'The common law pre-contractual duty of disclosure and the test of materiality: *Carter* to *Pan Atlantic* – a factual analysis'

Dogan Gultutan*

Introduction

Insurance, at its simplest, is the placing of one's risk with another (the insurer). The terms of the coverage may vary from policy to policy, but it is essentially a contract whereby *"one party agrees to pay a given sum upon the happening of a particular event*"[1] in return for a consideration (the premium). Since the assured usually knows more about the subject matter and the risks involved, the insurer is put in a vulnerable position. Without being informed of all the circumstances relating to the risk, he cannot properly assess the risk and decide whether or not to accept insuring the risk and, if so, on what terms and at what premium. The need to impose a duty on the assured to disclose what he privately knows to the insurer was therefore recognised by Lord Mansfield CJ in ***Carter v Boehm***.[2] The failure to disclose such circumstances entitles the insurer to avoid the contract "*because the risque run is really different from the risque understood and intended to be run, at the time of the agreement*".[3] Whether or not an insurer is permitted to avoid the contract depends ultimately on the materiality of the fact undisclosed. The test of materiality currently stands as determined by the House of Lords decision in ***Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd***[4], a decision this article aims to dissect in full. Although the focus of this article will be on the test of materiality relating to non-disclosure, as opposed to misrepresentation, in most cases the line between the two is "*imperceptible*".[5]

The ultimate purpose of this article is to determine whether or not the test of materiality established by their Lordship (by majority) is one that is in accordance with the previous authorities and whether it is a satisfactory test, given that over time access to information has become much easier and Sir Francis Bacon's rather eloquent phrase "*scientia potentia est* (knowledge is power)" no longer holds full sway in the internet age, where access to information has become extremely easy. In order to do so, this article has been divided into two distinct parts: (i) the first part will focus on the authorities prior to *Pan Atlantic* on the issue of materiality and the degree of influence required; (ii) and the second part will then proceed to scrutinise the House of Lords' decision in *Pan Atlantic*, providing a commentary of the decision. The Court of Appeal's decision in *Pan Atlantic* will be looked into within part two in order to obtain a complete picture of the options that were available to the Law Lords when delivering their judgment.

1. The 1906 Act and Materiality Before 1995

I. The Marine Insurance Act 1906

The *Marine Insurance Act 1906* (1906 Act) was a codification of the common law principles relating to marine insurance. Its primary purpose was to provide commercial men with the commercial certainty they desire the most. It is not surprising, therefore, that Lord Herschell, when introducing the Marine Insurance Bill into the House of Lords, quoted Willes J in ***Lockyer v Offleyin*** where he had expressed that "*...as in all commercial transactions the great object is certainty*".[6] The reasoning, according to ***Howard Bennett***, is that businesspeople would rather have a clear rule that might operate harshly and against their interests in a particular case than an unclear rule designed to produce a fair and equitable

* Dogan Gultutan is an associate at Esin Attorney Partnership, a Member Firm of Baker & McKenzie International, a Swiss Verein and a PhD candidate at City University, London. Dogan is admitted to the Bar of England & Wales (Barrister (2011)) and the Istanbul Bar Association (Attorney (2013)). He is a scholar of The Honourable Society of Lincoln's Inn.

[1] *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658 (KB), at p 660 *per* Channell J.
[2] (1766) 3 Burr. 1905 (KB).
[3] *Ibid* at p 1909 *per* Lord Mansfield CJ.
[4] [1995] 2 Lloyd's Rep. 427 (HL).
[5] *Ibid* at p 452 *per* Lord Mustill.
[6] (1776) 97 ER 1079 (KB), at p 1084.

result in each case but might require a lengthy and costly process to apply.[7] A well-established rule, which is consistently applied by the courts will inevitably reduce the risk of litigation.

