Joshua Williams Memorial Essay 1994

Sir Joshua Strange Williams was resident Judge of the Supreme Court in Dunedin from 1875 to 1913, and he left a portion of his estate upon trust for the advancement of legal education. The trustees of his estate, the Council of the Otago District Law Society, have provided an annual prize for the essay written by a student enrolled in law at the University of Otago which in the opinion of the Council makes the most significant contribution to legal knowledge and meets the requirements of sound legal scholarship.

We publish below the winning entry for 1993.

THE RIGHT OF AN INNOCENT CO-INSURED SPOUSE TO RECOVER UNDER A "JOINT" INSURANCE POLICY

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INTRODUCTION

People who insure their property cannot recover for damage caused by their own deliberate acts.[1] This rule appears to have unfair consequences where property is jointly-owned and jointly-insured: an innocent party may have an insurance claim rejected because of the actions of a co-insured. The typical scenario involves a husband burning down the family home, jeopardizing the entitlement of the innocent wife.

Insurance law is on the cusp of contract and property law: the insurance proposal and policy are a contract between the insurer and insured, but the subject matter of the contract is property. The resulting confusion and overlap between the different concepts is particularly apparent when dealing with the problem of the innocent co-insured.

The courts use different variations of the "joint versus several" test. The test may focus on whether the property *interests* are joint or several, whether the *contract* is joint or several, whether the indemnification *obligation* undertaken by the insurer is joint or several, or whether the *liability* for the insured's disqualifying misconduct is joint or several. These variations differ according to where the judge draws the line between property and contract principles: if the focus is property, often the first two tests are used interchangeably. If a contractual analysis is preferred, either of the latter two tests may be adopted.

THE THREE NEW ZEALAND CASES

Until quite recently, the New Zealand courts refused to uphold a claim by an innocent co-insured spouse.

1 *Beresford* v *Royal Insurance Company Ltd* [1938] AC 586 at 595.

In the 1990 case of *Royal Insurance Fire & General (NZ) Ltd* v *Renata*[2] Barker J said an innocent wife could not claim under an automobile insurance policy for loss resulting from her husband's failure to use due diligence. Mrs Renata's husband had struck her while she drove the family car, resulting in an accident. Mr Renata acknowledged that it would not have happened had he not struck his wife. According to Barker J, the conduct was clearly contrary to the insurance policy condition of due diligence: "The insured shall take all reasonable precautions to prevent any destruction, loss, damage, or liability." Therefore, Mr Renata could not recover under the policy.

Mrs Renata claimed for her half of the insured value of the car. The judge quickly dealt with this by determining that the interests of Mr and Mrs Renata in the policy were joint, rather than separate. The interests were so "inseparably connected" that the misconduct of one precluded recovery by the other.[3]

That approach was again followed in mid-September 1992 by Neazor J in *McQuade* v *Sun Alliance Insurance Co.*[4] he refused to allow relief to an innocent husband after the wife intentionally burnt down the family home. The plaintiffs made a claim following a fire in their home in 1986. The defendant insurance company declined it on the grounds that the fire was intentionally lit by Mrs McQuade, one of the co-insureds. After hearing evidence, Neazor J concluded the wife had lit the fire.

Neazor J rejected Mr McQuade's argument that he had a separate interest in the property and a separate contractual right. The McQuades owned the property jointly, their interests were co-extensive in every respect. The insurance company did not contract to indemnify against wrongdoing by the insured, and because of the joint nature of the contract, the wife's actions also denied her husband recovery.

However, two weeks later on similar facts in *Maulder* v *National Insurance Company of New Zealand Ltd,*[5] Eichelbaum CJ ordered the insurance company to pay an innocent widow half of the value of the family home which her husband had burnt down when he killed himself. The judge knew of the earlier decisions, particularly *McQuade,* but decided not to follow them. Instead, he applied a line of case law which has developed over recent years in the USA and Canada, citing in particular *Higgins* v *Orion Insurance Co Ltd,*[6] and *Hedtcke* v *Century Insurance Co.*[7]

The former case compared the "old" and the "new" rules of construction of the insurance contract.[8] Under the old rule, claims by innocent co-insureds were rejected for two reaons:

2 Unreported, High Court, Whangarei, 12 December 1990, AP 50/90, Barker J.
3 According to the dicta of Viscount Cave in *Samuel & Co* v *Dumas* [1924] AC 431 at 445.
4 (1992) 7 ANZ Ins Cas 61-136.
5 [1993] 2 NZLR 351.
6 (1985) 17 DLR (4th) 90 at 101.
7 109 Wis 2d 461 (1982).
8 Also known as the "traditional" and "modern" approaches.

1 The spouses held joint interests in the insured property and, therefore, the misconduct of one was imputed to the other.
2 There was concern that a wrongdoer could benefit directly through the recovery by the innocent party.

According to the new rule, responsibility or liability for disqualifying misconduct under the policy is presumed to be several and separate rather than joint. Furthermore, the second consideration above is thought to be outweighed by the "patent unfairness of denying insurance protection to an innocent insured by imputation of fraud".[9]

Hedtcke said that under the "modern" rule, the contract of insurance is construed according to the reasonable expectations of the co-insureds. Consequently, in the absence of any language in the policy specifying whether the obligations of the co-insureds are joint or several, they are considered several.

