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MARINE INSURANCE - IS THE DOCTRINE OF "UTMOST GOOD FAITH" OUT OF DATE?

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The Background of American Law

Although many threads of uniformity run through American law, it is various because of our federal system and one must take care in generalizing about it. Marine insurance, by virtue of the Admiralty Clause in the Constitution, falls under Federal control, potentially in its entirety. In practice, however, the extent of Federal control became vague with the Wilburn\(^1\) decision in 1955, which is possibly the Supreme Court's murkiest and worst ever on the allocation of State and Federal authority. The case involved warranties in the insurance of a houseboat on an inland lake and the Court expressed no limitation of vessels or geography.

Happily, for my task if not for other reasons, the rule of utmost good faith as it relates to disclosures is almost universally regarded as one of the established Federal rules, although decisions around the country vary somewhat in the details of its expression and application. I will not therefore trouble you with the confusion caused by the Wilburn case, beyond observing that it is the reason for a few variant decisions and an occasional hedge in the following discussion.

Our early writers viewed English and American Common Law and, to an important extent, the Continental Civil Law of insurance as a system uniform in principles and, for the most part, in rules. Most of our States have a common heritage of English Common Law. The great exception is Louisiana, where the legal system is that of the French Civil Law. The doctrine of utmost good faith was attributed in the United States, however, to both French and English sources and has come down to us with the understanding that it generally conforms to English

\(^{1}\) Wilburn Boat Co. v. Fireman's Fund Insurance Co., 348 U.S. 310, 1955 A.M.C. 467 (1955) left marine insurance policies to be governed by Federal rules, when they are established, and otherwise by State rules, without explaining how to determine when a Federal rule is established.
law. Alone among the States, California has a chapter (66 sections) of its Insurance Code devoted to marine insurance. It was codified from English, American and French sources in the Nineteenth Century and many of its provisions are similar to those of the English Marine Insurance Act, 1906. I may therefore refer at times to the California code as a general authority.

**Utmost Good Faith, Generally**


The contract of insurance has been said to be a contract *uberrimae fidei*, and the principles which govern it are those of an enlightened moral policy. The underwriter must be presumed to act upon the belief that the party procuring insurance is not, at the time, in possession of any facts material to the risk which he does not disclose . . .

Fifty-five years later, in *Sun Mutual Insurance Co. v. Ocean Insurance Co.*, 107 U.S. 485, 510 (1883), the Court provided a more expansive statement, by quoting Duer with approval:

The assured will not be allowed to protect himself against the charge of an undue concealment, by evidence that he had disclosed to the underwriters, in *general* terms, the information that he possessed. Where his own information is specific, it must be communicated in the terms in which it was received. General terms may include the truth, but may fail to convey it with its proper force and in all its extent. Nor will the assured be permitted to urge, as an excuse for his omission to communicate material facts, that they were actually known to the underwriters, unless it appears that their knowledge was as particular and full as his own information. It is the duty of the assured to place the underwriter in the same situation as himself; to give him the same means and opportunity of judging of the value of the risks . . .

While courts vary their words somewhat, the *Sun* and *M’Lanahan* cases continue to be cited as

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controlling authorities.\textsuperscript{3}

Exceptions to the duty of disclosure by the prospective assured correspond to those in English law. They include the underwriter's knowledge or duty to know, waiver, exception of the risk from the policy and exclusion by warranty. Both the underwriter and the assured are expected to be aware of usages of trade and political and general causes affecting the risks underwritten, sufficiently at least in the case of the underwriter, to prompt the necessary questions about them.\textsuperscript{4} Apart from such matters, the knowledge to which the assured is held is his actual knowledge, either in person or through agents; he is not said to have a duty of diligence in collecting knowledge about the risk, but he may be held to know of some matters he ought to know, and will in practice surely not be allowed to pursue a studied course of ignorance. While the assured may have to disclose opinions of third persons concerning the risk, he does not have to give his own and, in recognition of a limit of realism, he need not disclose, however true it be, that he himself is a scoundrel! \textit{Sun} at 510.

**Duration of the Duty**

The duty of disclosure (including correction of representations) clearly exists beyond the placement and up to the time of inception of the policy, under the \textit{M'Lanahan} case, where Story, J. said (at 185):

The true principle deducible from the authorities on this subject is, that where a party orders insurance, and afterwards receives intelligence material to the risk, or has knowledge of a loss, he ought to communicate it to the agent, as soon as, with due and reasonable diligence, it can be communicated, for the purpose of countermanding the order, or laying the circumstances before the underwriter.


