

# Should Insurance Risk Avoidance be Reformed and would Reform be of a Right of Equitable Rescission or a Right Sui Generis?

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☞ Keywords

## **Abstract**

*This article explores the distinction between the alternative explanations for the remedy of insurance risk avoidance in the event of breach of the duty of utmost good faith. It asks whether the remedy is an avoidance of a void contract, or a rescission of a voidable contract. The article then considers the general significance of that distinction to the capacity of a party to exercise its primary right of avoidance, and to the secondary rights of the contracting parties—arising in consequence of the avoidance—to prevent unjust enrichment or achieve restitution. Before considering the potential for—and the desirability of—further reform in the area, the article evaluates the importance of the legal characterisation of insurance risk avoidance in the particular context of insurance contracts affording indemnity to multiple insured parties.*

## **Introduction**

The continuing review of insurance law (the JLC Review) by the joint Law Commissions of England & Wales and Scotland has understandably addressed the concept of insurance risk avoidance from the perspective of reviewing underwriters' substantive rights of avoidance. The review has not to date sought to address in detail the nature of the remedy inherent in the concept of risk avoidance. But whether the remedy arises at law in contract, or in equity is a question of some significance in terms of the consequences of the avoidance. The significance of the answer is that it effectively determines whether the rescission is conditional upon the parties being able to achieve *restitutio in integrum* and restore each other to their original pre-contract position—sometimes called the status quo ante—and whether the equitable bars to rescission may be asserted by way of defence to avoidance. The answer is of particular importance as regards those insurance contracts that afford indemnity protection to multiple insured parties claiming, respectively, as original joint or several insureds, subsequently declared insureds, assignees, third parties, or as loss payees. The aim of this article is to explore the issues arising and how the present uncertainties as to the nature of the avoidance

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remedy might be the subject of reform. Initially the article addresses the nature of insurance risk avoidance, goes on to consider the legal consequences of that nature and their effects in the context of multi-party insurance prior to suggesting areas for potential reform.

## The nature of avoidance

In the light of the House of Lords' decision in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*,<sup>1</sup> the starting point for any analysis of contractual rescission in insurance would seem to be the working assumption that it should not differ (save as to its accommodation of the non-disclosure<sup>2</sup> concept specific to insurance contracts) from generally applicable principles of contractual rescission. This seems appropriate since, in the *Pan Atlantic* case, their Lordships explicitly recognised that the avoidance of insurance risks by reason of material non-disclosure or material misrepresentation was indeed subject to ordinary rules of law as to voidable contracts<sup>3</sup> and they relied on that conclusion in unanimously deciding that underwriters were only entitled to avoid where the material misrepresentation or material non-disclosure had induced the underwriting of the risk. As the House of Lords has confirmed, s.17 of the Marine Insurance Act 1906 imposes a mutual reciprocal duty of the utmost good faith on all parties to an insurance contract in connection with the formation and throughout the performance of the contract.<sup>4</sup> This general duty manifests itself at the pre-contract stage as a particular duty of disclosure (placed on the insured and on the agent to insure)<sup>5</sup> to disclose all facts that may be material to the risk and corresponding duties to ensure that all representations of material fact are true and all representations of opinion are believed to be true.<sup>6</sup> Aside from these particular duties on the insured and its agent to insure at the pre-contract stage, which may revive when the contracting parties agree to vary the insured risk, the post-contract duty manifests itself as a mutual duty of honesty.<sup>7</sup> The remedy for breach of this duty of the utmost good faith sounds only in avoidance and not in damages.<sup>8</sup>

There appear to be two approaches to the classification of the legal remedy of avoidance: the classic insurance approach, that it is a *sui generis* remedy entitling insurers to avoid without making restitution but requiring them to return to the insured the consideration received in the form of premium on the basis that there has been a total failure of consideration<sup>9</sup>; or the classic equitable approach that it

<sup>1</sup> *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501 HL.

<sup>2</sup> *Seaman v Fonereau* (1742) 93 E.R. 1115.