Eichelbaum CJ was concerned about the apparent unfairness to Mrs Maulder of taking the old approach, which had "little to commend it in logic". He considered it inappropriate to allow the nature of the ownership of the insured property to dominate the question whether the obligations under the policy were joint or several. He recognised that the most common insurances in multiple names are those of husband and wife or de facto partners. Considering the serious possibility of a spouse or partner deliberately destroying insured property, there is a significant gap in policies which do not cover the innocent co-insured. He also commented on the advance in women's property rights over recent years and the accompanying changes in the law:

> The rule of construction no longer accords with reality, practicality or expectations. Relationships alter rapidly; by the time of the loss the parties may have separated. The manner in which legal title is held masks the rights arising on separation. Insurers must be taken to know that the ostensible categorisation of property as joint is meaningless.[10]

His Honour adopted the North American modern line of authority, seeing it as being more relevant to modern social conditions in directing attention primarily at the actual language of the contract. He construed the policy as composite, severally insuring the respective separate interests of the insured in the property. However, he did not base his decision on the rule of construction in *Hedtcke* that a policy should be interpreted according to the insured's reasonable perception of it; he preferred the traditional objective approach, subject to the contra proferentem rule.

Using the latter rule of strict construction, the judge said an ambiguity existed in the clause: "You must . . . not cause or facilitate loss to the

9 Supra n6 at 102-3.
10 Supra n5 at 359.

house or incur liability by any reckless or wilful act."[11] An insurer seeking to impose joint obligations on the insured must use clear language. Here, it was unclear whether "you" meant both of the insureds or either of them, and the clause should have been construed against the party trying to rely on it.

The insurance company, therefore, had no defence to Mrs Maulder's claim. Eichelbaum CJ left the quantum of the award to the parties to decide between them, but he suggested Mrs Maulder was entitled to recover her half-share in the destroyed property based on her joint interest in the house and contents.

THE TRADITIONAL vs THE MODERN APPROACH

It is not a simple task to distinguish between the "traditional" and "modern" approaches used in cases of innocent co-insureds, despite the apparent ease and readiness of the courts to do so. There is more fluidity between them than most judges and commentators are prepared to admit. This argument is proven in part by the smooth historical development from one to the other.

(i) *The Traditional Approach*

The traditional approach equates the nature of the contract with the property interests of the co-insureds.[12] The courts distinguish between joint and composite contracts. If the husband and wife jointly-own the insured property, it is prima facie assumed that the insurance policy is a joint one.

11 Eichelbaum CJ, supra n5 at 359, decided it was not an exclusion clause because it was not dealt with separately with the other exclusions: "I interpret it as simply recording the common law position for the insured's benefit and adding nothing to it." However, he also considered the possibility that, contrary to his opinion, it *was* an exclusion and found it to be ambiguous.

12 Traditionally at common law, if a promise is made by two or more parties, the question whether the resulting obligation is owed to the parties jointly or severally is primarily a matter of construction. The rule of construction from *Slingsby's* case (1587) S Co Rep 18b applied in *Sorsbie* v *Park* (1843) 12 M & W 146 was that a covenant will be construed to be joint or several according to the interest of the parties. For example, if the interests are separate, as in the case of a lessee and lessor, the obligations will *necessarily* be owed to them severally despite the wording of the policy. This rule has since been relaxed so that, if possible, the court will construe the nature of the contract consistently with the nature of the interest. However, a contrary intention expressed by clear words will prevail. 9 Halsbury's Laws of England (4th ed) para 620; see also *Challenge Finance Ltd* v *State Insurance General Manager* [1982] 1 NZLR 762 at 767.
The earlier strict version of the rule is an example of the traditional approach relying solely on property law principles to construe insurance policies and the latter version illustrates a slight movement towards more of a contractual anlysis.

The following logic ensues:

(i) It is a clear rule of law that a joint contract creates only joint rights and obligations.[13] Similarly, if the contract is a composite one, the co-insureds have separate rights and obligations under it.

(ii) If the rights are joint, then one party cannot enforce the contract alone; both parties must sue together. Likewise, if one party is barred from suing, so too is the other. As a consequence, joint obligations require the co-promisors in a joint contract to be liable for each other's actions under it.

(iii) Therefore, if the policy is avoided against one co-insured for misconduct, it is also avoided against the other, or others, if the property is owned and insured by more than two people.

A composite policy insures the separate and distinct interests of two or more people. Usually the very nature of their ownership is different; for example a mortgagor and a mortgagee, or a legal owner and a bilee under a hire purchase agreement. In this situation, each claim must be treated separately. Therefore, the rights and obligations of the innocent co-insured will remain unaffected by the wrongdoing of the other co-insured.[14]

The most often quoted discussion of joint and composite policies under the traditional approach is that of Sir Wilfred Greene MR in *General Accident, Fire and Life Assurance Corporation Ltd, and Drysdale* v *Midland Bank Ltd.*[15] This can be summarized as follows:

13 At common law, a promise cannot be made to two or more people both jointly and severally, but this has been modified by statute with respect to covenants (agreements under seal) 12 Halsbury's Laws of England (4th ed), para 1556: The Law of Property Act 1923, s81(1) (UK) says that a covenant made on or after January 1, 1926 with two or more people jointly, to pay money or to make a conveyance or to do any other act to them or for their benefit, is to be construed as being also made with *each* of them, unless a contrary intention is expressed in the covenant and subject to the provisions contained in it. New Zealand has a similar section, s67 of the New Zealand Property Law Act 1952, which says a covenant with respect to land is deemed to bind the covenantors both jointly and severally.
Although a promise cannot be made *to* several persons both jointly and severally, an obligation can be owed *by* several persons both jointly and severally. For example, ,Parke B in *King* v *Hoare* (1844) 13 M & W 494, 153 ER 206 speaks of a "joint and several bond . . . though on one piece of parchment or paper in effect comprises the joint bond of all, and the several bonds of each of the obligors and gives different remedies to the obligee". See Kevin Nicholson, "Conundrums for Co-insureds". 3 Insurance Law Journal 218 at 224, note 36; and Glanville Williams *Joint Obligations* (1949).