\textsuperscript{4} See Cal. Ins. Code §§ 333, 335, 336, 1900; 2 DUER 552, 559-60.
There is no doubt that this rule applies to renewals, and the California Code is explicit that the same rules apply to any modification of the contract. The duty may continue during the policy period and require disclosure of an increase in the risk due to a change made by the assured in trade or structure or other circumstances, or where a cancellation right is available.

**Mutuality**

Duer said the duty of utmost good faith is owed by both insurer and assured, each to the other. He was probably influenced by the philosophical consideration of equality and mutuality in contracting, rather than any reports of litigation of insurer bad faith. Until recently, such reports have been non-existent or rare, and it is not remarkable that the many cases dealing with concealments by assureds would not mention a principle of mutuality. Recent litigation of insurer bad faith, usually in respect of claims practices, has spilled over into marine insurance, where the protection of assureds has corresponded to that in non-marine practice, especially in what may be called "consumer" cases. While the classic precedents on utmost good faith have not been commonly cited in such cases, there can be no doubt that the mutuality of the doctrine, when put in issue, will be confirmed in accordance with Duer's precept. The possibilities for its application to underwriters in placements, however, will no doubt continue to be rare.

**Materiality--What Is It?**

Of course, only material facts are those that must be disclosed and not misrepresented; it matters not what others the assured keeps to himself. But which are material and which are not is an issue at the core of almost every disclosure dispute, bringing into focus two questions about the test of materiality: (1) by whose mind is it to be tested, that of the actual underwriter or a

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hypothetical prudent one; and (2) what effect upon that mind is critical?

It is remarkable, in the recent notable English cases dealing with these questions, that the courts have respectfully examined four Nineteenth Century American treatises in search of the understanding of the times as to the Common Law. It is perhaps equally remarkable that these treatises required careful interpretation and ultimately pointed them in different directions. It is not remarkable, therefore, that the signals have been differently read in the United States.

**Prudence or Actuality?**

The Supreme Court has never discussed the question squarely, but it is hard to read the words of the *M'Lanahan* case as having anything to do with the actual underwriter's mind. Story, J. states that the underwriter "must be presumed to act upon the belief" that he has been told everything material (at 185). If this is a matter of presumption, it would seem that the actual underwriter and his mind have nothing to do with it; he goes on to say that materiality "rests upon the judgment of underwriters and others who are conversant with the subject of insurance" (at 188) and omits any meaningful reference to the actual underwriter.

In the *Sun* case, the Court appears to persist in that view. It refers to a "prudent underwriter," and not to the actual one, and reverses a judgment for the assured, holding a policy avoided for non-disclosure and calling the matter so clear that there is no need for "proof of usage or opinion of those engaged in the business" (at 509-10). Most Federal courts appear to have followed this view.

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3/ But in Puritan Ins. Co. v. Eagle S.S. Co S.A., 779 F.2d 866, 1986 A.M.C. 1240 (2d Cir. 1986) the court affirmed a decision against the insurer, on the ground that the resistant underwriter would not have relied on certain undisclosed prior losses and would have written the policy in any event, based on evidence that he relied on the
Another view is found in California, a State of considerable maritime importance, where the code (based on some of the same authorities cited for the contrary view) provides:

Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries.

The party to whom the communication is due is the actual underwriter, but expert testimony can be taken on the question of probable and reasonable influence. In the contest between Federal and State law, underwriters are happy to rely on the California law in cases that arise rather frequently on yacht policies, and assureds can see no comfort in claiming the existence of an overriding Federal rule.\textsuperscript{10/}

\textit{The Test of Influence}

The second serious question about the materiality test concerns the effect of the undisclosed or misrepresented fact on the mind of the relevant underwriter, actual or prudent. This question also has never been squarely posed and discussed by the Supreme Court, but it has been impliedly dealt with inconsistently. An early expression of Justice Washington, on circuit, strongly indicated a test of actual inducement or causation like that recently announced in England.\textsuperscript{11/}

In \textit{M'Lanahan}, Story, J., for the whole Court, with Washington therefore not dissenting, judgment of lead underwriters rather than information furnished by the assured. This decision can be reconciled to the main stream as an instance of waiver, the underwriter's choice of business procedure having rendered disclosure irrelevant.


\textsuperscript{11/} Clason v. Smith, 5 F. Cas. 990, 991, No 2868 (C.C. D. Pa. 1812) ("If in point of fact, it had no influence . . . then it is impossible to say that it was material.").
referred to "the ultimate fact itself, which is the test of materiality--that is, whether the risk be increased so as to enhance the premium . . ." and never suggested the materiality of the effect on the actual underwriter. This formula appears the same as that of Steyn, J. in the Court of Appeal, recently rejected in the House of Lords in *Pan Atlantic Insurance Co. v. Pine Top Insurance Co.*, [1994] 3 Re LR 101 (H.L. 1994).

