"If They Wanted to Know, Why Didn't They Ask?" A Review of the Insured's Duty of Disclosure

HILARY K WHAM*

The duty of disclosure in New Zealand insurance law is in need of reform. Honest and innocent non-disclosures currently entitle insurers to avoid insurance policies from their inception, leaving an insured with an uncovered loss. This problem could be fixed if only insurers asked the questions they needed the answers to. Insureds who have their claims rejected on the grounds of non-disclosure are left wondering: if they wanted to know, why didn't they ask? This article examines the current common law duty of disclosure and assesses why this dissatisfaction occurs. It examines the origins of the duty and the reform of the duty in Australia and England. The 1998 New Zealand Law Commission paper "Some Insurance Law Problems" is also analysed to assess the workability of New Zealand's initial attempt at reform. Abolition of the duty altogether and alternative recommendations are also discussed. Ultimately, this article recommends that New Zealand follow Australia and England in creating legislative reform to modernise this area of insurance law.

I INTRODUCTION

The common law duty of disclosure, imposed on insureds in New Zealand, requires reform. Currently, a prospective insured must disclose all material facts that would influence the judgement of a prudent insurer before the conclusion of an insurance contract. Insurer-friendly tests define each of the three key aspects of the duty: knowledge, materiality and inducement. If the insured breaches this duty, the insurer can avoid the contract retrospectively, as if the contract never existed. The duty of disclosure is a unique feature of insurance contracts and is in stark contrast to the general contract law principle of caveat emptor: let the buyer beware. Instead, the insured is responsible for protecting not only his or her own interests but also those of the insurer.

The current law is unsatisfactory because existing tests provide that innocent and honest non-disclosures entitle insurers to avoid. Generally, insurers discover non-disclosures when the insured has made a claim, leaving the insured with a loss. Insureds often do not understand what

* LLB(Hons)/BCom, Solicitor, Chapman Tripp. I would like to acknowledge Rohan Havelock for his supervision and support of this dissertation.

information they are required to disclose and the law does not incentivise insurers to draw out such information. This creates inherent inefficiencies in the insurance market as policies are based on incomplete information. Additionally, the avoidance remedy available to insurers after breach of the duty creates the incentive to find missing information so as to avoid paying out on the policy. As a result, insureds are left with an uncovered loss. So while insurance may be cheaper, it is effectively worthless.

This article examines the origins of the duty of disclosure and concludes that while the duty was justified in its genesis, it is no longer justified in its current form. The New Zealand common law position on the duty of disclosure is analysed to expose the extent of the imbalance. This article considers possible modifications to, and arguments to overcome, the duty of disclosure. Reform to the duty that has occurred in Australia and England is analysed to stimulate ideas for potential New Zealand reform. The reform proposed by the New Zealand Law Commission in 1998 is also analysed to see if it would have created a workable change, had it been implemented. While abolition of the duty is also considered, the arguments in favour of the duty, particularly in relation to sophisticated insureds, suggest that this should not occur. This article recommends that New Zealand follow its Commonwealth companions in creating legislative reform to modernise this area of insurance law.

II HISTORY OF THE DUTY OF DISCLOSURE

Duty of Utmost Good Faith – Uberrimae Fidei

Parties to an insurance contract must act with the utmost good faith to each other. Also known by the Latin term uberrimae fidei, the duty of utmost 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."[1] Breach entitles the aggrieved party to rescind the contract from its inception, justified by the vitiation of their consent by entering into a contract on incomplete information. The duty of disclosure is born out of this wider duty of utmost good faith.

The duty of utmost good faith originated from the law of merchants, the *lex mercatoria*, which seeped into the common law through the development of English commercial law.[2] As domestic commerce grew, the common law borrowed rules from the law of merchants to manage trade.[3] One of the most important principles of the merchant was good faith.[4] The law of merchants also fashioned the first insurers.[5] In 1756, Lord Mansfield

1 *Carter v Boehm* 3 Burr 1905, [1766] All ER Rep (KB) 183 at 185 per Lord Mansfield.
2 Peter MacDonald Eggers, Simon Picken and Patrick Foss *Good Faith and Insurance Contracts* (3rd ed, Lloyd's List, London, 2010) at [4.03].
3 At [4.04].
4 Edmund Heward *Lord Mansfield* (Barry Rose (Publishers), Chichester, 1979) at 101.
5 Eggers, Picken and Foss, above n 2, at [4.07].

was appointed Chief Justice of the King.[6] Lord Mansfield was essentially "the founder of English commercial law and in particular, insurance law."[7] Lord Mansfield considered merchants more competent than lawyers to decide the form of their interactions.[8] Lord Mansfield incorporated the law merchant's principle of good faith into insurance contracts through the seminal case of *Carter v Boehm*.[9]

1 Carter v Boehm

Carter v Boehm reveals the duty of disclosure as a creature of its time. However, even in its most relevant era, Lord Mansfield recognised the potential for harsh outcomes and so limited its reach. Applying these limitations, Lord Mansfield found for the insured – a conclusion often overlooked by those citing *Carter v Boehm* as authority for the duty of disclosure.

In *Carter v Boehm*, the insured was Roger Carter, Deputy Governor of Fort Marlborough, Sumatra, from 1756.[10] Anglo-French conflict in India seemed likely to spread to Sumatra, which was divided between the competing trading interests of the English East India Company and the Dutch East India Company.[11] When an attack on Fort Marlborough became a possibility, Carter wanted to protect his personal trading interests. He pursued insurance cover through an underwriter in London.[12] After the attack arrived, Carter sought to recover under his policy. The insurer resisted, arguing Carter had breached the duty of utmost good faith by not disclosing the weakness of Fort Marlborough and the probability of an attack.[13] It was on these facts that Lord Mansfield stipulated the duty of utmost good faith, the duty of disclosure and the limitations on those duties. This judgment is widely referenced as authority for the duties, despite the clear differences between the modern insurance industry and that in 1766.[14] The key extract states:[15]

> First, insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the insured only ... Keeping back such circumstances is a fraud, and, therefore, the policy is void. Although the suppression should happen through mistake without

6 At [4.09].
7 At [4.06] (footnotes omitted); and see also Heward, above n 4, at 101.
8 CHS Fitfoot Lord Mansfield (Clarendon Press, Oxford, 1936) at 118 as cited in Heward, above n 4, at 101.
9 *Carter v Boehm*, above n 1.
10 Stephen Watterson "Carter v Boehm (1766)" in Charles Mitchell and Paul Mitchell (eds) *Landmark Cases in the Law of Contract* (Hart Publishing, Portland, 2008) at 62.
11 At 61 and 63–69.
12 At 72 and 76.
13 *Carter v Boehm*, above n 1, at 187; and RA Hasson "The Doctrine of Uberrima Fides in Insurance Law — A Critical Evaluation" (1969) 32 MLR 615 at 616.
14 Michael Kirby "Australian Insurance Contract Law: Out of the chaos — A modern, just and proportionate reforming statute" (2011) 22 ILJ 1 at 8.
15 *Carter v Boehm*, above n 1, at 184.

> any fraudulent intention, yet still the underwriter is deceived, and the policy is void, because the risk run is really different from the risk understood and intended to be run at the time of the agreement.

While Lord Mansfield justified the duty on the speculative nature of an insurance contract, all contracts are "speculative" as they all contain some risk. General contract law principles have developed to incentivise parties to look after their own interests. So how has Lord Mansfield's duty survived these developments?

Marine Insurance

The marine industry, the first to implement insurance, paved the way for general insurance to develop.[16] The common law of non-marine insurance grew out of the Marine Insurance Act 1906 (UK).[17] This legislation was the codification of over 2,000 cases that made up the law of marine insurance.[18] The principles it codified apply to insurance law generally.[19] The Marine Insurance Act 1908 replicated the 1906 Act in New Zealand. Both Acts codify the duty of disclosure as requiring the insured to:[20]

> ... disclose to the insurer, before the contract is concluded, every material circumstance 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 insured fails to make such disclosure, the insurer may avoid the contract.

The common law has interpreted and expanded on these pieces of legislation over time, the results of which are analysed below.