14 But note *McLaren & Co* v *NZ Ins Co Ltd* [1930] NZLR 437. Where two persons are jointly insured, the breach of a condition (ie "while any motor vehicle is being driven in a damaged or unsafe condition") by the one in whose sole power it is to observe such a condition, will contaminate the whole insurance, if the innocent person contracted with full knowledge of, and subject to, such a condition. This is notwithstanding that the interests of the two insured are distinct, or that the contracts might be construed as a separate insurance for each.

15 [1940] 2 KB 388.

1 A joint policy exists of two people are joint owners of property, using the term in its strict legal sense, and the contract undertakes to indemnify them jointly in respect of a joint loss which they have jointly suffered. Such an interest is automatically inseparable.
2 In a composite policy, the interests of each of the parties covered are of a "differing character" and "interests in respect of which not all of the parties were in anything like the same situation".

> Again, there can be no objection to combining in one insurance a number of persons having a different interest in the subject-matter of the insurance. However, I find myself unable to see how an insurance of that charazcter can be called a joint insurance. In such a case, the interest of each of the defendants is different. The amount of his loss, if the subject-matter of the insurance is destroyed or damaged, depends upon the nature of his interest, and the covenant of indemnity which the policy gives must necessarily, in such a case, operate as a covenant to indemnify in respect of each individual different loss which the various persons named may suffer. There is no joint element at all in such a case. There is no joint risk. There is no joint interest.[16]

The judge's comments are particularly interesting because he takes a wider look at the nature of the interests than merely property ownership, by also considering the nature of the risk taken and the loss suffered. However, his discussion remains limited as he equates joint legal ownership and joint interests under the policy necessarily with the joint risks and joint loss.

(ii) *The Modern Approach*

Rather than relying on property law concepts, the modern or new rule directs its attention primarily to the language of the insurance contract: "The dispute is essentially a contract dispute between an insurance company and a policy-holder and should be governed by contract law and not by property law."[17] In construing the contract, a presumption has developed that interests, and rights and obligations under the policy are prima facie severable.[18]

Three dissenting judges "squarely espoused" the modern rule[19] in the Canadian Supreme Court case of *Scott* v *Wawanesa Mutual,*[20] where a

16 Ibid at 404-5.
17 *Higgins* supra n6.
18 As a result, the rule regarding joinder of parties does not carry much weight under the "modern" approach. This is also possibly due to the court's reluctance to mould legal principles around rigid procedural rules. According to Glanville Williams, *Joint Obligations* at 57-59, the rule had already been relaxed to a limited extent and the "time is ripe for its abolition": "The reason was formerly valid so far as it went, but it may be doubted whether the advantage to the defendant balanced the vexation of the rule to the plaintiff where some of the joint contractors were unknown to the plaintiff or difficult to sue." *Walsh* v *Canadian General Insurance Co* (1989) 60 DLR (4th) 358, at 367 went further in saying: "That joint obligations must be jointly enforced is a principle now to be doubted." However, the rule appears to remain in force with respect to plaintiffs who are jointly entitled to relief. *Roche* v *Sherrington* [1982] 1 WLR 599. Andrew Beck, *Principles of Civil Procedure* (1992) at 54.
19 per Eichelbaum CJ in *Maulder,* supra n5 at 357.
20 (1989) 59 DLR (4th) 660.

teenage boy burnt down the family home. In this case the policy excluded: "Loss or damage caused by a criminal or wilful act or omission of the insured or any person whose property is insured hereunder." The term "insured" was defined to include "(1) The named insured and (2) If residents of his household, his spouse, the relatives of either, and any other person under the age of 21 in the care of an insured."

According to the minority, recovery depended on whether the obligation outlined in the clause was joint or several according to the language of the contract – whether "the insureds had promised the same performance, or a separate performance as to each, that is, whether *each* insured has promised that *all* insured parties will use 'reasonable means' to preserve the property, or whether *each* has promised that *he or she* will protect the property [emphasis added]".[21] The minority ruled that each co-insured would have reasonably presumed they were only liable under the policy for their own conduct, and that the son's arson did not affect the parents' right to recover.[22]

The ruling of the majority does not necessarily contradict the finding of the minority regarding the suitability of the modern approach. The majority did not appear to perceive themselves as being tied down by the old approach, being willing to construe the contract according to the intent of the parties, rather than consistent with traditional property law principles: "Were I convinced that a different interpretation would advance the true intent of the parties I would gladly subscribe to it."[23]

According to Eichelbaum CJ in *Maulder,* it is important to note that, on the view of the four majority judges, the legitimacy of the claim depended on the clear and unambiguous terms of the contract in excluding that type of risk.[24] They did not find it necessary to express any opinion on the merits of the new rule. His Honour said he was applying *Scott*[25] in allowing the innocent co-insured to recover under the policy.

The minority decision was neither approved nor rejected by the Newfoundland Court of Appeal two weeks later in *Walsh* v *Canadian General Insurance Co.*[26] Again the claim failed on the language of the policy.

21 Ibid per La Forest J at 665 quoting *Hedtcke,* supra n7.

22 It is uncertain whether the modern approach focuses on the severability of the contract rights, or the liability for fraud, to determine the innocent spouse's rights. It has been suggested that it employs both factors. Leane English Cerven, "The Problem of the Innocent Co-Insured Spouse: Three Theories on Revovery" (1983) 17 Valparaiso University Law Review 849 at 867.

23 per L'Heureux Dube J at 676.

24 The majority could just as easily have found an ambiguity in the exclusion clause. Although the definition of "the insured" included the son, there was no suggestion that his misconduct affected a claim by his parents.