<sup>3</sup> The judgments of Lord Mustill and Lord Lloyd, being the principal judgments of both the majority and minority decisions of the House (since they were respectively approved by Lords Goff and Slynn as to the former and Lord Templeman as to the latter), each accepted (*Pan Atlantic* [1995] 1 A.C. 501 at 544–545 and 570–571 respectively) the comment of Chalmers and Owen in *A Digest of the Law relating to Marine Insurance* 1st edn (1907), p.22 (and 2nd edn (1913), p.24) that: “the ordinary rules of law as to voidable contracts apply to insurance” as a correct statement of both marine and non-marine insurance law.

<sup>4</sup> *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 A.C. 469 at 493 and 511.

<sup>5</sup> Marine Insurance Act 1906 s.18 and s.20.

<sup>6</sup> Marine Insurance Act 1906 s.19.

<sup>7</sup> *The Star Sea* [2001] UKHL 1; [2003] 1 A.C. 469 at 496 and 514.

<sup>8</sup> *The Star Sea* [2001] UKHL 1; [2003] 1 A.C. 469 at 494.

<sup>9</sup> *MacGillivray on Insurance Law* 11th edn, edited by N. Legh-Jones, J. Birds and D. Owen (Sweet & Maxwell, 2008), para.17-029: “The contract ... remains in force until avoided by the insurer. The exercise of the insurer’s right does not depend upon his ability to make restitution ... premiums paid are returnable, but the basis for such recovery is not equitable restitution but quasi-contractual ...”

is a right in rescission<sup>10</sup> arising from the confluence of legal and equitable principles following the Judicature Acts of 1873 and 1875.<sup>11</sup> It may be a modern contemporary judicial approach to treat the terms of “avoidance” and “rescission” as interchangeable<sup>12</sup> but the conceptual distinction between them is stark. It is appropriate to address the jurisprudential basis of each of them prior to considering their potential effects.

The classic insurance approach appears to arise from a principle inherent in law that a contract of insurance is a contract of the utmost good faith and that an agreement to insure is contingently conditional upon the insurance risk being properly described to the underwriters.<sup>13</sup> In the event that fair disclosure of the risk was not made to the underwriter then the condition would not have been satisfied and the contingency attaching to the contract would not have been fulfilled and the contract would be void.<sup>14</sup> Conceptually, the concept of a contract being void by reason of the non-satisfaction of a pre-condition implied at law is not problematic. It is a concept reflected elsewhere in contract law: for instance in the doctrines that contracts made in restraint of trade are void<sup>15</sup> and that contracts prohibited at law are illegal and void.<sup>16</sup> Effectively, the duty of the utmost good faith at law may be seen as a fundamental contingent condition to the validity of the contractual bargain between the parties that they should be open and frank with each other as to the likelihood of the occurrence of the insured risk.<sup>17</sup> In the event of any misrepresentation or non-disclosure as to the circumstances of the insured risk, such fundamental contingent condition would not have been fulfilled and the contract would be void at law,<sup>18</sup> wholly depriving the insured of consideration for the premium and entitling the insured to recover the premium by action for money had and received. On this basis, rather than insurers having a right of avoidance, it would be more appropriate to regard insurers simply as having the right to waive the non-satisfaction of the pre-condition and affirm the contract and it is this approach that can be described as the traditional approach to the categorisation of defences to avoidance.<sup>19</sup>

However, this traditional approach to avoidance has been undermined by case law that has clearly moved away from considering the contract to be entirely void

<sup>10</sup> *Strive Shipping Corp v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)* [2002] EWHC 203 (Comm); [2003] 1 C.L.C. 401 at 474.

<sup>11</sup> Supreme Court of Judicature Act 1873 and Supreme Court of Judicature Act 1875.