The provisions dealing with the duty of utmost good faith in the 1906 Act are sections 17-20. *Section 17* stipulates that "*[A] contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.*"[8] The avoidance is *ab initio* (i.e., from inception) and the insurer can reject any claims and demand repayment of any claims paid, but at the same time must refund any premiums paid by the assured (unless the assured acted fraudulently).[9] The statute then provides two instances deriving from section 17: disclosure by the assured (*section 18*) and representations pending negotiation of contract (*section 20*). Since this article is concerned with non-disclosure, section 18 will be scrutinised, not section 20. However, as was noted before, the line between the two is hard to draw and the test of materiality contained in *section 18 (2)* is identical to that contained in *section 20 (2)*. For ease of reference, the relevant part of section 18 is as follows:

"***18. – Disclosure by assured.***

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

(2) ***Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk [emphasis added].***"[10]

Furthermore, by virtue of *section 91 (2)*, the common law continues to apply unless it is inconsistent with the express provisions of the 1906 Act. Although the 1906 Act is named the Marine Insurance Act, it has been repeatedly held to be applicable to non-marine insurance as well as marine insurance.[11]

II. Section 18 (2) and the Test of Materiality

The interpretation of section 18 (2) of the 1906 Act has been the subject of considerable debate. Disagreement has been expressed by judges and commentators on the interpretation to be afforded to section 18 (2). Three possible interpretations were advanced. A circumstance is material if:

(1) had it been disclosed, it would have led the underwriter to request a higher premium, change the wording of the policy or refuse to insure (the decisive influence test);

(2) it was something which the underwriter would have wanted to know in assessing the risk, not necessarily leading him to take an action one way or another (the might influence test);

(3) had it been disclosed, it would have varied the risk without the need for it to have decisive influence on the prudent underwriter's judgement (the increased risk test).

III. The Degree of Influence

i. The Authorities before CTI

[7] See, H.N. Bennett, 'The Marine Insurance Act 1906: Reflections on a Centenary' [2006] 18 *Singapore Academy of Law Journal* 669, at p 673.

[8] The Marine Insurance Act, section 17.

[9] See, C. Croly, 'Non-Disclosure and Misrepresentation in Insurance Contracts in England and Wales, Scotland and South Africa' [1986] 14 *International Business Lawyer* 110, at pp 110-111.

[10] The Marine Insurance Act 1906, section 18.

[11] *Pan Atlantic*, no 4 above, at p 432 *per* Lord Mustill. See also, *Lambert v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485 (CA), at pp 485-486 *per* McKenna J.

The interpretation of the test of materiality as contained in section 18 (2) was discussed in several cases before the decision of the Court of Appeal in ***Container Transport International v Oceanus Mutual Underwriting Association (Bermuda) Ltd***[12] (CTI), which conclusively defined the test of materiality. The decision, as will be discussed later, withstood the scrutiny of the House of Lords in *Pan Atlantic* on the materiality point. The authorities before *CTI* will therefore have to be examined to see whether the step taken by the Court of Appeal was universally accepted or whether different thoughts of opinion were expressed on the matter.

The first reported case that seems to have dealt with the meaning of materiality, albeit in the Ontario Insurance Act of 1914 (1914 Act), was the opinion of the Privy Council in ***Mutual Life Insurance Co of New York v Ontario Metal Products Co Ltd***.[13] That case concerned an alleged non-disclosure of material facts in a life insurance policy. The relevant provision, section 156 (4) of the 1914 Act, stated that "*[N]o contract shall be avoided by reason of the inaccuracy of any such statement (i.e., in an application for a policy) unless it is material to the contract*". Sub-section 6 then went on to provide that the question of materiality in any contract of insurance is a question of fact for the jury or for the Court, where no jury is involved. The Board, in the absence of a definition of materiality, had to decide whether a fact should be material if had the fact concealed been disclosed, the insurers would have acted differently, either by declining the risk or increasing the premium, or if the insurers would have delayed the acceptance of the risk until further inquiries were made. Lord Salvesen, in delivering the Board's judgment, stated:

> "*If the former proposition were established in the sense that a reasonable insurer would have so acted, materiality would, their Lordships think, be established, but not in the latter if the difference of action would have been delay and delay alone.*"[14]

Next is the decision of the Court of Appeal in ***Zurich General Accident and Liability Insurance Co Ltd v Morrison***.[15] That case concerned section 10 of the Road Traffic Act 1934 (1934 Act), which was passed to give injured third parties a right of recovery against the motorist's insurance, unless the insurer had obtained a declaration from the Court that he was entitled to avoid the policy for non-disclosure or misrepresentation of a material fact. The definition of materiality in the 1934 Act was identical to that contained in the 1906 Act.[16] Any views expressed in this case must naturally be powerful and persuasive, if not binding, if one wishes to consider the meaning of materiality in the 1906 Act. Lord Greene MR, with whom Mackinnon LJ concurred, held that the trial judge (Atkinson J) was right in adopting the test laid down by the Privy Council in *Mutual Life*.[17] This is despite the fact that judgments of the Privy Council are only persuasive and not binding authority, even for first instance courts.