25 Also see the later case of *Walsh* v *Canadian General Insurance Co* (1989) 60 DLR (4th) 358.

26 Idem.

The judges appreciated that the future of the old rule was now uncertain,[27] however, they did not find it necessary to add any further comments except the obiter mark, "For the time being, however, the law is unchanged."[28]

I suspect that the judges did not feel in a position to adopt the minority approach in the Supreme Court for three reasons:

1 They felt bound by the majority decision of a higher court.
2 *Walsh* followed only two weeks after the judgment in *Scott*. There was little time for the change in emphasis of the earlier case to be fully recognised and further developed.
3 The exclusion clause in *Walsh* was not considered to be very different from the "clear and unambiguous" wording in the Supreme Court case.[29]

Although there is admittedly some hesitation to embrace fully the modern approach in Canada, it is only a matter of time before the Supreme Court, or even a more confident lower court, is obliged to consider the two approaches and rejects the rigidity and unfairness of the traditional approach.

In modern American decisions, insurance contracts are usually construed according to the reasonable perceptions of the insured, thus protecting the weaker party's expectations at the expense of the stronger:

> The ordinary person owning an undivided interest in property, not versed in the nice distinctions of insurance law, would naturally suppose that his individual interest in the property was covered by a policy which named him without qualification as one of the person's insured.[30]

Although adopting the "modern" approach in *Maulder,* Eichelbaum CJ was careful to reject this type of analysis, preferring the traditional objective approach as stated in *Walsh:*[31]

27 "The *Higgins* decision and the minority decision of La Forest J in the *Scott* case may indeed spell the beginning of the end of the old rule in cases such as this" at 368. Further at 371: "The *Scott* decisions may mark a turning point with regard to the old and new approaches. Whether it does or not, the language of the policy is paramount. If it excludes coverage in given circumstances, neither approach can change that."

28 Supra n25 at 368.

29 The court in *Walsh,* supra n25, should not have felt so constrained here. The definition of "you" only included the person(s) named as insured, compared to the contract in *Scott,* supra n20, which also listed additional parties not usually included within the term. Furthermore, the policy issues are different between inter-spousal liability, which is an outdated assumption, and the general and ongoing responsibility of parents for the actions of their children.

30 *Hoyt* v *New Hampshire Fire Ins Co* 29 A 2d 121 (1942) at 123.

31 Supra n25 at 366. This may be an implied rejection of the minority's approach to construction in *Scott* outlined above.

> The idea that a policy should be interpreted according to the insured's reasonable perception of it is not a principle of Canadian Law. A policy is to be interpreted according to its plain meaning and, if its meaning is not plain, then in most cases such as this where a standard form is used the *contra proferentem* rule would be applied.

There are two essential differences between the rules of construction:

1 The American rule is pro-insured. In Canada and New Zealand, contracts are construed according to the intentions of *both* parties.

2 The American rule ventures well beyond the express words of the contract to ascertain what the reasonable perceptions of the insureds are. Canada and New Zealand realistically consider the surrounding circumstances in construing the contract but prefer the following stricter approach:

> One looks to the terms and provisions of the actual bargain and not to what the parties thought the position was, as the test is that of the objective bystander, and an examination of what in fact the parties agreed to, not what they thought they had agreed to.[32]

(iii) *Tracing the Development*

It is a complicated exercise to pin down the exact differences between the traditional and modern approaches. There has been an obvious development in the law in this area, and it is difficult to draw the line between where the traditional approach ends and the modern begins.

The distinction often drawn between the traditional and modern rules is that the former is concerned with the property ownership and the latter with the words of the contract. This is correct but may cause confusion when a traditional decision begins with, "It is a question of construction" and finds words "capable of two constructions." This often amounts to nothing more than a cursory glance at the contract followed by the application of the following "rule of construction": a contract made with more than one person is moulded according to their interests — if their interests are joint the covenant will be construed as joint and if their interests are several, it will be construed as several.[33] When contrasted with the modern approach, the traditional approach is not really construing the contract at all.

The best means of tracing the evolution of the traditional into the modern approach is to scan the vast amount of American case law in the area. The development can be clearly seen in the differences between 24 Annotated Law Reports (3rd), which discusses the effect of misconduct on the claim of an innocent co-insured up to 1967, and its subsequent supplement. In the original text, all of the cases listed under the heading "Interest or obligation held to be joint so as to bar recovery" involve property owned jointly by a married couple. Likewise, there are only composite policies (eg mortgagee-mortgagor) under the heading "Interest or obligation held divisible so as to allow recovery". In the supplement, which lists

32 A A Tarr and J A Kennedy, *Insurance Law in New Zealand* (2nd ed, 1992) at 157.
33 See *Keightley* v *Watson* (1849) 3 Exch 716, per Pollock CB.

every relevant case up to 1990, the first category includes similar cases to those above. However, there have emerged under the head where the interest is held to be divisible, some situations involving co-insured spouses with joint-ownership. More importantly, there is a new, third, category of cases: "Determination without regard to whether interest or obligation[34] is joint or divisible."

American commentator Leane Cerven analyses the above categories as three distinct theories of recovery. The first and third resemble the traditional and modern approaches; the second is a mixture between the two and, contrary to her view of it existing as a separate category, it merely accounts for those decisions in the transitional phase where the courts are moving between the two approaches. Cerven lists them as three distinct theories because, in a country such as her own with numerous different state jurisdictions, she sees them all existing together at the one time. Her three theories are:

1 A theory based on property law. She calls it "the old rule, an all or nothing proposition" where the wrongdoing of one spouse absolutely bars the innocent spouse from recovery. Recovery depends upon the form and divisibility of the interests under the contract coupled with a strong public policy concern that a wrongdoer should not profit.
2 The "rebuttable presumption" theory which allows recovery where the insured's interests in the property are severable. This theory was "created" to afford the innocent co-insured an opportunity to refute the old rule's conclusive presumption of a joint contract, by altering the focus of inquiry to that of the reasonable expectations of the insured. However, it also relies on property law concepts and therefore is incapable of properly addressing the question of the innocent co-insured's right to recover.[35] Like the old rule, the rebuttable presumption rule rests on a perceived link between joint-ownership of property and a joint contractual obligation.[36]
3 The "new dominant" and "best reasoned" rule permits recovery irrespective of whether the property interests are joint or several.[37] The significant factor is "the responsibility or liability for the fraud".[38]