<sup>12</sup> See, for instance, the following footnote comment at fn.447 of p.226 of *Colinvaux's Law of Insurance*, 9th edn, edited by R. Merkin (Sweet & Maxwell, 2010), para.6-075: “However, the terms rescind and avoid these days tend to be used interchangeably in insurance cases... Whichever word is used would, on this interpretation, appear to be a matter of taste rather than legal significance.”

<sup>13</sup> *Blackburn, Low & Co v Vigors* (1886) L.R. 17 Q.B.D. 553 CA at 562.

<sup>14</sup> *Seaman v Fonereau* (1742) 93 E.R. 1115.

<sup>15</sup> *Goldsoll v Goldman* [1915] 1 Ch. 292 CA, where the Court of Appeal found a restrictive covenant to be void as it went beyond what was reasonably necessary for the protection of the covenantee's business being the pre-condition at law for the validity of such a clause.

<sup>16</sup> *Phoenix General Insurance Co v Halvanon Ins. Co Ltd* [1988] Q.B. 216 CA (Civ Div), where the now repealed Insurance Companies Act 1974 was held to make illegal and void any contract of insurance entered into by an insurer outside the scope of their authorisation.

<sup>17</sup> *Carter v Boehm* (1766) 3 Burr. 1905 at 1910 per Lord Mansfield: “Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.”

<sup>18</sup> *Carter v Boehm* (1766) 3 Burr. 1905 at 1909 per Lord Mansfield: “The keeping back such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the underwriter is deceived, and the policy is void; because the risqué run is really different from the risqué understood and intended to be run, at the time of the agreement.”

<sup>19</sup> *Morrison v Universal Marine Ins. Co* (1872–73) L.R. 8 Ex. 197.

towards considering the contract to be valid until avoided.<sup>20</sup> The developing case law has recognised that the logical purity of the traditional approach breaks down when addressing breach of the continuing duty of the utmost good faith after the placement of the risk, which similarly sounds in avoidance *ab initio*,<sup>21</sup> since contractual validity is not generally dependent upon the proper discharge of contractual duties. Generally, even if a contractual breach were to be fundamental to the future performance of the contract, breach would not result in contractual invalidity. Instead, the party deprived of its consideration by the guilty party's breach would be able to elect—as and when it became aware of its right to elect—whether to allow the contract to continue or to terminate it.<sup>22</sup> In other contractual situations involving breach of a term considered fundamental to the bargain reached between the parties, the contractual remedy is not one of avoidance *ab initio*<sup>23</sup> but, instead, contractual repudiation discharging the parties from continued contractual performance only as from the date of the breach.<sup>24</sup> The developments in case law have also been prompted by the statutory intermingling of legal and equitable principles initiated by the Judicature Acts<sup>25</sup> and continued thereafter.<sup>26</sup> These developments have created formidable conceptual obstacles to the notion that breach of the duty of the utmost good faith in insurance contracts simply results in the nullity of the contractual bargain, which is the traditional characterisation of the insurance remedy of avoidance. In consequence of these legislative reforms courts have been driven towards characterising the remedy as one of the avoidance of a voidable contract and away from treating the contract as void from the outset.<sup>27</sup>

Indeed, the decision of the House of Lords in *Pan Atlantic Insurance v Pine Top Insurance*<sup>28</sup> could be seen as a decisive rejection of the traditional *sui generis* approach to avoidance by its conflation of the tests for non-disclosure and misrepresentation, in the context of insurance contracts, with the generally applicable test for misrepresentation in tort law.<sup>29</sup> Prior to that decision there seemed good reason to maintain that the traditional remedy of avoidance for breach of the duty of the utmost good faith in insurance contracts prevailed as a *sui generis* remedy standing apart from general principles of equitable rescission, at least in the context of non-disclosure,<sup>30</sup> notwithstanding the fusion by the Judicature Acts<sup>31</sup> of the legal and equitable remedies for tortious misrepresentation. But as the

<sup>20</sup> *Mackender v Feldia AG* [1967] 2 Q.B. 590 CA.

<sup>21</sup> *The Star Sea* [2001] UKHL 1; [2003] 1 A.C. 469 per Lord Clyde at [50] and [51].