They were the two main, and as it seems, only, reported authorities on the definition of materiality. What they illustrate is that the relevant test was the '*decisive influence test*' and not the '*might influence test*'. Whether the Court of Appeal in *CTI* followed the trend will now be examined.

ii. CTI at trial

At first instance, Lloyd J held that materiality can only be established if the insurer satisfies the Court that a prudent underwriter, if he had known the fact in question, would have declined the risk altogether

[12] [1984] 1 Lloyd's Rep. 476 (CA).
[13] [1925] AC 344 (PC).
[14] *Ibid* at pp 351-352.
[15] [1942] 2 KB 53 (CA).
[16] Road Traffic Act 1934, section 10(5). See, *CTI*, no 12 above, at pp 495 and 509 where Kerr and Parker LJJ respectively concede this point.
[17] *Zurich General*, no 15 above, at p 58.

or charged a higher premium.[18] He then went on to clarify the test, as he understood it to be, by stating that some difference of action is required to establish materiality. The mind of the reasonable prudent underwriter must have been influenced so as to induce him to refuse the risk or alter the premium.[19] This should not be confused with the requirement of inducement of the actual underwriter.[20]

iii. CTI in the Court of Appeal

On appeal by the defendants, the Court of Appeal unanimously allowed the appeal and overturned the judgment of Lloyd J. The Court held that an insurer is entitled to avoid a contract under section 18 (2) if the assured, before the conclusion of the contract, failed to disclose any circumstance a prudent underwriter would take into account when reaching his decision on whether or not to accept the risk or the rate of premium to charge. The test, in the Court's view, was satisfied by the appellants (the insurers). Kerr LJ cited several 19th-century cases including ***Rivaz v Gerussi***[21] and ***Tate v Hyslop***[22] in support of his conclusion of the applicable test in determining materiality.[23] He also distinguished *Zurich General* as a case turning on the construction of the 1934 Act.[24]

Parker LJ added a further argument in favour of the might influence test: that no other test accords with common sense or practical reality. His Lordship opined that the decisive influence test would involve the Court in the task, perhaps years after the event, of endeavouring to ascertain what a prudent underwriter would have done if the undisclosed circumstance was disclosed before the conclusion of the contract. He stated that such a test is on its face impractical. He reasoned that it is not possible to say that prudent underwriters in general would have acted differently. According to his Lordship, there is no absolute standard by which they would have acted or the weight they would give to undisclosed circumstances had they been disclosed.[25]

iv. Commentary – CTI dissected

There are several weaknesses in the Court of Appeal's decision in *CTI*, which will need to be discussed. First, Kerr LJ, it is respectfully submitted, erroneously distinguished *Zurich General* as a case turning on the construction of the 1934 Act. He relied on a passage from the judgment of MacKinnon LJ to support his contention. However, when one reads the judgment of MacKinnon LJ in full, one can easily see that the relevant provision of the 1934 Act consisted of two parts: the insurer must, in order to avoid for non-disclosure, prove (1) that the circumstance was material to the risk and (2) that in fact the underwriter's mind was so affected, and the policy was thereby 'obtained'.[26] With respect, his Lordship should have realised that MacKinnon LJ's statement in relation to the first part must necessarily be applicable to section 18 (2). It is the second part of the provision that differs from the 1906 Act. Thus, the *Zurich General* case, being the only Court of Appeal authority since 1906 on the degree of influence needed to prove materiality, was binding upon the Court in *CTI* as a matter of precedent, and should have been treated as such. This view is adhered to by ***Henry Brooke QC*** who is of the opinion that the decision of the Privy Council in *Mutual Life*, adopted by the Court of Appeal in *Zurich General*, was the leading case on materiality until 1982. He argued that "*in both cases the court was concerned to construe the word 'material'*".[27]

[18] [1982] 2 Lloyd's Rep. 178 (QBD Comm), at p 187.
[19] *Ibid* at p 188.
[20] See, *Pan Atlantic*, no 4 above.
[21] (1880) 6 QBD 222 (CA).
[22] (1885) 15 QBD 368 (CA).
[23] *CTI*, no 12 above, at pp 493-494. Parker LJ concurred at pp 507-508.
[24] *Ibid* at p 495. Parker LJ concurred at pp 508-509.
[25] *Ibid* at p 510. Stephenson LJ concurred at pp 526-527.
[26] See, *Zurich General*, no 15 above, at p 60 *per* MacKinnon LJ.
[27] H. Brooke QC, 'Materiality in Insurance Contracts' [1985] *Lloyd's Maritime and Commercial Law Quarterly* 437, at p 449.