Cerven's second theory can be seen in cases like *Holmes* v *GRE Insurance Ltd*[39] and *Higgins,*[40] where the courts regarded the insurance con-

34 The ALR is possibly mistaken to include "obligations" here. Although the American courts often do not expressly state that they are concerned with joint or several "obligations" under the "modern" approach, it underlies the decisions.
35 Cerven, supra n22 at 864.
36 The "rebuttable presumption" originated in *Hoyt,* supra n30 where the three insured people were tenants in common.
37 Cerven, n22 at 865.
38 The first case to apply this new rule was *Howell* v *Ohio Cas Ins Co* 327 A 2d 240 (1974).
39 (1989) 5 ANZ Ins Cas 60-894.
40 Supra n6. However, this was obiter because the court found the wording of the exclusion clause in the policy go be clear and unambiguous.
It is also possible to view *Maulder* supra n5 as taking the transitional approach, except that Eichelbaum CJ clearly considers the respective obligations of the parties.

tract as a composite one by which the spouses each intended to insure their "respective rights and interests" in the insured property, whether owned individually or jointly. These do seem to be somewhat transitional in their approach. Although they say they are embracing the "modern" approach, they have not quite arrived at the point of relying solely on the nature of the rights and obligations owed by either the insured or the insurer under the contract.

This is supported in part by the suggestion[41] that the above two cases illustrate a muddying of the waters between joint and composite interests – one of the symptoms of the evolution between the traditional and modern approaches:

> It is submitted that these two decisions go far to obliterate the distinction between joint and composite insurance, for even where the property is completely jointly owned, the intention of the parties is seen to be to insure their individual interest in the joint property. In the light of these decisions it will be difficult in future to envisage the circumstances in which two or more co-insureds will be held to have intended to cover only their joint interests as opposed to their separate or individual interests in the subject matter of the insurance jointly owned by them.[42]

Competing Policy Considerations

Interpreting an insurance contract usually involves weighing up different public policy considerations. Such objectives are particularly relevant when dealing with the claims of innocent co-insureds: instinctively it often appears fairest to allow recovery; however, stronger policy reasons may dictate a different result.

At the risk of being overly simplistic, it is possible to affiliate different policy considerations with the two approaches discussed in the previous section. There are two main principles: one should not profit from one's own wrongdoing, and one should not be held vicariously liable for the wrongs of another. Courts which take the "traditional" approach usually justify their decisions with the non-profit rule, while the "modern" approach emphasises the injustice of vicarious liability outside of tort.

(i) *The Non-Profit Rule*

A person cannot recover insurance for property which they intentionally destroy, because the courts refuse to assist a criminal to benefit from his crime. It is a maxim which is repeated in much of the case law in this area and is discussed at length in the suicide case of *Beresford* v *Royal Insurance Company Ltd:*[43]

> On ordinary principles of insurance law an assured cannot by his own deliberate act cause the event upon which the insurance money is payable. The insurers have not agreed to pay on that happening. The fire assured cannot recover if he intentionally burns down his house, nor the marine assured if he scuttles his ship, nor the life assured if he deliberately ends his own life.

41 Sutton, *Insurance Law in Australia* (2nd ed, 1991) para 3.108.
42 Idem.
43 Supra n1 at 595.

However, it is difficult to see why the non-profit principle should affect the rights of innocent co-insureds. This apparent unfairness can be explained in three ways:

1 The courts admit that the above principle is not undermined by allowing a claim by the innocent co-insured. However, they feel constrained by the strict legal rule of joint contracts that the rights of the co-insureds stand or fall together.

2 The courts consider there still to be a chance, no matter how remote, that the wrongdoer will indirectly receive some gain from an award. For example, a husband may burn down the failing family business, knowing that, although he will not be entitled to anything himself, his wife will at least get her share under the policy. However, it could be counter-argued that he may be seeking retribution, and that to refuse an award to the wife would be to give him exactly what he desires.

3 Complicity is immediately suspected, because of the intimate nature of the marital relationship.[44] Suspicion of complicity will vary according to whether the marriage is continuing, where there will be a co-mingling of resources, or the fraudulent spouse has died etc. Even if the spouses separate, in the likely event that the property was mortgaged, the wife's proceeds will probably go towards meeting the obligations of both parties to repay the loan.[45]

The operation of the non-profit rule was a significant underlying factor[46] in the contrasting decisions of *McQuade* and *Maulder*. In the former case, the wife, who intentionally burned down the house, initially made a joint claim with the innocent husband and when it was refused, they proceeded to sue the insurance company together under the policy. In the latter case, the husband successfully committed suicide. Therefore, in the latter case, there is no risk the dead husband will indirectly benefit from his own wrongdoing, while this result is unavoidable in *McQuade*.

The death of the spouse was also an important factor in *American Economy Insurance Company* v *Liggett*:[47] "In this case the valid public policy reason denying profit to a possible wrongdoer does not exist. Mr Liggett is dead and will receive his reward (or punishment) in another forum."

Contrast this with the dicta of Lord MacMillan in *Beresford:* the insured could never benefit from the suicide by receiving the money him-

44 See *Wilson* v *Concordia Farmers Mut Ins Co* 479 S W 2d 159 (1972).

45 This can be contrasted with a business partnership, which does not benefit if an innocent partner uses his or her payout to discharge joint debts worth more than his or her proportionate share. The right of recovery will accrue against the wrongdoer, to which the insurer will be subrogated, "The wrongdoer will not benefit in fact, there will merely be a change in the name of his or her creditors". Nicholson, supra n13 at 249.