III THE CURRENT LAW IN NEW ZEALAND

Introduction

State v McHale is the leading authority on the duty of disclosure in New Zealand.[21] The common law position reflects what is set out in the Marine Insurance Act 1908. The duty requires the insured to divulge to the insurer, before the conclusion of their insurance contract, all material facts within his or her knowledge.[22] The rationale for this duty is that asymmetrical knowledge exists between the insured and the insurer, weighing in the

16 Paul Jaffe "Reform of the Insurance Law of England and Wales—Separate Laws for the Different Needs of Businesses and Consumers" 87 Tul L Rev 1075 at 1083.
17 Marine Insurance Act 1906 (UK) 6 Edw VII c 41.
18 Jaffe, above n 16, at 1083.
19 At 1083.
20 Marine Insurance Act 1908, s 18.
21 *State Insurance v McHale* [1992] 2 NZLR 399 (CA).
22 At 406–407.

insured's favour.[23] To correct this imbalance the insured is obligated to comply with the duty of disclosure.

The duty of disclosure is onerous due to the extent of information the insured is required to volunteer and the consequences of breach, which entitle the insurer to avoid the contract ab initio (from its inception).[24] This remedy has been justified on the basis that non-disclosure vitiates the insurer's consent to the contract.[25] The undisclosed fact can be unrelated to damage incurred by the insured and still entitle the insurer to avoid the policy. The insurer has the onus of proving breach on the balance of probabilities.[26]

Knowledge, materiality and inducement are the three key aspects of the duty of disclosure, each defined by the common law. Each aspect has its own test and each test is favourable to the insurer.

Knowledge

The insured is obliged to disclose facts within their actual or presumed knowledge, which are facts that they know or ought to know.[27] The issue is whether knowledge should extend to constructive knowledge. By including constructive knowledge, the non-disclosure defence is available for innocent and honest non-disclosures. This goes beyond utmost good faith because good faith only requires an honest and reasonable standard.[28] As the duty of disclosure is a subset of good faith, if the good faith duty is met, the disclosure duty should also be met.

In *Economides v Commercial Assurance Co Plc*, the English Court of Appeal drew a distinction between the knowledge required by commercial and consumer insureds. Private individuals were entitled to reprieve by limiting the requirement to actual knowledge only, with the test being honesty.[29] The Court held the insured was not in breach by not making extra inquiries as to the true value of the goods insured.[30] The Court interpreted s 18 of the Marine Insurance Act 1906 (UK) as imposing constructive knowledge to insureds in business only. The Court quoted the judgment of Moulton LJ in *Joel v Law Union and Crown Insurance Co*: "[t]he duty is a duty to disclose, and you cannot disclose what you do not know. The obligation to disclose, therefore, necessarily depends on the knowledge you possess."[31]

New Zealand courts have not yet drawn this distinction. *State v McHale* creates precedent and clearly states that the knowledge requirement

---

23 *Carter v Boehm*, above n 1, at 184.

24 *State Insurance v McHale*, above n 21, at 403.

25 See *Carter v Boehm*, above n 1, at 184. See also David St L Kelly and Michael Ball *Principles of Insurance Law in Australia and New Zealand* (Butterworths, Sydney, 1991) at [3.267].

26 See *Royal Insurance Co v Coleman* (1906) 26 NZLR 526 (CA) at 533–534.

27 *State Insurance v McHale*, above n 21, at 407 and 409.

28 Neil Campbell "Insurance" [1999] NZ L Rev 191 at 193.

29 *Economides v Commercial Assurance Co Plc* [1998] QB 587 (CA) at 601 and 607.

30 At 601.

31 *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863 (CA) at 884 as cited in *Economides v Commercial Assurance Co Plc*, above n 29, at 601.

includes actual and presumed knowledge.[32] Neil Campbell argues that the *Economides* distinction has merit because it mitigates the harshness of the duty on consumer-insureds, based on the assumption that consumer-insureds are unlikely to understand the extent of the duty of disclosure.[33] The distinction would need to be addressed if the issue came to court today. *McHale* could be distinguished on the fact that the McHales owned a rental property and could therefore be categorised as commercial insureds.

Materiality

To constitute a breach of the duty, the undisclosed information has to be material and relevant to the risk insured. The test for materiality is whether the undisclosed fact "would influence the judgment of a prudent insurer".[34] This is an objective test. *McHale* confirms that the test focuses on what would influence the judgment of a prudent insurer, regardless of what the insured thought was relevant.[35]

There are two key issues with the materiality test. The first issue is the meaning of "influence the judgment". The second issue is the burden placed on insureds by the "prudent insurer" test. In respect of interpreting "influence the judgment", *McHale* recognised two interpretations. Either the test requires a different decision from the insurer, had they known the undisclosed fact, or the test only requires the insurer to be interested to know the fact.[36] Commentators have recognised that the "interested to know" test imposes a heavy and disproportionate burden on the insured, one that goes beyond what is required by the underlying duty of utmost good faith.[37] This is because facts that an honest and obliging insured may not consider material could still be of interest to the insurer, putting the insured at risk of breaching the duty of disclosure and their policy being avoided.

The House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* discussed the alternative tests.[38] The majority applied the "interested to know" test but a strong dissent applied the "different decision" test.[39] The majority argued that the word "influence"[40] by itself denotes something less than "decisively" changing the insurer's mind.[41] Bearing its

32 At 407 and 409.

33 Campbell, above n 28, at 193 and 205.

34 Marine Insurance Act 1906, s 18(2); and Marine Insurance Act 1908, s 18(2). For further clarification, see *State Insurance v McHale,* above n 23, at 402–403, 407, 409 and 411. See also *Lambert v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep 485 at 487, which held that the s 18(1) test applies to all forms of insurance; and *Mayne Nickless Ltd v Pegler*, above n 29, at 239.

35 *State Insurance v McHale*, above n 21, at 407 and 409.

36 At 407.

37 Anthony Tarr and Julie-Anne Tarr "The Insured's Non-Disclosure in the Formation of Insurance Contracts: A Comparative Perspective" (2001) 50 ICLQ 557 at 606; Campbell, above n 28, at 193 and 205–206.

38 *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501.

39 At 517 per Lord Goff, at 541 per Lord Mustill; at 551–552 per Lord Slynn; at 560 and 571 per Lord Lloyd dissenting; and at 515 per Lord Templeman dissenting.

40 Marine Insurance Act 1906 (UK), s 18(2).

41 At 531 per Lord Mustill.

plain meaning, "influence" could not be interpreted as "change the mind".[42] The majority said this accords with the practicalities of the industry, as it is easier for the insured to judge what an insurer would be interested to know rather than what would actually change the insurer's mind.[43]

The minority argued that, if the insurer would not have changed the premium or the terms despite the non-disclosure, then this must mean the risk is the same, with or without disclosure.[44] Therefore, how can the non-disclosure be considered material if it would not have changed the risk? How could the insurer then say their consent is vitiated such as to warrant avoidance of the contract? In respect to the practicalities of the industry, the minority took an opposite view.[45] What the prudent insurer would want to know is indefinite.[46] The minority cited *Ionides v Pender*, the foundation of s 18 of the Marine Insurance Act 1906 (UK):[47]

> ... [I]t would be too much to put on the assured the duty of disclosing everything which might influence the mind of an underwriter. Business could hardly be carried on if this was required.

While at odds with the plain and ordinary meaning, the minority position is more persuasive in light of the phrase as a whole, the purpose of the section and the consequences of the two interpretations.[48]

It is unclear which test New Zealand courts will prefer.[49] The Court of Appeal applied the materiality test from the majority in *Pan Atlantic* "without determining whether that approach is to be the law in New Zealand".[50] While it is difficult to understand how a court can apply a test but not adopt it as the current law, the statement expressly leaves it open for another court to adopt a different test. Judicial comment in *McHale* noted the unsatisfactory position of the law on materiality, recognising the injustice that such a wide test can have.[51]

Inducement

Inducement is the next requirement for an insurer to avoid a contract on the basis of non-disclosure. The non-disclosed fact must have had a causative effect on the decision made by the insurer. This is a subjective test. *Pan*

42 At 531.
43 At 531–532.
44 At 557 per Lord Lloyd.
45 At 557.
46 At 557.
47 *Ionides v Pender* (1874) 9 LR 531 QB at 539 per Blackburn J as cited in *Pan Atlantic Insurance*, above n 38, at 561.
48 See also Kelly and Michael Ball, above n 28, at [3.134]–[3.135].
49 *Benjamin v State Insurance Ltd* (1998) 10 ANZ Insurance Cases 61-414 (NZCA) at 74,660. But see *Jaggar v Lyttelton Marina Holdings Ltd (in rec)* [2006] 2 NZLR 87 (HC) at [154] and [155] where Panckhurst J proposes to follow the *Pan Atlantic* approach regarding inducement; and *Jaggar v QBE Insurance International Ltd* [2007] 2 NZLR 336 (CA) at [40].
50 *Benjamin v State Insurance Ltd*, above n 49, at 74,660.
51 At 404–405 and 415.

