] (1880) 6 QBD 222
[27] *Lonides v Pender* (1874) LR 9QB 531
[28] *Mayes v. Massachusetts Mutual Life Insurance Co*., 608 S.W.2d 612, 616 (Tex. 1980)
[29] *Adams v. John Hancock Mutual Life Insurance Co*., 797 F.Supp. 563, 566 (W.D. Tex. 1992).

For example, in *Albany Insurance Co. v. Anh Thi Kieu*, 927 F.2d 882, 885 (5th Cir. 1991), Anh Thi Kieu, a Vietnamese immigrant residing in Texas, seeking insurance coverage for her shrimping vessel, submitted an application to Albany Insurance Co. However, the application contained a number of inaccuracies, including representations (1) that Anh Thi Kieu regularly operated the shrimping vessel as captain, (2) that the vessel had sustained no damages in the last five years and (3) that the purchase price of the vessel was $110,000. In truth, Anh Thi Kieu purchased the shrimping vessel for $30,000 and assembled an independent crew to guide the vessel in fishing and shrimping operations off the coast of Port Arthur, Texas. In November, 1988, the shrimping vessel sustained damage and Ahn Thi Kieu submitted a claim to Albany Insurance. After Albany investigated and learned of the misrepresentations, Albany filed a declaratory judgment action. In concluding that Texas law, rather than the federal maritime law applied, the court held that the insurer failed to prove that the insured intended to deceive or defraud Albany and found that the negligence or carelessness of the insured in completing the application of insurance would not support the invalidation of an insurance policy.

Conversely, in *Marine Insurance Co. v. Cron*, (S.D. Tex. Oct. 6, 2014), the insured purchased a yacht at auction for $65,000 and purportedly began a complete overhaul of the vessel. The insured then sought to refinance the vessel, but the lender required insurance covering the yacht. The insurance application at issue included spaces for "market value" and "purchase price" - both of which the insured completed with "$300,000." Just over a year after the marine insurance policy became effective, the yacht caught fire while in drydock in Dickenson, Texas, —-resulting in a total loss. The insurance carrier filed a declaratory judgment action, seeking to void the policy due to the misrepresentation on the application concerning the purchase price. In applying New York's *uberrimae fidei* doctrine, the court concluded that the purchase price was a fact material to the risk and the insurer was entitled to void the policy based on the insured's material misrepresentation.

6. CONCLUSION

Despite the fact that the insured property owner is in the best position to know of the risks and exposures of its own property, Texas law regarding misrepresentations is significantly less stringent than the duty of utmost good faith. And although the common law implied duty of good faith and fair dealing is premised on the purported "unequal bargaining power" between the parties - the ability of the insured to either incompletely or untruthfully answer an insurance application with no recourse unless the carrier proves intent to deceive is inequitable from the carrier's perspective. It should be worth considering whether the pendulum of good faith should swing in the other direction and insured's should be held to the high standard of utmost good faith, or *uberrimae fidei*.

It is clear, therefore, that whilst utmost good faith is making some contribution to fairness, the duty is not reaching its full or intended potential. It has served as a launching pad for industry-driven enunciations of best practice which are moving towards procedural fairness. However, utmost good faith has done little to improve substantive unfairness in policy terms. To a large extent, insurers are constricted in the exercise of their discretion regarding

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