Second, it is contended that Parker LJ was wrong in relying on *Rivaz* and *Tate* as authoritative on section 18 (2). It has been repeatedly asserted that the case-law before 1906 was not decisive on the degree of influence required to prove materiality.[28] This was taken a step further by ***Henry Brooke QC*** who argued that the authorities in fact favoured the decisive influence test, by using two 19th-century cases to support his contention. His first example was *Ionides*. He noted that in that case the court had rejected as too onerous a duty of disclosing everything that might influence the mind of an underwriter.[29] He then cited ***Stribley v Imperial Marine Insurance Co***[30] where Blackburn J (with whom Lush J concurred) said that he thought that the test was whether a fair and reasonable underwriter would find the risk speculative, which he will either decline to insure, or if he does insure, will do so at a higher premium. *Henry Brooke QC* therefore concluded by saying that there is little doubt that the court would have regarded it as insufficient for the insurance to be avoided if all the reasonable underwriter would have said is that the circumstance was one which he would have taken into account, but that he might have reached the same ultimate judgment as to the acceptability of the risk and the amount of the premium to be charged.[31] Further, he did not see *Rivaz* or *Tate* as departing from *Ionides*.

Third, one of the reasons why Parker LJ, with whom Stephenson LJ concurred, dismissed the decisive influence test was on the grounds of impracticality. He reasoned that five prudent underwriters would disagree on whether a circumstance would have altered their decision and that the might influence test posed no such problems. However, this ground, with respect, is untenable. The decisive influence test has been in use in the US since 1896, illustrating it is indeed workable.[32] Additionally, even with the might influence test, underwriters are bound to disagree. Not all prudent underwriters would want to know about a circumstance, and there may not be a universal way in which risks are assessed in the insurance industry.

The final weakness in the Court of Appeal's unanimous decision is that it departed from the never totally rejected requirement established in *Carter*, that the undisclosed circumstance must vary the risk. ***Anthony Diamond QC***, though rejecting that the word 'influence' in section 18 (2) means decisive influence, suggested that the word requires an objective assessment, that the non-disclosure of a particular circumstance must have rendered the risk a different risk. He stated that otherwise it would allow the insurer to avoid a contract where the risk is precisely the risk he intended to cover.[33] *Anthony Diamond QC* is right in suggesting that the test must relate to the risk being insured, but he fails to appreciate that a prudent underwriter is bound to refuse to insure or increase the premium if the risk is increased by a disclosed circumstance. If not, it is only reasonable to assume that such disclosure will in some way alter the wording of the policy. To expect a prudent underwriter to act otherwise would be a mistake. This line of reasoning is evident in ***Henry Brooke QC***'s paper where he argues in favour of the decisive influence test as well as for the preservation of the risk element.[34]

2. Pan Atlantic and Materiality

I. The Facts of Pan Atlantic and the Judgment of Waller J

[28] See, *Pan Atlantic*, no 4 above, at p 459 *per* Lord Lloyd of Berwick. See also, Lord Mustill at p 445.
[29] *Brooke QC*, no 27 above, at p 441.
[30] (1875) 1 QBD 507 (QBD).
[31] *Brooke QC*, no 27 above, at pp 441-442.
[32] See, *Penn Mutual Life Insurance Co v Mechanics' Savings Bank & Trust Co* 72 F. 413 (6th Cir. 1896). See also, M.A. Clarke, 'Failure to Disclose and Failure to Legislate: Is it Material? Part 2' [1988] *Journal of Business Law* 298.
[33] A. Diamond QC, 'The Law of Marine Insurance – Has it a Future?' [1986] *Lloyd's Maritime and Commercial Law Quarterly* 25, at pp 32-33. This view was adopted by Y.H. Ying, 'Recent Developments in Materiality Test of Insurance Contracts' [1995] *Singapore Journal of Legal Studies* 56, at p 58.
[34] *Brooke QC*, no 27 above, at p 439.