Atlantic is the leading authority on the requirement of inducement, and went further by creating a presumption of inducement in favour of the insurer if materiality is proved.[52]

A low materiality test of "interested to know" combined with the presumption of inducement makes it extremely hard for the insured to defend an alleged breach. It makes more sense to have an inducement requirement if the "different decision" test is applied. If the test is "interested to know", then it is unimportant whether it induced the insurer because there is no requirement that the insurer would have done anything differently. Neil Campbell considers an inducement requirement logical as the law of misrepresentation requires inducement by s 7(3) of the Contractual Remedies Act (CRA).[53]

The New Zealand Court of Appeal in *Jaggar v QBE Insurance International Ltd* required inducement but did not apply the presumption of inducement when it proceeded on the assumption that there was materiality.[54] In *Jaggar*, the insurer's failure to proffer evidence from their underwriter was fatal to their non-disclosure defence. The Court held without such evidence the insurer had failed to satisfy the court that it was induced to enter into the contract by the non-disclosure.[55] This is an insured-friendly conclusion.

Remedy

For a breach of the duty of disclosure, the remedy to the insurer is avoidance of the contract from its inception (avoidance ab initio).[56] It is an all-or-nothing result: either avoid the contract or not. The insured is entitled to repayment of the premium, unless the contract states otherwise, and the insurer is entitled to repayment of any money it has paid out to the insured in respect of any loss.[57] Given that non-disclosures are usually investigated and discovered once a claim is made, the insured is left with an uninsured loss. This remedy is draconian, particularly for innocent non-disclosures.

The extreme nature of the avoidance remedy is obvious when contrasted with the remedies prescribed by the CRA. Retrospective avoidance is unavailable under the CRA. Prospective cancellation under the CRA is only available if a party was induced to enter the contract by a misrepresentation and the truth of that representation was essential or the effect was substantial.[58] Avoidance is significantly harsher on insureds when compared to an equivalent party to a non-insurance contract.

---

52 *Pan Atlantic Insurance*, above n 38, at 549–551.

53 Campbell, above n 28, at 192.

54 *Jaggar v QBE Insurance International Ltd*, above n 49, at [39] and [46]. However, the Court took the view that there was no material non-disclosure and, if there was, it was only by a narrow margin: at [38] and [45]. It did not answer the question of whether there is a presumption of inducement: at [42].

55 At [46].

56 *Carter v Boehm*, above n 1, at 184.

57 See *Black King Shipping Corp v Massie* [1985] 1 Lloyd's Rep 437(QB) [The Litsion Pride] at 515. See also Kelly and Ball, above n 25, at [3.267].

58 Contractual Remedies Act 1979, s 7.

IV MODIFICATION OF THE DUTY

Comprehensive reform is the most satisfactory way to solve the issues with the duty of disclosure highlighted above. In the meantime, there are possible ways to argue around the duty.

Contracting Out

The duty can be expressly or impliedly modified by the insurance policy or questionnaire. While unusual, an insurer can expressly contract out of the duty of disclosure.[59] The contract may also expressly limit the instances when the insurer can use the remedy of avoidance, for example, only when the non-disclosure was fraudulent.[60] An insurer's conduct may impliedly modify or completely waive the duty of disclosure. The most common way is by asking specific or targeted questions in the proposal form.[61] The success of this argument will depend on all of the circumstances.[62] For example, in *State Insurance v Peake*, the motor vehicle insurance proposal asked 10 questions relating to motor vehicles. Question three asked whether the insured had any convictions or demerit points from vehicle offences. The final question was a "catch-all", asking if there was any "further information likely to affect the acceptance of this insurance".[63] The Court held that the specific question on vehicle-related offences amounted to a modification of the duty because it implied that the insurer did not consider other convictions material.[64]

Each case is determined on its own facts by construction of the proposal form.[65] The duty is not automatically waived if the insurer does not ask specific questions.[66] For example, failure to ask questions about past criminal convictions does not mean the form is interpreted as impliedly waiving the duty to disclose any convictions.[67] The possibility of waiver goes some way towards resolving the problem of insurance companies not directly asking about other criminal convictions, yet relying on any non-disclosure of such offences to avoid a policy.[68]

Another way of impliedly limiting the duty of disclosure is through the use of a declaration at the end of the proposal form.[69] In *State Insurance Ltd v Fry*, the declaration stated:[70]

---

59 *Switzerland Insurance (Australia) Ltd v Gooch* [1996] 3 NZLR 525 (CA).
60 *Scottish Provident Institution v Boddam* (1893) 9 TLR 385 (QB) at 386.
61 *State Insurance General Manager v Peake* [1991] 2 NZLR 287 (HC) at 291–292.
62 *Misirlakis v The New Zealand Insurance Ltd* (1985) 3 ANZ Insurance Cases 60-633 (NZCA) at 78,897.
63 *State Insurance General Manager v Peake*, above n 61, at 289–290.
64 At 294. See also *State Insurance General Manager v Hanham* (1990) 6 ANZ Insurance Cases 60-990 (NZHC) at 76,608.
65 *State Insurance Ltd v Fry* (1991) 6 ANZ Insurance Cases 61-075 (NZHC) at 77,239.
66 *State Insurance General Manager v Peake*, above n 61, at 291.
67 *Quinby Enterprises Ltd (in liq) v General Accident Fire and Life Assurance Corp Public Ltd Co* [1995] 1 NZLR 736 (HC) at 741–743.
68 Paul Rishworth "Insurance Law" [1991] NZ Recent Law Review 268 at 269.
69 *State Insurance v Fry*, above n 65, at 77,239–77,240.
70 At 77,238.

> ... to the best of my knowledge and belief the particulars and answers given above are in every respect true, and that I have not withheld any information likely to affect the acceptance of this proposal.

The Court held that this declaration displaced the more onerous duty by requiring a subjectively assessed disclosure standard instead.[71]

Contractual Remedies Act 1979

It would be beneficial to the insured if the CRA applied in respect of non-disclosures as the avoidance remedy is not available under the existing regime. Application of the CRA would result in less harsh remedies for the insured than avoidance ab initio. The question of whether the CRA provisions extend to non-disclosure is relatively unexplored. It is unlikely that the CRA was drafted with non-disclosure or insurance contracts specifically in mind.[72] However, the general purpose of the CRA is applicable to insurance contracts just as to any form of contract. For misrepresentation issues, the CRA applies in the absence of any express provision to the contrary.[73] The issue is that while non-disclosures and misrepresentations often overlap, this is not always the case. So the question is: can non-disclosures fall within the definition of "misrepresentation"?

"Misrepresentation" is undefined by the CRA, requiring one to look at the common law definition of a false "statement of present or past fact".[74] Generally, silence does not amount to a misrepresentation.[75] The English Court of Appeal rejected the argument that a non-disclosure amounts to a representation that there is nothing to disclose.[76] Dawson and McLauchlan agree with the analysis that the phrase "a misrepresentation made" only applies to active misrepresentation and not to non-disclosure.[77] The New Zealand High Court in *Scales Trading Ltd v Far Eastern Manufacturing and Commerce Corp* took the opposite view, finding that a non-disclosure does amount to a representation that something does not exist in relation to a guarantee.[78] This required the Court to consider whether the general law or the CRA should apply.[79] Unfortunately the Court of Appeal and Privy

71 At 77,240.

72 Kelly and Ball, above 25, at [3.284].

73 Contractual Remedies Act 1979, s 5.

74 *Ware v Johnson* [1984] 2 NZLR 518 (HC) at 537.

75 *March Construction Ltd v Christchurch City Council* (1994) 6 TCLR 69 (HC) at 75.

76 *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd (previously Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd)* [1990] 1 QB 665 (CA) at 787 and 790.