46 In *Maulder,* supra n5 Eichelbaum CJ did not place any outward importance on the husband's death while Wellington QC, John Upton, gives it only a passing mention when discussing the case in his paper "When is Joint Insurance Not Joint?" at 2: "Coincidentally, he killed himself as well – but that is not relevant to the present discussion." It is argued that it is in fact very relevant.

47 426 N E 2d 136 (1981) at 140.

self, but he knew when he committed the act that he would be taking care of his family. This is benefit enough: "I feel the force of the view that to increase the estate which a criminal leaves behind him is to benefit him."[48]

It has often been suggested, particularly in *Higgins,*[49] that this problem can be overcome in the way the judgment is fashioned. However, this is difficult, if not impossible, in practice: "Either the claim of the innocent co-insured is to be met or it is not. Australian courts can exercise very little control over the way the judgment proceeds will be spent once received."[50]

(ii) *Vicarious Liability*

In recent times there has been growing concern about the injustice of decisions which in effect make an innocent co-insured responsible for the acts of their spouse. Lord Sumner puts forward a convincing argument against vicarious liability in *Samuel and Company Ltd* v *Dumas:*[51]

> Of course, it is true that he cannot take advantage of his own wrong, or as it is sometimes put 'Dolus circuitu non purgatur'. This, however, seems to me to be obviously a case of personal disability, which cannot affect persons who are neither parties to the dolus nor stand in the guilty person's shoes. Fraud is not something absolute, existing in vacuo; it is a fraud upon someone. A man who tries to cheat his underwriters fails if they find him out, but how does his wrong against them invest them with new rights against innocent strangers to it?

The court in *Liggett* commented on the peculiarity of making a spouse vicariously liable in such situations. Responsibility for tort did not apply between spouses just because of the marriage, and it did not apply to anyone at all in the case of criminal acts.[52] The fiction that a married couple constitutes a single legal entity has its foundation in ancient rules of coverture and the accompanying inability of married women to own and sell property separately.

The assumption is aggravated by the accompanying legal fiction of the joint tenancy which was originally designed to protect married couples, preventing the individual creditors of either spouse from taking the matrimonial home: "I find it a perversion of this legal fiction, designed to protect the spouses' rights and marital property, to use it to destroy the property rights of an innocent spouse."[53]

The majority of the United States Supreme Court was critical of "feminist" type arguments in *Short* v *Oklahoma Farmers Union Insurance Co.*[54] It refused to accept that married people, or more particularly

48 Supra n1 at 605.
49 Supra n7 at 111-112.
50 Nicholson, n45 at 250.
51 Supra n3 at 469.
52 Butler and Freemon, at 206, argue that, here, basic tort analysis has been incorrectly applied to actions which are fundamentally contract in nature.
53 Supra n47 at 139 per Garrard J.
54 11 ALR 4th 1217 (1982).

women, were being discriminated against by being refused payment under the policy. The innocent wife's submissions were based on section 15 of 32 Oklahoma Statute 1971 that a wife has the same legal rights as her husband,[55] and section 9(1) of the same act that neither husband nor wife will be answerable for the acts of the other. According to the five judges, the statute only ensured that a spouse was treated the same as a single person in the same position; it did not exempt individuals from the binding effects of their contracts.

On the other hand, the minority followed the New Jersey approach in *Howell* which, relying on statutes similar to Oklahoma's, based its decision upon the now separate legal status of married women. A refusal to permit recovery by an innocent spouse is based on the outmoded legal fiction of the oneness of husband and wife, which is irrelevant to a contract dispute between an insurance company and a policyholder. The three judges focused, not on property interests or contract rights, but on the responsibility or liability for the fraud, which it concluded was several and separate.[56]

Similar considerations arose in *Shearer* v *Dunn Co Farmers Mutual Insurance Co*[57] where the court rejected the insurer's suggestion that the actions of Mrs Shearer, an uninsured spouse, be imputed to the insured husband seeking to recover under his insurance policy:

> This court rejects the invitation to invent a doctrine that a spouse should be denied recovery on an insurance contract because of the actions of the other spouse when those actions cannot be imputed to the insured spouse. The marriage relationship should not be used as a basis for such a law. Married people are still individuals and responsible for their own acts. Vicarious liability is not an attribute of marriage.[58]

It could be argued that the above comments regarding women and marriage are unfounded. Vicarious liability has little or nothing to do with the marriage partnership; it is a widely accepted and essential feature of joint contractual liability that each person is liable in contract for the acts or omissions of the others. Evidence for this assertion can be derived from the fact that business partnerships are treated no differently from marriages in this respect.[59]

The modern approach has been accused of being obsessed with vicarious responsibility and marriage.[60] The real issue is not whether denying

55 Cf the identical New Zealand provisions in The Married Women's Property Act 1908.
56 They take the "modern" approach.
57 159 N W 2d 89 (1968).
58 Ibid at 93.
59 *Higgins,* supra n6 at 101: "No distinction in principle is drawn between situations involving co-insured spouses, partners or others holding undivided interests in the property." A detailed discussion of business partnerships is beyond the scope of this paper. For further information see Mark J Cooney, "The Extension of Michigan's 'Innocent Co-Insured' Doctrine: From Marriage to Business Partnerships?" (1991) 8 Thomas M Cooley Law Review 637.
60 Cerven, supra n22 at 870.

recovery imputes the misconduct to the innocent spouse based on the marriage relationship, but the nature and extent of the contractual obligations under the insurance policy. This attitude also ignores some of the realities of the marital relationship by assuming there was no collusion between the spouses, when there may well have been. The onus is on the insurance company to prove that both co-insureds partook in the misconduct, which is a "virtually unsurmountable obstacle", because proof of complicity is even more difficult than proof of arson.[61] It has been suggested by more than one commentator that the burden of proof be shifted to the "innocent" spouse to establish his or her lack of involvement in the fraudulent acts of the other spouse.[62] However, if one has a fair degree of faith in the fact-finding process, it must be concluded that those insured persons who are not truly innocent will be exposed. Even if there are legitimate evidentiary problems, legal principles and policy should not be overly concerned with them.