Pan Atlantic (the plaintiffs) was the reassured and Pine Top (the defendants) was the reinsurer under a Casualty Account Excess of Loss reinsurance. Pan Atlantic had placed the reinsurance with insurers other than the defendants between 1977 and 1980. They reinsured the risk with the defendants during 1980 and 1981. In 1982, Pan Atlantic renewed its reinsurance with Pine Top. A dispute between the parties arose and the plaintiffs claimed payment or damages for non-payment of paid losses. Pine Top, as a defence, pleaded non-disclosure or misrepresentation of material facts relating to the 1977-1979 years and misrepresentation or non-disclosure of additional losses for the years 1980 and 1981.

Waller J found for the defendant underwriters and held that the additional losses for the year 1981 were material to the risk being insured, and should have been disclosed on the date when the final presentation of the risk took place.[35] They were facts that would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk, in the sense that it would have had an impact on the formation of his opinion and on the decision-making process.[36] He dismissed the defence of misrepresentation or non-disclosure of material facts relating to the 1977-1979 years, holding that the broker had made available to the underwriter the history relating to the 1977-1979 years, and that that history, if the underwriter wished to examine it, was "*a perfectly fair presentation of those earlier years*".[37] The plaintiffs appealed to the Court of Appeal.

II. Pan Atlantic in the Court of Appeal

Steyn LJ, with whom both Farquharson LJ and Sir Donald Nicholls V-C concurred, dismissed the appeal applying the somewhat modified version of the test. He opined: "*the test is whether a prudent underwriter, if he had known the undisclosed facts, would have regarded the risk as increased beyond what was disclosed on the actual presentation.*"[38] He reasoned that the Court of Appeal in *CTI* had merely rejected the decisive influence test but that it had left open the exact test to be used. He identified two possibilities: (1) the might want to know test and (2) the increased risk test. He preferred the second solution for three reasons. First, and the most important, is that he saw the second solution to be more in line with the rationale of the duty of disclosure as enunciated by Lord Mansfield in *Carter*. He noted that Lord Mansfield had held that the underwriter was entitled to avoid the policy because the risk insured was not the risk the underwriter had understood he was insuring.[39] His second reason was that the second solution would provide a fairer and more balanced solution as between the assured and the insurer, when compared with the first. His third, and final, reason was that since the law on non-disclosure applies to consumers with same effect, it is particularly important that the law is fair and balanced. He reasoned that consumers, unlike commercial assureds, lack the assistance of sophisticated brokers.[40]

III. Materiality at its Last Stop – Pan Atlantic in the House of Lords

The plaintiffs (Pan Atlantic) intended, from the commencement of the lawsuit, to argue their case before the House of Lords with a view of persuading the Court to depart from the test of materiality as declared by the Court of Appeal in *CTI*. That is why they invited the trial judge to make findings of fact on how the particular underwriter (Mr O'Keefe) would have acted had the non-disclosed circumstances been disclosed.[41] The House was divided into two on the issue of materiality. The majority, led by Lord Mustill, held that the test of materiality should be the might influence test as expressed by the Court of Appeal in *CTI*. The minority, led by Lord Lloyd of Berwick, dissented and opted for the decisive

[35] *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1992] 1 Lloyd's Rep. 101 (QBD Comm), at p 112.
[36] *Ibid* at p 103.
[37] *Ibid* at p 106.
[38] *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd's Rep. 496 (CA), at p 505 *per* Steyn LJ.
[39] *Carter*, no 2 above, at p 1909.
[40] *Pan Atlantic*, no 38 above, at pp 505-506.
[41] *Pan Atlantic*, no 35 above, at p 103. See also, *Pan Atlantic*, no 38 above, at p 504 *per* Steyn LJ.

influence test. The reasoning advanced by both sides in justifying their preference of one over the other will now be examined in detail.

The majority advanced three main grounds justifying their rejection of the decisive influence test. The first, advanced by Lord Mustill, is that he could not find the suggested meaning (the need to show decisive influence) in the words of the 1906 Act. He noted that had Parliament intended the test of materiality to be the decisive influence test, it would have inserted the word 'decisively' or 'conclusively' before influence to make its intentions clear. In the absence of these words, his Lordship stated the provision bears its ordinary meaning. That, he opined, was not the meaning Pan Atlantic suggested. He concluded by saying that the phrase "*influence the judgment of a prudent insurer in . . . determining whether he will take the risk*" denotes an effect on the thought process of the insurer in weighing up the risk.[42] Both Lord Goff of Chieveley and Lord Slynn of Hadley expressed that they agreed with the reasons advanced by Lord Mustill.[43]