77 Francis Dawson and David W McLauchlan *The Contractual Remedies Act 1979* (Sweet & Maxwell, Auckland, 1981) at 21.

78 *Scales Trading Ltd v Far Eastern Manufacturing & Commerce Corp* HC Christchurch CP41/97, 9 April 1998 at 45 [*Scales Trading* (HC)]. See also *Scales Trading Ltd v Far Eastern Manufacturing & Commerce Corp* [1999] 3 NZLR 26 (CA) at 38 [*Scales Trading* (CA)]; and *Commercial Bank of Aust Ltd v Amadio* (1983) 151 CLR 447 at 458.

79 *Scales Trading* (HC) at 43 and 45.

Council reversed the judgment on appeal and consequently reserved opinion on whether the CRA applied in place of the general law.[80]

Kelly and Ball argue that the CRA should cover non-disclosure.[81] The key argument in favour of this is the ineffectiveness of the CRA if the legislation is limited to misrepresentation only, enabling the insurer to circumvent the Act by arguing non-disclosure.[82] This is available because whenever an insured makes a misrepresentation with respect to a material fact, the insured also fails to disclose the true fact.[83] The insurer is then entitled to the choice of two remedies: cancellation through the CRA (absent express provision to the contrary) or avoidance ab initio through breach of the duty of disclosure.

Fair Trading Act 1986

Another possible method of circumventing the duty of disclosure is for the insured to argue that the insurer is in breach of the Fair Trading Act 1986 (FTA).[84] First, by implying that the completion of the proposal form is all that is required from the insured, it can be argued that the insurer is acting in a misleading and/or deceptive manner. Secondly, failing to ask specific questions about matters that insurers consider material arguably amounts to misleading or deceptive conduct.[85] Breach of s 9 of the FTA does not require an intention to mislead.[86]

Barker J rejected the FTA argument put forward by the insured in *Quinby Enterprises Ltd (in liq) v General Accident Fire and Life Assurance Corp Public Ltd Co*.[87] He based his rejection on the reasoning in *Gate v Sun Alliance* but the justification was weak.[88] His reasoning was based on interpreting New Zealand's legislation by reference to the Australian equivalent and the insurance law landscape in Australia. His rejection would have been more convincing if it was based on an application of the text in light of its purpose, as required by s 5(2) of the Interpretation Act 1999.

The purpose of the FTA is to protect consumers and redress information imbalances. Therefore a purposive interpretation supports the application of s 9.[89] *Red Eagle Corp Ltd v Ellis* states that the question is

---

80 *Scales Trading* (CA) at 38; and *Far Eastern Shipping Company Public Limited v Scales Trading Ltd* [2001] 1 NZLR 513 (PC) at [34].

81 Kelly and Ball, above n 25, at [3.287].

82 At [3.287].

83 At [3.287].

84 Fair Trading Act 1986, s 9.

85 Les Arthur "Recent Developments in the Scope of the Insured's Precontractual Duty of Disclosure: Strategies for Reform" in Duncan Webb and David Rowe (eds) *Insurance Law: Practice, Policy and Principles* (The Centre for Corporate & Commercial Law, Christchurch, 2004) at 73.

86 *Goldsbro v Walker* [1993] 1 NZLR 394 (CA) at 397, regarding misleading conduct. However, deceptive conduct may require intention: *Prudential Building & Investment Society of Canterbury v Prudential Assurance Co of NZ Ltd* [1988] 2 NZLR 653 (CA) at 658.

87 *Quinby Enterprises Ltd (in liq) v General Accident Fire and Life Assurance Corp Public Ltd Co* [1995] 1 NZLR 736 (HC) at 745.

88 *Gate v Sun Alliance Insurance Ltd* [1995] LRLR 385 (NZHC) as cited in *Quinby Enterprises Ltd*, above n 87, at 745.

89 Arthur, above n 85, at 73.

whether a reasonable person in the claimant's situation, with the characteristics known or that ought to have been known to the defendant, would likely have been misled or deceived.[90] If so, then a breach is established.

A successful FTA argument would incentivise insurers to better warn insureds of their duty and to ask better questions. The rebuttal to this proposition is that it would put an unfair burden on insurers to provide advice to insureds. While insurers often include a short paragraph somewhere within the policy document, the warning often does not go beyond this. Given the extreme result if the duty is breached, it is not an unfair burden on insurers to take greater initiative to communicate the duty and its consequences to customers.

Breach of the Duty of Utmost Good Faith

Insurance contracts are also subject to the broader duty of utmost good faith, owed mutually by both parties. It may be that an insurer should not be able to rely on "catch-all" or unasked questions for information if the insured does not know about the duty of disclosure or the consequences of breach. A failure to warn the insured of this duty of disclosure could amount to a breach of the insurer's wider duty of good faith. Richardson J recognised the potential for this argument in *Gate* when he stated:[91]

> [T]hose insurers concerned about moral risk should put their cards on the table and signal that fair and accurate answers to all questions in the proposal may not discharge the proponent's disclosure obligations.

Banque Financiere de la Cite SA v Westgate Insurance Co Ltd considered whether an omission could amount to a breach of the duty of utmost good faith by the insurer.[92] The Court had considerable difficulty in defining the breadth of the duty.[93] This is because breach by the insurer is rarely considered as a breach of the good faith duty.[94] The Court of Appeal defined materiality in relation to the insurer's duty of utmost good faith as:[95]

> ... [A]ll facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer.

90 *Red Eagle Corp Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [28].
91 *Gate v Sun Alliance Insurance Ltd* (1995) 8 ANZ Insurance Cases 75,806 (NZCA) at 75,817.
92 *Banque Financiere de la Cite*, above n 76.
93 Eggers, Picken and Foss, above n 2, at [12.06].
94 At [12.05].
95 *Banque Financiere de la Cite*, at 772.

On appeal, the House of Lords approved the materiality test but applied it differently to the facts, finding no breach of the duty.[96] Eggers, Picken and Foss recommend that any defence, which might be raised by the insurer under the proposed policy, would be a material fact the insurer must disclose to the insured before the contract is concluded.[97] It remains to be seen whether this provides an insured, who has not been warned about the duty, with an effective rebuttal.

Self-regulation

The insurance industry in New Zealand has a self-regulation mechanism that sets out "best practice" standards: the Fair Insurance Code (the Code).[98] The Insurance Council, an industry-representative body, administers the Code. The Code sets out the responsibilities of both parties to the insurance contract. A consumer can complain to the Insurance Council if he or she feels that the code has been breached. The Code indirectly addresses the duty of disclosure by requiring insurers to tell insureds of the information they are required to disclose and the importance of this requirement. It does not require the words "duty of disclosure" to be mentioned. In contrast, the responsibilities the Code sets out for consumers are much more explicit. As the Insurance Council is an industry body, the one-sided nature of the Code is unsurprising.

In contrast, the Insurance and Savings Ombudsman (ISO) is an independent body. This is a free service designed to deal with consumer complaints in respect of an insurance or financial organisation. The decisions of the ISO are binding on the insurance providers but not on consumers.[99] While the ISO provides an opportunity for a complaint to be thoroughly and independently investigated, the ISO is limited in that it must refer to the current law in making its decisions. Therefore, arguments that a non-disclosure was innocent will be unsuccessful.[100] While these grievance mechanisms show a positive attribute from the industry, they are limited in power and effect.

Tort

This section will discuss whether tort claims may be available to an insured who is uninformed about the duty of disclosure and its consequences. The two possible tort claims are deceit and negligent misstatement. The issue

96 *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd (previously Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd)* [1991] 2 AC 249 (HL) at 269 and 280–281.

97 Eggers, Picken and Foss, above n 2, at [12.16].

98 Insurance Council of New Zealand "Fair Insurance Code" (June 13 2014) Insurance Council of New Zealand <www.icnz.org.nz>.

99 Insurance and Savings Ombudsman "Using the ISO" (24 May 2012) Insurance and Savings Ombudsman <www.iombudsman.org.nz>.

100 See Insurance and Savings Ombudsman "Complaint No 109660" (2002) Insurance and Savings Ombudsman <www.iombudsman.org.nz>.

with the application of both torts is whether a non-disclosure fits their requirements.