<sup>22</sup> *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827 HL at 849.

<sup>23</sup> *Photo Production* [1980] A.C. 827 at 850.

<sup>24</sup> *Photo Production* [1980] A.C. 827 at 850.

<sup>25</sup> Supreme Court of Judicature Act 1873 and Supreme Court of Judicature Act 1875 reflected in the provision at s.49(1) of the Senior Courts Act that “Subject to the provisions of this or any other Act, every court exercising jurisdiction in England or Wales in any civil cause or matter shall continue to administer law and equity on the basis that, wherever there is any conflict or variance between the rules of equity and the rules of the common law with reference to the same matter, the rules of equity shall prevail”.

<sup>26</sup> For instance: the Marine Insurance Act 1906 by which remedies for misrepresentation and non-disclosure were conflated; the Misrepresentation Act 1967 affording various statutory remedies for misrepresentation; and the Consumer Insurance (Disclosure and Representation) Act 2012 which, at para.2 to Sch.1, permits an insurer to “avoid the contract” for deliberate or reckless qualifying misrepresentations.

<sup>27</sup> *The Grecia Express* [2002] EWHC 203 (Comm); [2003] 1 C.L.C. 401.

<sup>28</sup> *Pan Atlantic* [1995] 1 A.C. 501.

<sup>29</sup> *Pan Atlantic* [1995] 1 A.C. 501 at 544–545 and 570–571.

<sup>30</sup> As the utmost good faith concept, codified by the Marine Insurance Act 1906 s.17 to s.19, was unique to insurance law.

<sup>31</sup> Supreme Court of Judicature Act 1873 and Supreme Court of Judicature Act 1875.

distinction between material non-disclosure and material misrepresentation is often a matter of form rather than substance (and is generally regarded as such in legal proceedings where statements of case in insurance disputes tend to assert allegations of misrepresentation and non-disclosure of material facts in the alternative) such an argument was not convincing and is now scarcely credible in the light of the decision in the *Pan Atlantic* case.<sup>32</sup> In the 9th edition of *Colinvaux's Law of Insurance*<sup>33</sup> it is suggested that it is “now beyond argument” that the remedy of avoidance “is the equitable one of avoidance ab initio”. Cited in support of this proposition is the conclusion of Colman J. in *The Grecia Express*<sup>34</sup>:

“[T]hat, whatever the conceptual origins of the substantive requirements of s.17 of the Marine Insurance Act, the remedy for non-compliance with the requirement of the utmost good faith is one derived from the equitable jurisdiction of the court to avoid contracts for misrepresentation in cases where it could not be said that the contract had been rendered void ab initio as distinct from voidable.”

If the remedy for contractual rescission is the same—irrespective of whether or not the contract is conditional on the performance of the utmost good faith—it is necessary to examine the nature of equitable rescission in the context of insurance avoidance. To ensure clarity in the discussion this article will now use the term “avoidance” to indicate the classic *sui generis* insurance characterisation of the remedy for breach of the *uberrimae fidei* duty and “rescission” to indicate the generally applicable equitable remedy for misrepresentation.

Even 137 years after the Judicature Acts, the rights of contractual rescission at common law by reason of misrepresentation are still best appreciated as a choppy confluence of legal and equitable principles. The primary remedy of the courts of law was an award of damages but they would also recognise rescission on grounds of fraud<sup>35</sup> provided the parties could be restored to their original pre-contract status (the status quo ante); while courts of equity (which would give as extensive a remedy as at law under their concurrent jurisdiction) had no jurisdiction of their own to award damages but would also permit rescission (in equity as at law) even in the event of innocent misrepresentation provided there were no bars to such relief arising in equity.<sup>36</sup> It is a continuing debate whether equity exercised its wider discretion to award rescission, or simply to permit rescission as a self-help remedy as at law.<sup>37</sup> Subsequently, after the fusion of law and equity, courts proceeded to

<sup>32</sup> *Pan Atlantic* [1995] 1 A.C. 501, particularly in the context of Lord Mustill's reasoning at 549 that “Nevertheless if one looks at the problem in the round, and asks whether it is a tolerable result that the Act accommodates in section 20(1) a requirement that the misrepresentation shall have induced the contract, and yet no such requirement can be accommodated in section 18(1), the answer must surely be that it is not — the more so since in practice the line between misrepresentation and non-disclosure is often imperceptible”.