The second reason, advanced by Lord Mustill and concurred in by the other two Law Lords, was that the decisive influence test would be impractical.[44] Lord Goff rejected the decisive influence test on the basis that it "*faces insuperable practical difficulties*".[45] This view has also been adopted by ***Howard Bennett*** who rejects the decisive influence test (he refers to it as the 'different decision test') on the basis that "*...the reaction of the hypothetical insurer could not be determined by expert evidence some years after the event*".[46]

Third, Lord Mustill, having examined the pre-1906 authorities as well as reputable and well-known writings relating to those authorities, expressed that although the pre-1906 authorities and writings do not conclusively establish that the decisive influence test is unsound, "*they furnish substantial support for the view that the duty of disclosure extended to all matters which would have been taken into account by the underwriter when assessing the risk*".[47] With regards to the post-1906 authorities, he was of the view that none of those authorities concerned the narrow matter the House was being asked to consider.[48]

Another reason, which seems to have only been highlighted by Lord Goff, and therefore, may not be regarded as the reasoning of the majority, was that the introduction of the requirement of inducement of the actual underwriter dispenses with the need to bring in the decisive influence test. Lord Goff went as far as asserting that the introduction of the decisive influence test becomes "*not merely unnecessary, but inappropriate*".[49]

The minority differed from the majority on all three points. On the statutory interpretation point, Lord Lloyd was of the view that the proper interpretation of the word 'judgment' was the key to the solution. Taking a purposive approach, Lord Lloyd held that in a legal or quasi-legal context the word 'judgment' is often used in the sense of a decision or determination.[50] He therefore concluded that for the judgment of the prudent underwriter to be influenced, the undisclosed circumstance, had it been disclosed, must alter his decision one way or another. Lord Templeman agreed, holding that the judgment of a prudent insurer cannot be said to be 'influenced' by a circumstance that, if disclosed, would not have affected acceptance of the risk or the amount of premium to be paid. His reasoning was that if the alternative test was adopted, it would "*give carte blanche to the avoidance of insurance*

[42] *Pan Atlantic*, no 4 above, at p 440. See also, *CTI*, no 12 above, at p 491 *per* Kerr LJ.
[43] *Ibid* at pp 431 and 454 respectively.
[44] *Ibid* at p 440.
[45] *Ibid* at p 431.
[46] H.N. Bennett, 'The Duty to Disclose in Insurance Law' [1993] *Law Quarterly Review* 513, at p 515.
[47] *Pan Atlantic*, no 4 above, at p 445.
[48] *Ibid* at p 447.
[49] *Ibid* at p 432.
[50] *Ibid* at p 458.

contracts on vague grounds of non-disclosure supported by vague evidence even though disclosure would not have made any difference."[51]

On the practicality point, Lord Lloyd asserted that the decisive influence test poses no such practical difficulties. He took the opposite view contending that the decisive influence test is in fact simpler. He robustly claimed that *"[W]hat the prudent insurer would have wanted to know is as nebulous and ill-defined as the alternative is precise and clear-cut.*"[52] He dismissed Parker LJ's justification that five experienced and prudent underwriters will disagree on what circumstance would have had a decisive effect, noting that the five experienced and prudent underwriters are more likely to disagree on what they would have wanted to know than what they would have done.[53] Lord Templeman agreed and explained why the decisive influence test is simpler and more practical. He said that if the test was the decisive influence test, and the underwriter states that had he known the fact he would not have accepted the risk, his evidence can be evaluated against what insurance underwriters in the industry generally accept. However, if the alternative test is adopted, there are no objective or rational grounds upon which the prudent underwriter's desire to know certain facts can be tested to ascertain that he would have wanted to know the undisclosed circumstance(s).

Last, but not least, is the minority's difference with the majority on the interpretation of the authorities both pre and post-1906. Although Lord Lloyd agreed with Mr Beloff QC, counsel for the plaintiff, that the pre-1906 authorities were of little assistance since they had never dealt with the narrow point with which the House of Lords was concerned, he stated that the evidence in the relevant cases (*Ionides* and *Tate*), which formed the basis of section 18, demonstrates that the court in each case was concerned with what the underwriters would have done, rather than what they would have wanted to know.[54] However, regarding the post-1906 authorities, he disagreed with Lord Mustill's view that the Privy Council in *Mutual Life* was not concerned with materiality in the narrow sense. He regarded the decision as the leading authority on the application of the prudent insurer test and the meaning of materiality in English law.[55]