Negligent misstatement only arises if there is a "special relationship" between the person making the representation and the person to whom it is made.[101] This argument has not succeeded in New Zealand or Australia with respect to insurers and insureds.[102] The English Court of Appeal considered the issue in *Banque Financiere de la Cite.*[103] The Court recognised that the tort may be available where an insurer had voluntarily assumed responsibility to make full disclosure of all material facts and the insured had relied on it.[104] The Court held that the action could extend to silence provided there was assumption of responsibility and reliance.[105] However, the facts of the case did not meet this test, even when a failure to say something constituted a breach of the insurer's duty of utmost good faith.[106]

Similarly, deceit requires a false representation with the intention that the person receiving the representation rely on it and suffer damage due to that reliance.[107] Again, the issue is whether an omission to tell the insured about the duty of disclosure can amount to a false representation. The problem is that representation connotes a positive action such that mere silence is not normally a misrepresentation.[108] Therefore, it is unlikely that such an omission could give rise to an action in the tort of deceit.[109] Overall, these torts need to be artificially stretched to be applicable and therefore are not capable of offering the insured real reprieve.

V COMPARATIVE APPROACHES

Australia

There has been significant reform to the common law duty of disclosure in Australia. The catalyst for legislative change was the Australian Law Reform Commission (ALRC) *Insurance Contracts* report.[110] The Insurance Contracts Act 1984 (Cth) adopted the report's recommendations into legislation. While the insured continues to owe a duty of disclosure, the duty has been significantly limited compared to the common law standard.

101 *Hedley Byrne and Co Ltd v Heller and Partners Ltd* [1964] AC 465 (HL).
102 Kelly and Ball, above n 25, at [4.61].
103 *Banque Financiere de la Cite*, above n 76.
104 At 800; and Kelly and Ball, above n 25, at [4.61].
105 *Banque Financiere de la Cite*, above n 76, at 794–795.
106 At 800–801.
107 *Amaltal Corp Ltd v Maruha Corp* [2007] 1 NZLR 608 (CA) at [46]–[50].
108 Stephen Todd *The Law of Torts in New Zealand* (5th ed, Brookers, Wellington) at [15.2.02(3)].
109 Eggers, Picken and Foss, above n 2, at [16.100].
110 Australian Law Reform Commission *Insurance Contracts* (ALRC P20, 1982).

1 Knowledge and Materiality

The Act defines the duty of disclosure.[111] The definition requires the insured to disclose to the insurer every matter within the insured's actual knowledge known to be relevant to the insurer's decision of whether to accept the risk or on what terms to accept the risk. This limits the "knowledge" element to actual knowledge.[112] Some leeway is given to insurers by including the alternative: those matters that "a reasonable person in the circumstances could be expected to know".[113]

The ALRC wanted a more subjective test that took into account characteristics of the particular insured, such as education, literacy and whether English was their first language. However this was considered too unworkable.[114] Instead, "reasonable person in the circumstances" applies a mixed subjective-objective test that strikes some balance between the interests of the insurer and the insured. This excludes the idiosyncrasies of the insured while allowing the court to consider some external factors, such as the general knowledge available to the insured, the type of policy and the marketing material the insured was exposed to, in order to assess what a person in that circumstance would have known to be material.[115] The statute defines the materiality test to be the "different decision" test. Something is only material if it would change the insurer's mind in accepting the risk or the terms on which they accept that risk.[116] This is a positive reform measure because it means that irrelevant non-disclosures cannot impact on an insured's cover.

2 Warning and Waiver

The new legislation gives the insurer more responsibility in respect of the duty of disclosure. The Act requires the insurer to inform the insured of the duty of disclosure before the contract is concluded.[117] This requires more than advising the insured of the duty in a general way. As a result, notice of the duty on the back of a policy form, without highlighting or express reference, was held to be inadequate compliance.[118] Section 21A of the Insurance Law Amendment Act 1998 (Cth) outlines the steps an insurer must take in order for the duty to apply. An insurer is deemed to have waived the duty if they do not ask specific questions. This imposes a positive obligation on the insurer to pursue specific information relevant to the risk in

111 Insurance Contracts Act 1984 (Cth), s 21.
112 *Advance (NSW) Insurance Agencies Pty Ltd v Matthews* (1987) ANZ Insurance Cases 60-813 (NSWSC) at 74,998.
113 Insurance Contracts Act 1984 (Cth), s 21(1)(b).
114 Australian Law Reform Commission, above n 110, at [180] and [182].
115 Julie-Anne Tarr *Disclosure and Concealment in Consumer Insurance Contracts* (Cavendish Publishing London, 2002) at 62.
116 Insurance Contracts Act, s 21(1).
117 Section 22.
118 *Suncorp General Insurance Ltd v Cheihk* (1999) 10 ANZ Insurance Cases 61-442 (NSWCA) at [38]–[40].

order for the duty of disclosure to apply.[119] An insurer is also deemed to have waived compliance with the duty if they accept a blank or incompletely answered proposal document without further inquiry.[120]

3 Remedy

The new legislation also modifies the availability of avoidance as a remedy.[121] In particular, under s 28, avoidance is only available in cases of fraudulent non-disclosure or misrepresentation. Avoidance acts as a deterrent for fraudulent applications and better balances the interests of the insurer and the insured.[122] The court has authority to disregard the avoidance remedy if it would be harsh and unfair on the insured and the insurer was not significantly prejudiced.[123]

No remedy is available to the insurer if the insurer would have entered into the contract for the same premium and on the same terms, regardless of whether the insured failed to comply with the duty.[124] An innocent non-disclosure that would have changed the premium or the terms no longer entitles the insurer to the remedy of avoidance. Instead, the insurer can reduce its liability by the amount necessary to put the insurer in the position they would have been had there been disclosure.[125] The reduction in liability reflects the loss to the insurer due to the non-disclosure.[126] The loss is the difference between the premium and the terms actually given, and those that would have been given had there been proper disclosure.[127] The onus of proving that there would have been a difference in the policy is on the insurer, as only the insurer has this knowledge.[128] The exercise of this remedy has been called "retrospective underwriting".[129]

4 Conclusion

When reform was initially proposed in Australia, the insurance industry argued that it would "impede competition and prejudice market efficiency".[130] However, the ALRC recognised that the piecemeal approach taken so far had resulted in a chaotic mix of outdated common law principles and targeted legislation that was only partially effective.[131] The reforming

119 Tarr and Tarr, above n 37, at 598; and Kirby, above n 14, at 15.
120 Insurance Contracts Act, s 21(3)(a) and s 21(3) (b).
121 Kelly and Ball, above n 25, at [3.292].
122 See Insurance Contracts Act, s 31(3).
123 Section 31; and *Von Braun v Australian Associated Motor Insurers Ltd* (1999) 10 ANZ Insurance Cases 61-419 (ACTSC) at [93]–[97].
124 Insurance Contract Acts, s 28(1).
125 Sections 28(2) and 28(3).
126 Kelly and Ball, above n 25, at [3.294].
127 Australian Law Reform Commission, above n 110, at [192] and [194].
128 Tarr and Tarr, above n 37, at 603.
129 *Some Insurance Law Problems* (NZLC R46, 1998) at [23].
130 At 5.
131 At 2–3.

legislation has been in place for almost 30 years and is considered to operate to the benefit of both insurers and insureds.[132]

Australia's reformative legislation confronted the major issues identified with the current common law principles applicable in New Zealand. In particular, the new legislation closed the gates on the inclusion of constructive knowledge, abolished the prudent insurer test in favour of the perspective of the reasonable insured, affirmed the "different decision" test and limited the draconian remedy of avoidance to apply only to cases of fraud. The longevity and overall success of this legislation shows it as an excellent model of reform.

United Kingdom

The duty of disclosure law in England has also changed significantly since the passing of the Consumer Insurance (Disclosure and Representations) Act 2012 (UK) (CIDRA). The Law Reform Committee first recommended reform in 1957.[133] In 1980 the Law Commission (LC) further described the law of disclosure as "inherently unreasonable".[134] Both of these reports recommended a reasonable insured test but neither resulted in legislative action.[135] However, strong self-regulation mechanisms were established in response to the reports, such as the Financial Ombudsman Service (FOS).