<sup>33</sup> *Colinvaux's Law of Insurance* (2010), p.268, para.6-077.

<sup>34</sup> *The Grecia Express* [2002] EWHC 203 (Comm); [2003] 1 C.L.C. 401 at 474.

<sup>35</sup> In *Redgrave v Hurd* (1881–82) L.R. 20 Ch. D. 1 CA at 13 Jessel M.R. suggested that at law, even though a misrepresentation might not have been fraudulent, remedy would be given where it had been made recklessly; although Bowen L.J. cast doubt on that suggestion in *Newbigging v Adam* (1887) L.R. 34 Ch. D. 582 CA at 593.

<sup>36</sup> *Newbigging v Adam* (1887) L.R. 34 Ch. D. 582 at 592 per Bowen L.J.

<sup>37</sup> See, for instance, J. Poole and A. Keyser, “Justifying partial rescission in English law” (2005) 121 L.Q.R. 273, in which it is contended the wider discretion in equity operated as an ancillary remedy to be awarded by the court and *Chitty on Contracts*, 30th edn (2011), para.6-111 and fn.498 to para.6-118 where the contrary is argued. The unresolved distinction in these approaches is also remarked on by Saville, Ward and Phillips L.J.J. in *Society of Lloyd's v Leighs* [1997] C.L.C. 1398 CA (Civ Div) at 1403.

permit rescission under principles of equity—on the basis that equitable principles prevailed over those at law<sup>38</sup>—and award damages at law.

### Relevance of restitutio in integrum to avoidance and rescission

The concept of avoidance of a truly void contract does not require transactions to be unwound so as to require both parties to achieve restitutio in integrum by restoring themselves to their pre-contractual position, the status quo ante, as such restitution is not a concern where the invalidity of the contract results from the contract being truly void at its inception by reason of the non-satisfaction of a contingent pre-condition to validity. Perhaps it is for that reason that restitution never appears to have been required in the case of avoidance of an insurance risk.<sup>39</sup> If the position were to have been otherwise, post-loss avoidance of an insurance contract would not have been possible since, self-evidently, an insured can never be restored to their original position following loss to their interest in the subject-matter insured. Benefits, expenses and liabilities that may have passed between the parties, in the mistaken assumption that they had a valid contract when they did not, lie where they fall subject to one party's right to exercise quasi contractual remedies to prevent unjust enrichment.<sup>40</sup> Such rights in unjust enrichment embrace the right of the insured to recover premium as money had and received under a transaction for which the consideration has totally failed by reason of some want of utmost good faith,<sup>41</sup> at least where that transaction is rendered void otherwise than as a result of the insured's own fraud.<sup>42</sup> However, those limited rights of recovery do not require the parties to restore themselves to their original pre-contractual position and they do not necessarily involve the parties seeking restitution as between themselves. Rather it is a matter of each party that has bestowed benefits on someone else—be that the other contracting party or some third party—having the right to recover such of those benefits as may be considered to have unjustly enriched someone else.<sup>43</sup>

Conversely, parties to a valid yet voidable contract must make restitution—as between themselves—of benefits, expenses and liabilities arising under the contract when one of the parties seeks to have the contract rescinded. Courts of law, when unwinding contracts rendered void by fraud, were content to “put a strict interpretation on the requirement of restitution, and consequently restricted the field within which rescission could operate”.<sup>44</sup> A court of equity took a more flexible approach to rescission as it had no jurisdiction of its own to award damages and ordered rescission “whenever, by the exercise of its powers, it [... could ...] do what is practically just, though it [... could ...] not restore the parties precisely to the state they were in before the contract”.<sup>45</sup> However, the principle restitutio in

<sup>38</sup> Senior Courts Act 1981 s.49, stating: “wherever there is any conflict or variance between the rules of equity and the common law with reference to the same matter, the rules of equity shall prevail.”