IV. Commentary – Majority versus Minority

The minority view should be preferred over the majority for several compelling reasons. The practicality point has already been noted above when discussing the judgment of the Court of Appeal in *CTI*.[56] The short answer is that the decisive influence test is not, as has been suggested, impractical. The use of the decisive influence test in Australia[57] and in the US is a perfect illustration of this. Many authors have expressed their agreement with this view, including ***Malcolm Clarke***.[58] For example, ***John Birds*** and ***Norma Hird*** express that the much narrower duty established by the American courts "*works perfectly well and is fair to both parties*".[59] The decisive influence test is bound to work '*perfectly well*' because

[51] *Ibid* at p 430.
[52] *Ibid* at p 457.
[53] *Ibid* at p 458.
[54] *Ibid* at p 461.
[55] *Ibid* at p 462.
[56] See, no 32 above.
[57] See, *Mayne Nickless Ltd v Pegler* [1974] 1 NSWLR 228 (NSW SC), at p 239 *per* Samuels J. Note that the provision dealing with materiality in the Marine Insurance Act 1909, section 24(2) is identical to section 18(2) of the 1906 Act.
[58] *Clarke*, no 32 above. See also, M.A. Clarke, 'Good Faith and Bad Blood in Insurance Claims' [2002] 14 *South African Mercantile Law Journal* 64.
[59] J. Birds and N.J. Hird, 'Misrepresentation and Non-disclosure in Insurance Law – Identical Twins or Separate Issues?' [1996] 59 *Modern Law Review* 285, at p 290. See also, T.J. Schoenbaum, 'The Duty of Utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law' [1998] 29 *Journal of Maritime Law & Commerce* 1, at pp 8-9; A.A. Tarr and J.A. Tarr, 'The Insured's Non-Disclosure in the Formation of Insurance Contracts: A Comparative Perspective' [2001] 50 *International and Comparative Law Quarterly* 577, at pp 583-584; L.E. Trakman, 'Mysteries Surrounding Material Disclosure in insurance Law' [1984] 34 *University of Toronto Law Journal* 421.

just as insurers called to give evidence will testify what they would have wanted to know regarding the risk and the circumstances and then it is for the trial judge to determine what a prudent underwriter would have wanted to know, the insurers called to give evidence will be asked whether, if the undisclosed circumstance was disclosed, they would have increased the premium, changed the terms of the policy or refused to insure. The court will then determine, having heard the insurers called to give evidence from both sides, which view to accept as the view of a prudent underwriter operating in the insurance industry. Clearly this test achieves fairness.

Another reason to prefer the minority view is that Lord Goff's reasoning, that the introduction of the requirement of inducement of the actual underwriter makes the introduction of the decisive influence test inappropriate, is not entirely convincing. Since the majority in the House of Lords set the standard of materiality too low, the test can, in certain cases, continue to work against the assured.[60] ***Sarah Derrington*** concurs with this view, stating since the test of materiality is so wide, it in essence removes the objectivity element from the definition. She argues it is relatively easy to find a prudent insurer who would testify that he would have wanted to know of the particular fact, regardless of whether or not it would have had decisive effect.[61] Although Lord Mustill recognised this weakness of the current test of materiality when highlighting why the *CTI* decision was unpopular, he seems to have failed to resolve it.[62]

The flaw in Lord Goff's justification is best explained by way of an example. Let us assume that an assured approaches an underwriter with the intention of procuring an insurance policy for his business. Let us further assume that the assured, innocently, fails to disclose a circumstance the prudent underwriter would have wanted to know, but not one that would have led him to increase the premium, change the terms of the policy or refuse to insure. The actual underwriter, on the other hand, is induced by the non-disclosure in the sense that he would not have made the same contract if the undisclosed circumstance was disclosed.[63] Under these circumstances, the test fails to strike a fair balance. It favours the insurer. The inducement of the actual underwriter will only remedy the looseness of the test of materiality where the actual underwriter is a prudent one. As ***Anthony Diamond QC*** highlighted, there are occasions where the actual underwriter may choose not to act as a prudent underwriter in order to enter into a particular line of business or to keep the broker happy.[64] There is also the possibility he may indeed be a reckless underwriter insuring risks no prudent underwriter would accept. In such cases, the requirement of inducement of the actual underwriter is inadequate to remedy the injustice. The test of materiality, therefore, ought to be the decisive influence test.