The modern policy objectives can be examined in the larger context of the changing emphasis of insurance law generally in favour of the insured. Reforms have been moving towards more consumer protection, admitting that freedom of contract is a fiction when two parties do not have equal bargaining power, and attempting to redress that imbalance. In *Nairn v Royal Insurance Fire and General (NZ) Ltd*[63] Gallen J referred to the "changed insurance climate". This is mainly due to the influence of the Insurance Law Reform Acts of 1977 and 1985 which have not only made substantive changes in the law, but have indirectly contributed to a general change in attitude.[64]

Future Directions

The different results reached in *McQuade* and *Maulder* are remarkable considering they were decided within two weeks of each other. One posible reason may be that there was no discussion of the emerging "modern" approach in the earlier decision. On the other hand, even if the North American cases had been cited in argument to Neazor J, he may not have had the confidence to overturn the previously accepted "traditional" approach. The Chief Justice in *Maulder* may have felt in a better position to make such a delibnerate change.

Eichelbaum CJ has been accused of going against the trend in the rest of the Commonwealth.[65] I reject this view. On the contrary, he decided to bring New Zealand law in line with that in other jurisdictions. Admittedly, England has been slow to move in this area and still prefers the

61 Idem.
62 Idem and Nicholson, supra n13 at 249.
63 (1990) 6 ANZ Ins Cas 61-010 at 76,757.
64 Andrew Borrowdale and David Rowe (eds) *Essays in Commercial Law* (1991) at 66.
65 Upton, John. "When is Joint Insurance Not Joint?" at 2: "The result in *Maulder,* in my view, represents a complete reversal of what, up until 29 September 1992, had been the generally accepted Commonwealth state on the topic."

traditional approach;[66] however, there has been strong development elsewhere in the Commonwealth.

The Supreme Court in Canada is moving towards the modern approach. The majority in *Scott*[67] was unconcerned with the property interests of the co-insureds, concentrating on the unambiguous words of the policy. Although the four judges did not expressly adopt the modern approach or its accompanying policy considerations, they did not expressly approve of the traditional line. If the reasoning looks traditional, it is only when contrasted with the judgment of the minority which fully embraced the modern approach.

It is important to realise that the modern approach does not always mean a decision favouring the innocent co-insured; it is always possible that the policy will clearly preclude liability in the event of misconduct by either co-insured and the court will not (or should not) argue with that, although such a conclusion by the majority was not too convincing in the above case.

A commonwealth case which clearly does not take the traditional approach is the Tasmanian Supreme Court in *Holmes*.[68] Neasey J believed he was taking the modern approach in following a trend which he saw developing towards this approach in Australia in *Advance (NSW) Insurance Agencies Pty. Ltd* v *Matthews*[69] and *Lombard Australia Ltd* v *NRMA Insurance Ltd*.[70] Commentators doubt whether the two cases provide much support for the result in *Holmes*:[71] *Lombard* concerned a composite insurance policy where the interests of the insureds were entirely separate, and the judgments in *Matthews*, apart from the dissent of Samuels JA in the Court of Appeal, gave little assistance on the likely reaction of the common law to a fraudulent claim by a co-insured in the circumstances of *Holmes*.[72] Neasey J also relied on *Higgins* — a case which apparently[73] was not followed in later Canadian case law. As has already been pointed out, *Scott* and *Walsh* did not apply either approach. They decided the case on the clear and unambiguous exclusion clause in the policy. Therefore, arguably *Higgins* remains good law in Canada where the insurance company has not been sufficiently vigilant in wording its standard form contract.

More importantly though, the criticism of *Maulder* is based on a supericial analysis of only a few cases. There is a clear development towards

66 See E J MacGillivray. *MacGillivray and Parkington on Insurance Law* (8th ed, 1988) at 187; and Robert Merkin, *Insurance Contract Law* (1991) at A.4.6.

67 Supra n20.

68 Supra n39. As discussed above, this decision appears to belong to the transitional category rather than fit properly within the "modern" approach because it still relies on property law concepts.

69 (1987) 4 ANZ Ins Cas 60-813.

70 [1969] 1 Lloyd's Rep 575.

71 John Upton, supra n46 at 5: "So in my view there is a large question mark hanging over *Holmes*"; Nicholson, supra n45 at 246, although he approves of the actual result.

72 Upton emphasises that *Matthews* was later overturned by the High Court on appeal but this is of limited significance if the case was not really analogous to begin with.

73 According to Upton at 5.

the "modern" approach at a much deeper level: it can be seen in the general move away from property principles toward a more contractual-based analysis,[74] in the increasing relaxation of strict procedural rules with unfair results, in the lessening distinction between joint and composite contracts, and in the shifting emphasis on the rights of individuals, particularly in the marriage, all accompanied by a strong growing consumer concern. *Maulder* fits well within this larger picture.

How to Frame Future Contracts

None of these issues would have arisen if the insurance companies had expressly excluded their liability for the misconduct of either co-insured, and there is no doubt that *Maulder* will have a dramatic impact on the wording of insurance policies in New Zealand in the future.[75]

The most common exclusion for fraudulent misconduct in the contract is: "We do not insure loss or damage resulting from your intentional or criminal acts." However, there is an ambiguity in "you"; in the case of co-insureds it can mean "you two" as a partnership, or "either of you". Similar problems are encountered with the use of the term "the insured", which is assumed to mean the persons named on the policy; ie Jane and Joe Smith. That is fine if Jane and Joe burnt the house down together; however, it becomes uncertain if Joe did it on his own.