<sup>39</sup> See *MacGillivray on Insurance Law* (2008), para.17-029

<sup>40</sup> *Goff & Jones' The Law of Unjust Enrichment*, 8th edn, edited by C. Mitchell, P. Mitchell and S. Watterson (Sweet & Maxwell, 2011), para.19–001.

<sup>41</sup> *Feise v Parkinson* (1812) 4 Taunt. 640.

<sup>42</sup> See, for marine insurance, Marine Insurance Act 1906 s.84(1) and, more generally, *Derry v Peek* (1889) 14 App. Cas. 337 HL as to the right to damages for deceit.

<sup>43</sup> For instance by reference to actions for money had and received under mistake of fact or law under the principles applied in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 A.C. 349 HL.

<sup>44</sup> *Chitty on Contracts* (2011), para.6-116.

<sup>45</sup> *Erlanger v The New Sombrero Phosphate Co* (1877–78) 3 App. Cas. 1218 HL at 1279 per Lord Blackburn.

integrum whether at law or equity requires not just the simple restitution of benefits received under the contract but mandates a restoration of both parties to their original pre-contract situation<sup>46</sup>: so that the “true doctrine” is “that a party can never repudiate a contract after, by his own act, it has become out of his power to restore the parties to their original condition”.<sup>47</sup> Not only must the parties reciprocally set off their respective gains and costs but also the subject-matter of the transaction must not have changed,<sup>48</sup> although it may have deteriorated as did the value of the shares that were the subject of the fraudulent transaction, which was rescinded in *Armstrong v Jackson*.<sup>49</sup> Supplemented by principles of equity, rescission does not now require that each party should be restored to exactly the same position they enjoyed prior to the contract as long as they are put into substantially as good a position as before.<sup>50</sup> This may necessitate equitable readjustment by either or both parties. The representor will have to indemnify the representee for third-party liabilities and expenses (albeit, not the representee’s own losses) incurred because of the contract.<sup>51</sup> The representee will have to make restitution to the representor of a just proportion of any benefits received by the representee because of the contract.<sup>52</sup> What is important in rescission is that the readjustment achieves “practical justice”<sup>53</sup> in the restoration of the parties to their status quo ante.

In the context of insurance the concept of *restitutio in integrum* is problematic, since insurance “is a contract upon speculation”<sup>54</sup> of the risk of loss and if loss has happened the risk has changed and there can be no *restitutio in integrum* to the parties’ status quo ante.<sup>55</sup> As it is only in recent times it has been suggested that insurance avoidance should be reclassified as equitable rescission of a voidable contract, the conceptual problems inherent in the theoretical restoration of parties to their pre-loss position have not been addressed by decided insurance cases. But, even if avoidance was to be seen as equitable rescission, a potential rationale for disregarding the distinction in the speculation of a risk before and after loss (and the attendant impossibility of achieving *restitutio in integrum* in post-loss avoidance) may lie in the legal principle—encapsulated in the Latin maxim *commodum ex injuria sua nemo habere debet*—that no one should be allowed to

<sup>46</sup> *Erlanger* (1877–78) 3 App. Cas. 1218 at 1278, where Lord Blackburn comments: “It is, I think, clear on principles of general justice, that as a condition to a rescission there must be a *restitutio in integrum*. The parties must be put in *statu quo*.”

<sup>47</sup> *Clarke v Dickson* (1858) 120 E.R. 463 as, per Compton J. at 466, “when that party exercises his option to rescind the contract, he must be in a state to rescind; that is, he must be in such a situation as to be able to put the parties into their original state before the contract”.