In *Sun*, the Court premised its reversal on the view that the undisclosed fact was "important to the underwriter as likely to influence his judgment in accepting the risk," and that, "[h]ad it been known, it is reasonable to believe that a prudent underwriter would not have accepted the proposal as made" (at 509-10). The Court approved Duer's test that the fact "would probably have influenced the terms of the insurance" (at 510). These expressions of the Court in two leading cases are consistent with the "increased risk" test but also with the "decisive influence" test that was also rejected by the majority in *Pan Atlantic*. The words of these decisions do not crystalize the test and, in my view, are sufficiently malleable to permit a fairly open consideration of the question and possibly to accommodate, for example, the result in *Pan Atlantic*, if that found favor.

It remains to add that, where the underwriter asks a question, especially if it be asked and answered in writing, there will be a strong, and possibly conclusive, presumption that the answer is material.

**Evidence, Expert and Otherwise**

The opinions of experts are no doubt admissible on the question of materiality no matter what test of materiality be employed from the range of those considered. M'Lanahan tells us that the inquiry is "dependent upon the judgment of underwriters and others, who are conversant with the subject of insurance." (at 188). In *Sun, as I have said*, the Court considered questionable cases to be subject to "proof of usage or opinion of those engaged in the business" (at 509).
The evidence of the actual underwriter presents additional problems, especially if the test involves the effect of the undisclosed fact upon himself. If he were qualified (as one would hope), he might surely testify as an expert on usages and the importance of particular facts, if such testimony from a principal were thought valuable. He may undoubtedly testify as to his own previous practice, if any, in responding to facts of the character of what was not disclosed. But conventional rules of evidence would seem to preclude, as speculation, his testifying as to whether, and on what terms if any, he would have accepted the risk. Many good underwriters could be expected to recognize the merit of this point and, while resenting that they were denied fair consideration of a fact, take the position in some cases that they could not fairly say now what they would have done with it a year or two ago.

**Intent and Innocence**

Story, J. said in *M'lanahan* that the right to disclosure is unaffected "even if there be no intentional fraud" (at 185). And in *Sun* the Court said that the duty "is independent of the intention, and is violated by the fact of concealment even where there is no design to deceive" (at 510). Actual intent, negligence, inadvertence, and in the case of misrepresentation even actual knowledge, are irrelevant. No substantial doubt has been cast on this proposition, although sports may appear among the cases in the lower courts.\(^{12}\)

**Truth or Consequences**

Concealment of anything material, whether by non-disclosure or misrepresentation, makes the contract voidable at the instance of the other party, who may declare it avoided and defend against all further claims or go to court for a judgment of rescission and recovery of

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\(^{12}\) See, e.g., Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 13, 1987 A.M.C. 1, 6 (2d Cir. 1986) where the court, in disharmony with its other decisions, said that the standard for disclosure depended on "whether a reasonable person in the assured's position would know that the particular fact is material," but in the event held the policy avoided.
payments already paid. If the insurer takes this course, he must return the relevant premium or offer to do so. If he continues to collect premiums or does not act with reasonable promptitude after learning the truth, he will affirm the contract. He may, however, choose not to avoid the contract and resist only a particular claim on the ground of concealment relevant to it, while retaining premiums and paying other claims.

The Broker's Role

The broker is the agent of the assured, in arranging the insurance, and so the assured is charged, under the law of agency, with knowledge of the broker of which he himself is unaware. Thus the broker, in the exercise of care, is obliged to disclose material facts known to him from other sources, but not to his principal, or jeopardize his principal's insurance. The assured, on the other hand, is not insulated from risk by the good faith and diligence of his broker, acting without full and recent information. This is illustrated by the *M'Lanahan* case, where the owner's agent, following instructions to place insurance on the vessel, did not know that she had been lost a few days before, and it was held that the insurance depended on whether the owner had shown proper diligence to get word of the loss from Havana to the agent in Baltimore before the insurance incepted.