Eichelbaum CJ in *Maulder* says that "A and B" is not good enough; the policy must say "A or B", or "A and B or either of them". It has also been suggested that it would be more precise to substitute for "the" insured "any" or "an" insured. It is generally accepted that the use of "the" before a noun has a particularising or specifying effect, and that "a" and "an" is used in an indefinite or generalizing sense.[76]

A rather extreme example advocated by *Liggett* is that the following words be written across the front page of the policy in bold letters and red ink: "IF YOU OR ANY PERSON INJURED BY THIS POLICY DELIBERATELY CAUSES A LOSS TO PROPERTY INJURED THEN

74 This development does not just apply to insurance contracts. A judgment of Master Williams QC in *Robert Jones Investments Ltd* v *Morris & Limmershin Holdings Ltd* unreported, High Court, Wellington, 25 February 1993, CP874/92 ruled that the plaintiff was entitled to cancel a lease, traditionally seen as being governed by property law remedies only, in accordance with the Contractual Remedies Act 1979. (Since the time of writing the Court of Appeal has allowed an appeal in *Morris* v *Robert Jones Investments Ltd* [1994] 2 NZLR 275, but in doing so still applied the Contractual Remedies Act 1979: Ed.)

75 Upton, supra n46 at 2.

76 Comment: "Spouse's Fraud as a Bar to Insurance Recovery" (1979) 21 William and Mary Law Review 543 at 551. For example, in *Dooley* v *Penland* 300 S W 9 (1927) the Supreme Court of Tennessee interpreted a provision of a will that required the trustee to use "the interest" and as much of the principle of the deceased's property as was necessary to support his widow. The court held that in this context, "the interest" should be construed as meaning all of the interest and not merely a part of it. Similarly, "the insured" applies to both the co-insureds acting in unison, and not merely one of them.

THIS POLICY IS VOID AND WE WILL NOT REIMBURSE YOU OR ANYONE ELSE FOR THAT LOSS."

An insurance company can refuse to meet a claim of an innocent co-insured even if the policy is a composite one. It can expressly exclude liability if either co-insured is guilty of fraud, or it can include a term making each co-insured responsible for the conduct of the others. However, it should be made clear in the contract that it applies whether the insurance is composite or joint and, in the former case, may require sufficient notice to include the rather onerous exclusion clause within the contract.[77] If this became a popular practice, it is expected that lessors, bailors, landlords and mortgagors would obtain their own separate insurance. Whether a husband or wife could take this precaution, assuming they would first recognise the risks, remains to be seen.

CONCLUSION

When an innocent co-insured claims under an insurance policy, it must first be ascertained whether the contract is joint or several. A joint contract cannot be avoided against one insured, yet remain on foot in relation to the other. They have to sue together; if one person is disqualified, the other cannot sue alone. Under a several contract, each co-insured has separate and distinct rights and obligations; the wrongdoing of one does not affect the other. This much is clear.

Determining whether the contract is joint or severable is not so simple. According to the "traditional" approach, the insurance policy is joint if the ownership in the property is joint, and severable if the parties each have separate and distinct interests in the property. It cleaves to the arbitrary legal fiction of "joint ownership", which applies to most matrimonial property. It is obsessed with the rule against assisting a wrongdoer to profit, accepting vicarious liability as a feature of the unity of marriage.

The type of ownership is irrelevant under the "modern" approach which is largely concerned with the nature of obligations under the contract. The focus may be on either the joint or several obligations of the insurer or the joint or several obligations of the insureds, but is more often the latter when the judges are trying to promote individual, rather than vicarious, responsibility. The courts look to see whether the obligation to refrain from fraud is joint, but they do so by looking at the clauses specifically prohibiting the misconduct complained of, rather than by trying to derive this conclusion from an examination of the co-insureds' interests in the insurance and the insured property. This may involve an anlysis of what is meant by "the insured" in the provisions of the policy which preclude recovery for fraud and other misconduct. The court can either

77 See the "ticket" cases where onerous or unusual exclusions must be brought fairly and reasonably to the attention of the other party. If they are not, they do not become part of the contract. *Interfoto Picture Library Ltd* v *Stiletto Visual Programmes Ltd* [1989] 1 QB 433.

interpret "the insured" to mean the husband and wife as one collective entity, or the husband and wife as independent entities who insured co-extensive interests in the same piece of property. If the policy is ambiguous, it will be construed against the insurer. Using this contra proferentem approach, it may be possible to limit the construction of "the insured" to the collective action of both insureds. America goes further and construes the policy according to the "reasonable expectations" of the parties, usually concluding that the co-insureds did not intend to be liable for each other's fraudulent actions under the policy. The "modern" approach scorns the underlying fiction of married couples being a single legal entity, favouring individual responsibility. It promotes consumer interest in line with developments in insurance law generally, applying important policy considerations where appropriate.

Some confusion arises where the courts take a middle line between the two approaches, usually in the transitional phase between them. The courts are still focusing on the property interests covered by the policy, however it is not limited by the legal fiction of "joint ownership". According to this approach, a policy which insures the property of a husband and wife should be construed as a composite insurance by which each spouse insures their respective rights and interests in the insured property, whether owned individually or jointly.

If the courts are moving towards, or have fully embraced, the "modern" approach, it is difficult for an insurance company to succeed in vitiating the policy in respect of the innocent co-insured. To resist a claim, the language of the policy has to be clear and unambiguous; it must provide that the misconduct of one co-insured automatically precludes the other from recovery, based on the fact that it is a joint contract containing only joint rights and obligations.

Most of the textbooks have not yet taken the new development seriously; however, this is certain to change when more cases come through the courts, and, more importantly, when the Court of Appeal approves of Eichelbaum CJ's approach in a future case.