1 Self-regulation

In relation to insurance complaints, the FOS system has been a success. This service differs from the New Zealand equivalent as the terms of reference for the FOS are "what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case".[136] This wide reference meant the FOS does not have to apply the law if it had an unjust result. It seems a jurisprudential anomaly that an ombudsman body needs to disregard set legal principles in order to achieve a "fair and reasonable" outcome. While the FOS is effective in servicing consumer complaints in relation to harsh disclosure laws, it remains unsatisfactory that these bodies have no power over judicial outcomes.

2 Reform

Reform attempts reignited in 2006 when the LC joined with the Scottish Law Commission on a comprehensive insurance law review project. The issue paper *Misrepresentation and Non-disclosure* was released in

132 At 22.

133 Eggers, Picken and Foss, above n 2, at 109; and Law Reform Committee *Fifth Report: Conditions and Exceptions in Insurance Policies* (LCEW Cmnd 62, 1957).

134 Law Commission *Insurance Law: Non-Disclosure and Breach of Warranty* (Law Com 104, 1980) at [4.43].

135 Law Reform Committee, above n 133, at [14]; and Law Commission, above n 134, at [4.51]–[4.52].

136 Financial Markets and Services Act 2000 (UK), s 228 as cited in Law Commission and Scottish Law Commission *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (Law Com 319, Scot Law Com 219, 2009) at [2.44].

September 2006 and became the impetus for the consultation paper *Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured*.[137] In the latter, the Commissions decided to review the law on non-disclosure for consumers and businesses separately.[138] The consumer reform aimed to protect consumers. For businesses, the Commissions were more concerned with creating a "neutral" law that struck a balance between the parties by imposing reciprocal obligations.[139]

In 2009, a hefty 200-page report titled *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* was released.[140] Fortunately, the effort did not go to waste. It resulted in the enactment of CIDRA, which came into force in April 2013. The report acknowledged that the law as set out in the Marine Insurance Act 1906 no longer reflected the realities of the mass consumer market, which had generally accepted that insurers should ask consumers for the information they want to know.[141] Therefore, CIDRA abolishes the insured's duty to volunteer information and instead requires the consumer to take reasonable care not to make a misrepresentation.[142] The use of the word "misrepresentation" may create doubt as to whether it covers non-disclosures. However, CIDRA clearly states that this new duty replaces any prior law relating to disclosure that existed before CIDRA and that it modifies the Marine Insurance Act 1906 to the extent that it was previously used to interpret consumer insurance contracts.[143]

3 Reasonable Care

The standard of reasonable care is that of the "reasonable consumer", which in turn is decided in light of all relevant circumstances.[144] It considers the type of policy, clarity of questions, explanatory material and use of agents.[145] Personal characteristics such as literacy and language ability are not relevant to the inquiry, unless the insurer knew or ought to have known about them.[146] The reasonable insured standard gives insurers the incentive to ask specific questions, since the non-disclosure defence is no longer available for dissatisfactory answers to "catch-all" questions.

---

137 Law Commission and Scottish Law Commission *Insurance Contract Law: Issues Paper 1 — Misrepresentation and Non-Disclosure* (Law Com CP 182, IP, 2006); and Law Commission and Scottish Law Commission *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (Law Com CP 82, Scot Law Com DP 134, 2007).

138 At [1.3].

139 Law Commission and Scottish Law Commission *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (Law Com CP 204, Scot Law Com DP 155, 2012) at [1.17].

140 Law Commission and Scottish Law Commission *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation*, above n 136.

141 At [1.2].

142 Consumer Insurance (Disclosure and Representations) Act 2012 (UK), ss 2(4) and 2(2) [CIDRA].

143 Sections 2(4), 2(5)(a) and 2(5)(b).

144 CIDRA, ss 3(1) and 3(3).

145 Section 3(2).

146 Section 3(4); and Law Commission and Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation*, above n 136, at [4.16].

4 Materiality

In respect of materiality, the onus is on insurers to show that had it not been for the misrepresentation, they would not have entered into the contract or would have only done so on different terms.[147] The "different decision" test employed here is a legislative rejection of the majority decision in *Pan Atlantic* and is an excellent reform decision for the reasons stated above in Part III.[148] A misrepresentation for which the insurer has a remedy is called a "qualifying misrepresentation".[149] Qualifying misrepresentations are those that meet the "different decision" test and are made in breach of the duty to take reasonable care not to make a misrepresentation.[150] Therefore, all qualifying misrepresentations are either deliberate, reckless or careless.[151] CIDRA defines these terms and the onus is on the insurer to prove them.[152] Consequently, an honest and reasonable consumer who is non-fraudulent and non-negligent is protected. This is a positive reform measure because it addresses the injustice that resulted from the previous law. Moreover, insurers cannot contract out of the statute, which ensures its proper effect.[153]

5 Remedy

The avoidance remedy is retained in a limited form. Avoidance is only available if the insured was "deliberate or reckless" in their misrepresentation.[154] Retaining avoidance in this way promotes other policy objectives, such as deterrence and punishment, for this form of non-disclosure. For anything less than a deliberate or reckless non-disclosure, only proportionate remedies are available.[155] These proportionate remedies are determined by reference to what the insurer would have done had there been disclosure. This is the same approach taken by the Australian reforming legislation.

6 Conclusion

The English reform of the duty of disclosure is comprehensive and commanding. Despite an effective ombudsman service in the insurance sector, the legislature still regarded this area of insurance law as in need of review to ensure that the common law matched modern practice. CIDRA is simpler than the Australian equivalent but is nonetheless still effective. It addresses the crux of the issue by not requiring insureds to volunteer information. By implementing a reasonableness standard for answering questions, the reform rebalances the disclosure duty obligations.

---

147 CIDRA, s 4(1).
148 *Pan Atlantic,* above n 38.
149 CIDRA, s 4(2).
150 Section 4.
151 Section 5(1).
152 Sections 5(2)–5(4).
153 Section 10.
154 Schedule 1, pt 1, cl 2.
155 Schedule 1, pt 1, cls 4–8.

VI NEW ZEALAND'S ATTEMPT TOWARDS REFORM

Calls for Reform

It is no secret that the current law regarding the duty of disclosure in New Zealand is far from satisfactory. Commentators, judges and the industry ombudsman have all called for reform.[156] When the New Zealand Law Commission (NZLC) made inquiries for input into reform ideas, the ISO highlighted that "non-disclosure complaints represent one of the largest single reasons for consumer dissatisfaction and complaint".[157] This reflects consumers' lack of understanding of what insurers require of them. Great dissatisfaction is the inevitable result when insureds are informed of these requirements after the fact. The insured's response is often: "if they wanted to know, why didn't they ask?"

Judicial comments reflect the same sentiment. In the leading authority of *McHale*, Cooke P stated:[158]

> ... [T]he law of this country is in far from a clear or satisfactory state. ... Legislation on those lines has been introduced in Australia ... [I]t appears to be time that New Zealand did the same.

The Law Commission Report

The NZLC made a start towards reform in 1998 when they published the report, *Some Insurance Law Problems*.[159] This report highlighted the duty of disclosure as a key area due for reform. Unfortunately, no further action has been taken by the legislature following this report. The NZLC identified four issues with the duty of disclosure: what the insured has to disclose is uncertain; the insured is usually ignorant of the duty; specific questions do not relieve the insured of the duty; and, lastly, breach of the duty has a disproportionate remedy of avoidance.[160]

The NZLC reviewed previous reform attempts in England and Wales and reform in Australia. The NZLC thought the older English reform attempts were not sufficiently comprehensive.[161] This was before CIDRA was implemented. The NZLC said the Australian law reform solved some of the problems encountered but ultimately decided not to follow the approach.[162] The NZLC thought that the scope of disclosure remained

156 *State Insurance v McHale*, above n 21, at 404 and 415; Neil Campbell "Insurance Law" [2005] NZ L Rev 431 at 431; and Law Commission *Some Insurance Law Problems* (NZLC R46, 1998) at [8].

157 Letter from the Insurance and Savings Ombudsman Commission to the Law Commission regarding insurance law problems (11 June 1997) as cited in Law Commission, above n 156, at [8].

158 *State Insurance v McHale*, above n 21, at 404–405.