Fraudulent Claims

While we do not altogether lack for instances of fraudulent claims, there is little authority in America on the effect of their falsity under the doctrine of utmost good faith. While good faith is the expectation, the routine consequence of its lack is the loss of the claim. A false claim will not ordinarily, of itself, give cause to avoid the policy. But it often brings into focus a material misrepresentation or non-disclosure that may lead to avoidance, as when an inflated claim is made for loss of a vessel, the investigation of which leads to the discovery that her value or
condition was falsified in the placing.\textsuperscript{13}

**What Lies Ahead?**

**Pan Atlanticism?**

As I observed above, the Supreme Court's judgments on materiality are far from adamantine. The greatest pressure on materiality doctrine is undoubtedly directed at the relevance of the effect of non-disclosure upon the actual underwriter. Learned opinion has long been divided on this issue. There is no doubt a widespread instinct that an assured should not lose his insurance if it would have been accepted even with knowledge of the undisclosed fact. On the other hand, a test based on what the actual underwriter would have done makes the standard of conscience depend upon the inexperience, incapacity or gullibility of the other party, and also raises evidentiary problems in the mind of a trial lawyer. It must be impressive, however, that the Law Lords are unanimous on this point. Their opinion will be entitled to respectful consideration in the United States. Our Supreme Court has said that "[t]here are special reasons for keeping in harmony with the marine insurance laws of England, the great field of this business."\textsuperscript{14} It is therefore readily conceivable that the new English rule on this issue might be adopted in the United States, with or without the mechanism of adding the issue of causation to that of materiality.

The *Pan Atlantic* test for influence on a prudent underwriter appears to fall a little below the range of expression in the United States, which would call for a more nearly decisive effect upon him. This test might also be acceptable in company with the causation rule, but probably


not otherwise.

**Proportionality?**

There has been no prominent agitation in the United States for a rule of proportionality, and I do not foresee any in the near future. We may probably put aside as unrealistic any notion of adjusting premiums; it would be an invitation to starve underwriters out of business by postponing substantial premiums to the event of a loss, when it would also not serve the assured since the proper premium would at least equal the amount of the loss.\(^{15}\)

Proportioning the recovery to the insurance that could have been bought for the premium paid with full disclosure has a splendid equitable ring about it but presents serious practical problems giving it limited appeal. It would be easily workable where risks are rated according to manual or settled company practice and where the undisclosed fact places the risk in another rated category. It is probable that companies selling yacht policies have rating schemes that would lend themselves to this practice where, for instance, the fact is that the vessel is sometimes raced or used commercially or beyond the stated waters. We cannot, however, expect moral risk to be rated, or to be reasonably ratable after the fact. Overvaluation is a common problem. What insurance could the premium have bought on a fair disclosure? Much more, in fact, than the underwriter would be willing to sell. Should he pay the actual loss and return excess premium? Should he keep the premium and pay the actual loss? The difficulty is that he has been misled to insure a moral risk (sometimes a great one) that he could not have rated and never would have knowingly accepted. Apart from possibly a few instances arising under "consumers" yacht policies, where also the undisclosed facts prove to be easily ratable, there is little to inspire confidence in the assessment of proportional recoveries.

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Consumerism?

The movement for consumer protection has been strong in the United States, as elsewhere, and non-marine insurers have made improvements in their underwriting and claims procedures for the benefit of consumers and also taken wise precautions for their own. Many of these insurers are also marine insurers at the "consumer" level. Marine insurance generally has been affected, although not so dramatically.

Non-marine insurance is entirely under the regulation of the States. Personal lines, such as life, health, automobile and homeowners' policies, are commonly regulated by statute in respect of underwriting process and terms, including the subject of representations and disclosures, as to which the tendency is to require written proposals including questions as to all the material facts.

State laws also commonly exclude marine insurance from their general provisions of this sort. But there is no sharp dividing line between the rules of marine and non-marine insurance, and the marine will inevitably feel the influence of the non-marine and of "consumerism" represented in the hundreds of thousands of people who now own pleasure craft. The owners of the larger ones, and many others also, place their insurance through experienced brokers; as to them, probably no great case for change can be made. Most do not, and these are most likely, through their presumed innocence, to put pressure on the utmost good faith doctrine. It would not be surprising to see the recognition of a usage that their policies should be based on the questions and answers on proposal forms, with materiality defined by such forms, as in much non-marine insurance.

Conclusion--Does Utmost Good Faith have a Future?

While uberrima fides has been bruised, scratched and pierced with an occasional arrow, I conclude that none of its wounds, nor all together, are mortal. Occasional criticisms that it does
not reflect present views and conditions appear to spring from the notion that standards should chase morality downhill. The maintenance of utmost good faith enjoys strong support in the Maritime Law Association of the United States as well as professional insurance circles. While some adjustments may be made, I see no likelihood of its demise as a general principle in marine policies.

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