This does not mean, however, that the subjective element is unnecessary; quite the opposite. An ideal test should indeed consist of both the objective and the subjective elements. The actual insurer should not be entitled to avoid a policy unless he could show, had the circumstance been disclosed, he would have acted differently. The alternative would simply be, to use Kerr J's phrase, "*absurd*".[65]

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[60] See, Sir Andrew Longmore, 'An Insurance Contracts Act for a new Century?' [2001] *Lloyd's Maritime and Commercial Law Quarterly* 356, at p 365; J. Hird, 'Case Comment: Pan Atlantic – Yet More to Disclose?' [1995] *Journal of Business Law* 608, at pp 611-612; Australian Law Reform Commission, Report No 91, *Review of the Marine Insurance Act 1909* (Australian Government Publishing Service, 2001), para. 10.71.

[61] S.C. Derrington, 'The Requirement of Inducement and the Concept of Materiality in Section 24 of the Marine Insurance Act 1909' (2000) 11 *Insurance Law Journal* 236, at p 256.

[62] *Pan Atlantic*, no 4 above, at p 440 *per* Lord Mustill.

[63] See, *Pan Atlantic*, no 4 above, at pp 453-454 *per* Lord Mustill; *St. Paul Fire & Marine Insurance Co v McConnell Dowell Constructors* [1995] 2 Lloyd's Rep. 116 (CA), at pp 124-125 *per* Evans LJ. The non-disclosure must be an effective cause of him accepting the risk on the terms agreed, but it need not be the sole cause: *Assicurazioni Generali SpA v Arab Insurance Group* [2003] 1 All ER (Comm) 140 (CA), at paras. [59] and [87] *per* Clarke LJ.

[64] *Diamond QC*, no 33 above, at p 31.

[65] *Berger and Light Diffusers Pty Ltd v Pollock* [1973] 2 Lloyd's Rep. 442 (QBD Comm), at p 463 *per* Kerr J. See also, *Pan Atlantic*, no 4 above, at p 452 *per* Lord Mustill; *Trakman*, no 59 above, at pp 438-439; Steyn J (speaking extra-judicially), 'The Role of Good Faith and Fair Dealing in Contract Law: A Hair-Shirt Philosophy?' [1991] 6 *Denning Law Journal* 131, at p 139.

Similarly, the actual insurer should not be entitled to avoid if a prudent insurer would not have acted in the same way. The actual insurer has no one but himself to blame if the loss occasions and he has to pay out under those circumstances.

A third reason to prefer the minority view is that it is more in line with the rationale of *Carter*. It is more assured friendly and brings fairness to an area of law that require it most.

Finally, Lord Mustill's reasoning in rejecting the decisive influence test on the grounds of statutory interpretation is unconvincing; Parliament could have equally inserted the word 'might influence' as opposed to 'would influence'. It is suggested the phrase 'would influence', on a plain reading, lends more support to the decisive influence test.

Conclusion

Carter is a celebrated case and deserves to be. It established an equal playing ground for both the assured and the insurer whereby the prevention of fraud and the observance of good faith were facilitated. However, the English courts have failed to appreciate the purpose of the duty Lord Mansfield placed on the assured, and widened the duty - particularly with respect to the test of materiality - so much it became referred to as "*an engine of oppression*"[66] upon the assured. The test of materiality formulated by the majority in *Pan Atlantic* is too onerous and insurer friendly. The law must strike a fair balance between competing interests to the extent possible and this is certainly an area where such is the case.

Abstract:

This article examines the test of materiality as established by the House of Lords in Pan Atlantic Insurance v Pine Top Insurance 1995, so as to determine whether or not it is a test that is in accordance with previous authorities on materiality in insurance dealings and whether it is a satisfactory test in all circumstances. To this end, it examines the state of common law authorities on materiality prior to Pan Atlantic Insurance v Pine Top Insurance and what alternatives were open to the Law Lords when adjudicating the dispute. The article thereafter proceeds to examine Pan Atlantic Insurance v Pine Top Insurance in all its judicial stages, ending with a critical analysis of the test imposed. The article argues that the Law Lords (by majority) misinterpreted the common law authorities on materiality and consequently imposed a very onerous on the assured with respect to its duty of disclosure.

[66] *Niger v Guardian Assurance Co* (1922) 13 Lloyd's Rep. 75 at p 82 *per* Lord Sumner.