159 Law Commission, above n 156.

160 At [4]–[7].

161 At [13].

162 Law Commission, above n 156, at [23].

uncertain under the Australian legislation, in particular as to the definition of fraudulent non-disclosure. In respect of remedy, the NZLC was unfavourable toward the "retrospective underwriting" exercise that had arisen from calculating damages in place of avoidance.[163]

This article submits that the Australian approach was dismissed too quickly. While the problems in the Australian reform highlighted by the NZLC are fair, they are not so problematic as to disregard the Insurance Contracts Act 1984 (Cth). NZLC's concern with the uncertain meaning of fraudulent non-disclosure is capable of being addressed by the courts should the need arise. For example, the Court of Appeal had to consider the ambit of "fraud" in the Arbitration Act 1996 for the first time in *Ironsands Investments Ltd v Toward Industries Ltd*.[164] The Court defined fraud as a false statement made, knowingly or without belief in its truth, or recklessly, careless as to whether it is true or false.[165] The Court of Appeal in *Waller v Davies* also had to define "fraud" in the Land Transfer Act 1952 for the first time.[166] Therefore, the claim that the uncertain meaning of "fraud" justifies dismissing the adoption of the Australian approach is unpersuasive.

The damages remedy does require retrospective and hypothetical assessment to determine loss. This is a fictitious exercise but is not wholly inadequate. This exercise is still an improvement on the sledgehammer of avoidance ab initio. The principle of general contract law damages is to put the aggrieved party back in the position they would have been, had there been no breach. This requires the court to ascertain what the loss is, whether it is recoverable and how it is measured. These factors are not always simple to determine and yet the courts manage. While proportionate remedies are less distinctive, the trade-off of fairer results makes the extra analysis worthwhile.

1 The Recommendations

The NZLC recommendations focused on reforming the duty by confining the availability of avoidance as a remedy. This contrasts the Australian approach, which redefines the duty with insurer-friendly tests. However, the NZLC's approach almost indirectly abolishes the duty altogether. The proposed reform was articulated through a draft s 7A of the Insurance Law Reform Amendment Act.[167] Avoidance would only be available in three circumstances: reinsurance, "blameworthy" conduct and answering a specific question amounting to non-disclosure. This article focuses on the last two avoidance possibilities.

163 At [23].
164 *Ironsands Investments Ltd v Toward Industries Ltd* [2012] NZHC 1277 at [43]–[54].
165 At [41]–[42], [44] and [54].
166 *Waller v Davies* [2007] NZCA 51, [2007] 2 NZLR 508 at [31]–[33].
167 Law Commission, above n 156, at 62–65.

(a) Blameworthy Non-disclosure

The recommendations allow an insurer to avoid an insurance contract if the failure to disclose a fact is "blameworthy".[168] The NZLC defined blameworthy as follows:[169]

> A failure to disclose a fact is not blameworthy unless the insured knew, or in the circumstances a reasonable person could have been expected to know, both the undisclosed fact and that disclosure would have influenced the judgment of a prudent insurer in accepting the risk or the terms of such acceptance.

It is commendable that the definition considers relevance from the perspective of the insured or reasonable insured and not what would influence a prudent insurer. This relieves insureds from the current disclosure burden, as most reasonable insureds are unaware of less obvious influences on the judgement of a prudent insurer, such as moral hazards.[170] Reversing the onus in this way forces the insurer to ask about these softer facts if they want to know them.

A negative aspect of the blameworthy test is that the knowledge standard is not clear. "A reasonable person could have been expected to know" seems to include constructive knowledge. Therefore, the blameworthy definition continues to go beyond fraudulent non-disclosure to include negligent non-disclosure as well. Neil Campbell notes that the current offering of "blameworthy" catches careless non-disclosure too, and that this is arguably beyond the current common law position if the *Economides* distinction is adopted by New Zealand courts.[171] Carelessness is a much lower threshold than fraudulence. The NZLC have not followed the approach of *Economides* and the Australian reform, which limited the test to actual knowledge for consumer insureds.[172]

The blameworthy test has not clarified whether the materiality standard is the "different decision" or "interested to know" test. There is also no mention of inducement. The blameworthy definition refers to the "prudent insurer" rather than the actual insurer, which may imply that there is no inducement requirement. Reference to the prudent insurer may enable insurers to take advantage of a conservative market if the actual insurer would not have regarded some fact as material but the market would have.[173] This is contrary to current case law authority, which requires the actual insurer to prove they were induced. If the NZLC had clarified the inducement issue, they could have also stated whether there was a

168 At [32].
169 At [32].
170 Robert Merkin "The Future of Non-Disclosure" (paper presented to the University of Auckland Research Centre for Business Law, Auckland, October 1998) at 7.
171 Campbell, above n 28, at 207.
172 At 207.
173 Merkin, above n 170, at 7.

presumption of inducement. Overlooking these details makes the reform attempt incomplete.

(b) Specific Questions

The final circumstance under which the insurer is entitled to avoid the contract is if the insured answers a specific question incorrectly due to failure to disclose a fact.[174] This exception is designed to encourage the insurer to ask specific questions rather than "catch-all" questions that require the insured to volunteer information. A specific question must not require the insured to decide whether a fact is or might be relevant to the final decision of the insurer. In respect of materiality however, the test is defined by reference to what would be material to a prudent insurer. This is an odd formulation in that for the exception to be available, the specific question must be narrow, such as not to put any doubt to the insured about what the insurer requires in the question. But if the insured answers the question incorrectly, whether it is substantially incorrect such as to warrant avoidance is determined by reference to the old "prudent insurer" test. This is a hangover from the current law on duty of disclosure.

Determining "substantially incorrect" from the insurer's perspective, the same test as the current law, was concluded above as being unsatisfactory. The issue is that the insured is unlikely to know what information the "prudent insurer" would regard as material. If the question asked is specific enough, such that it passes the first test and opens the door for possible avoidance, the substantially incorrect element is judged by the prudent insurer standard – a standard that is not necessarily clear to the insured. However, this may be an unnecessary concern as the definition requires the question to be clear to the actual insured. If evidence shows that the insured was not clear whether a fact was relevant in answering that question, that question would not meet the exception to allow for avoidance.

The last issue with the specific question exception is the anomaly that can result due to the overlap with misrepresentation. A stronger remedy is available for non-disclosure than misrepresentation. Cancellation under the CRA is not an automatic right, since not every misrepresentation entitles cancellation.[175] Cancellation is also subject to the Court's discretion to grant relief.[176] The NZLC did not address this issue.

(c) Remedy

Avoidance ab initio remains alive under the NZLC recommendations. The remedy an insurer would be entitled to, if there was a fraudulent non-disclosure that would not have changed the policy, depends on the interpretation of "blameworthy". Avoidance could be available under the specific question exception. But under blameworthiness, avoidance could

174 Law Commission, above n 156, at [32].
175 Contractual Remedies Act 1979, s 7(4).
176 Section 9.

only result if the "different decision" interpretation of materiality was adopted. An innocent non-disclosure that would not change any outcome may result in avoidance if the reasonable insured ought to have known the fact to be material and the "interested to know" test was applied. This would be an unfortunate outcome. Ideally, an innocent non-disclosure that would not change the policy should not open the door to avoidance.

The reform is silent as to whether there would be a remedy for non-blameworthy non-disclosures that would have changed the policy. Either this implies there is no remedy available or that the NZLC was leaving it for the courts to decide as to whether damages could be available. It is a strange omission given that the Australian counterpart had provided remedies to insurers for this scenario with their proportionate approach. The NZLC rejected the Australian approach but did not come up with any alternatives. This is unsatisfactory.

Conclusion

The report is a decent start at reforming the duty of disclosure. The reform focuses primarily on reducing the availability of the avoidance remedy. However, alternative remedies to avoidance are not available. Having avoidance as the sole remedy is an oversimplified approach. Creating a "blameworthy" exception limits avoidance to fraudulent or careless non-disclosure, while the "specific question" exception incentivises insurers to ask clear questions. This means that the non-disclosure defence is not available for "catch-all" questions unless the non-disclosure is blameworthy. This is a good outcome for insureds.

Unfortunately, the exceptions do not read well together. The definitions of "blameworthy" and "specific question" are not harmonious as they have different tests for knowledge and materiality. The proposed reform does not set out any new definition of the duty of disclosure, nor does it clarify the issue and presumption of inducement. The NZLC's recommendations were a good start but more comprehensive reform is needed.

VII ABOLITION

Could we abolish the duty of disclosure? The NZLC did consider this option.[177] Without such a duty on the insured, the insurer would only be able to avoid paying out on a policy if a non-disclosure amounted to a breach of contract or misrepresentation under the CRA. This would incentivise the insurer to ask as many questions as possible. A specific question answered unclearly would give greater grounds to argue breach or misrepresentation than an unclear answer to an open-ended question. This would solve some of

177 Law Commission, above n 156, at [25]–[30].

the legal issues with the current law but would increase the cost of the insurance process.

Costs would increase as insurers would have more vigorous proposal forms, investigate insureds more thoroughly and factor in a higher risk of incomplete disclosure. These costs would be passed onto the consumer in higher premiums. However, the price could be worth paying if the trade-off was more valuable insurance policies. The NZLC did not regard an increased paper trail as persuasive enough to rule out abolition.[178] The NZLC was more concerned about the practice of temporary insurance being exposed.[179] Other than this however, the NZLC did not explore the idea of abolition further.

A key adverse consequence of abolishing the duty of disclosure would be the potential for commercial or sophisticated insureds to play the game when answering questions.[180] Such insureds would be advised that they owe no duty to proffer information they think may be material, so long as they do not make any misrepresentations when answering the insurer's questions.

Abolition would be heavily lobbied against by the insurance industry so it is not a pragmatic reform option. It is also noteworthy that neither Australia nor England decided to abolish the duty altogether when they carried out their reform. This is because there are still persuasive arguments in favour of keeping the duty, albeit in a modernised form. While insurers are extremely knowledgeable about many types of risk, they are not omniscient and risk will exist that is not covered by an insurance questionnaire. Insurers cannot know all the right questions to ask for commercial or unique consumer situations. Sophisticated insureds may be incentivised to take advantage of insurers if all insured responsibility is removed. Therefore, abolition of the duty would not be a sensible solution.

VIII RECOMMENDATIONS

Where to from here? New Zealand is late to the party in respect of reforming the duty of disclosure and as such is left with antiquated law containing the potential to create unjust outcomes. Black and white solutions, while attractive for their simplicity, are not helpful for reforming such a broad area of the law. A more nuanced approach is required so that vulnerable insureds are not taken advantage of, while sophisticated insureds cannot take advantage of insurers.

Proportionate remedies should be made available to reflect the change to the policy or premium that would have occurred, had there been proper disclosure. Ideally, avoidance would not be available at all in order to bring insurance law remedies in harmony with the CRA. However, in the

178 At [27].

179 At [29].

180 Enrique R Schaerer "Half-Truths, Whole Lies, & the Duty of Disclosure in Insurance Law" (Yale Law School Student Scholarship Papers, Yale Law School, 2007).

case of fraudulent non-disclosure where an insurer's consent is truly vitiated, avoidance may be justified.

Reform should aim to create the right incentives for both insurers and insureds. Insureds should be required to disclose information that a reasonable insured in their position would consider relevant and material to the risk they want insured. Insurers should be incentivised to ask the questions they know they need answers to, and to ask follow-up questions if required. Possible ways of achieving this outcome are considered below.

Define the Duty of Disclosure

Any reform measure should set out a new definition of the duty of disclosure as both Australia and England did. A "reasonable insured" test would be an effective and balanced way of redefining the duty. This would reverse the current position so that insureds only disclose what they know, or ought to know as material to an insurer:

> The insured must disclose all information that they know, or that a reasonable insured in their circumstances ought to know, as being material to the risk or material to the terms that an insurer would accept the risk on.

This definition requires the insured to disclose all information they know to be material to the insurer's decision whether to accept the risk or on what terms. This removes the issue of an insured having to read the minds of an insurer regarding what they consider material. Instead, if an insured answers an insurer's questions honestly they will fulfil their duty. Materiality should be defined:

> Material information is that which would change the issue, premium or terms of the policy.

This is anything that actually alters the risk. Proof of inducement should also be required. The insurer should be required to proffer evidence that the omission of material information induced the underwriter to offer the policy or the specific terms.

A Sophistication Scale

The option of the second limb: "a reasonable insured in their circumstances ought to know" can be used to qualify the "reasonable insured" by reference to personal characteristics. The legislation would set out the subjective conditions of this assessment. Australia and England qualify the "reasonably insured", in deciding what would be reasonable in the circumstances, with reference to external factors such as the particular policy and the questions asked. New Zealand could take this further and create a sophistication scale, allowing reference to personal characteristics such as special knowledge or the literacy and language skills of the insured.

Subjective elements may not be practical from the industry's perspective as they create uncertainty. However, it benefits the insurer if they can point to an insured's sophistication to say he or she should have known something was material such that the insured knew it needed to be disclosed. A reasonable insured test that moves up and down a sophistication scale is one way to create blanket reform to fit both consumer and commercial insureds, rather than to create separate legislation as England did.

Redefining the duty this way would incentivise the insurers to ask better questions. This is because there is less scope for the insurer to avoid, taking away the incentive to be passive. While this may increase the costs for insurers that will be inevitably be passed onto insureds, the cost is outweighed by the value gained in creating meaningful insurance policies. More explicit incentives could also be included, such as the use of an imposed waiver or an obligation to warn. However, these extra reforms may be redundant if the duty becomes more in line with insureds' expectations and the remedies are more reasonable.

Remedies

As the CRA is not applicable to non-disclosures, any reform would have to include the remedies that would be available instead of the all-or-nothing option of avoidance. It would be harmonious if the remedies reflected those in the CRA. This would mean that cancellation would be the strongest remedy available and it would only be available if the non-disclosure substantially increased the burden for the insurer. This would work well for those non-disclosures that would only have changed the price or particular terms of the policy.

However, for fraudulent non-disclosure or non-disclosures that would have stopped an insurer from offering a policy, retaining avoidance could be justified. In these instances the insurer's consent is vitiated as they would not have entered the contract knowing of the fraud, or knowing the undisclosed information. If avoidance was retained, the courts could have the power to overrule an avoidance remedy if it would be unjust in the circumstances.

In the alternative, New Zealand could follow the approach of Australia and England by providing proportionate remedies. These would reflect the extent that the non-disclosure would have changed the policy or premium, had it been known to the insurer. This would put the onus on the insurer to prove what policy would have been offered, had the information been disclosed. The difference between the counterfactual policy and the actual policy would be accounted for in the remedy awarded. For example, an increased premium or excess could be subtracted from an amount being claimed, or terms that would have been included in the policy could be deemed to exist when interpreting the policy.

IX CONCLUSION

The current state of the duty of disclosure is unsatisfactory. A review of the law as it applies in New Zealand today clearly shows that insureds who act honestly and reasonably can find themselves without cover. The common law duty of disclosure favours the insurer at every stage and only offers the extreme remedy of avoidance. While studying the duty of disclosure in the context of its 16th century origins helps in understanding its reasoning, the duty as formed in *Carter v Boehm* needs modernising. The duty of disclosure needs to rebalance the obligations of the insurer and insured to better reflect their respective knowledge banks.

An insured should only have to answer an insurer's questions honestly and reasonably to fulfil his or her duty. This is by reference to what the insured considers material to the insurer. A "reasonable insured" test would ensure that vulnerable insureds are not taken advantage of, while sophisticated insureds cannot take advantage of insurers. Material information should be information that would alter the premium or the terms of the policy in some way. This is anything that actually alters the risk, not just what the insurer may have been interested to know.

Reform should limit the avoidance remedy to apply only to fraudulent non-disclosure. Here it is legitimate that the insurer's consent is vitiated in entering into the contract. However, for non-disclosures that would have only changed a particular term or the price of the policy, these non-disclosures should have less severe remedies. This could either be done by mirroring the structure of the CRA, or alternatively by following the Australian and English law reform approach of proportionate remedies relative to breach.

Such reform would incentivise insurers to take more responsibility by ensuring they ask for the information they need. Retaining the duty of disclosure in a modified way reflects that insureds still hold key knowledge resources and are required to disclose what they know to be material. Beyond this, if insurers want or need to know more, they have to ask for it. This way, insurance policies will be formed based on a more complete picture. There is no risk that insureds are left with an uncovered loss for not complying with a counter-intuitive duty they may never have understood. This will increase the value of all insurance policies, with the flow-on effect of increasing confidence in the insurance market.