<sup>48</sup> *Clarke v Dickson* (1858) 120 E.R. 463, where a person induced by fraudulent misrepresentations to invest in a mining partnership venture was unable to rescind after the partnership had been incorporated and his partnership interest been replaced by shares in the corporation.

<sup>49</sup> *Armstrong v Jackson* [1917] 2 K.B. 822 KBD.

<sup>50</sup> *Compagnie Chemin de Fer Paris-Orleans v Leeston Shipping Co* (1919) 1 Ll. L. Rep. 235 KBD.

<sup>51</sup> *Whittington v Seale-Hay* (1900) 82 L. T. 49 in which a tenant rescinding a lease for an innocent misrepresentation as to its sanitary condition recovered an indemnity from the landlord for its liabilities to the council for rates and its expenditure on repairs pursuant to the lease but not for its own loss of poultry—of course damages are now recoverable under the Misrepresentation Act 1967 in addition to rescission under s.2(1) in the event of negligent misrepresentation, or in lieu of rescission under s.2(2).

<sup>52</sup> *Erlanger* (1877–78) 3 App. Cas. 1218, where Lord Blackburn refers to the jurisdiction of the court to “take account of profits and make allowance for deterioration”.

<sup>53</sup> *Halpern v Halpern* [2007] EWCA Civ 291; [2008] Q.B. 195, 221 where Carnworth L.J., at [69], so characterised the approach enunciated by Lord Blackburn in *Erlanger* (1877–78) 3 App. Cas. 1218.

<sup>54</sup> *Carter v Bohem* (1766) 3 Burr. 1905 at 1909 per Lord Mansfield.

<sup>55</sup> A point successfully made by the defence counsel in *Clarke v Dickson* (1858) 120 E.R. 463 at 465 by reference to an example of a lottery ticket, which after “it had turned up a blank” would not represent the same contingent chance that it had previously represented.

take advantage of their own wrong. Certainly it is that principle that appears to lie behind the conclusion of Colman J. that the remedy of rescission “is not fettered by some overriding equitable test as to whether the consequences would work unfairly to the misrepresenter”,<sup>56</sup> and behind the various cases noted by McCardie J. in *Armstrong v Jackson*<sup>57</sup> where rescission was permitted notwithstanding the return to the misrepresenter of property of diminished value.

## Relevance of severability to avoidance and rescission

The issue of severability is one that is equally important to avoidance and rescission. The contrast between an entire contract and a divisible contract is neatly explained in *Chitty on Contracts*<sup>58</sup> in the following terms:

“A contract is said to be ‘entire’ when complete performance by one party is a condition precedent to the liability of the other ... The opposite of an ‘entire contract’ is a ‘divisible contract’, which is separable into parts, so that different parts of the consideration may be assigned to severable parts of the performance ...”

In the context of rescission, it seems clear that an agreement must be rescinded in its entirety and that there cannot be a giving up of certain obligations and the retention of others. It has been judicially described as “an all or nothing process”.<sup>59</sup> Such a description aptly reflects its nature as a self-hand remedy at law,<sup>60</sup> which the courts may decline when the parties cannot be restored to their original position,<sup>61</sup> but which the courts may in equity also promote by granting other relief to achieve justice for the parties.<sup>62</sup> It has been contended that courts should be prepared to award partial rescission;<sup>63</sup> and, while there may be merit in the courts exercising wider jurisdiction to avoid unconscionable results,<sup>64</sup> the English courts have consistently declined invitations to do so.<sup>65</sup>

In the absence of any possibility of partial avoidance or partial rescission, the doctrine of severance is of critical importance. But that is a very blunt instrument, only facilitating avoidance and rescission of obligations that can be severed from other obligations on the basis that they represent an entirely distinct bargain.<sup>66</sup> Of course, for any entirely distinct bargain to exist in the context of English law and give rise to the doctrine of severance it must ordinarily be supported by an entirely distinct consideration but the fact that several promises are supported by a common

<sup>56</sup> *De Molestina v Ponton* [2002] 1 All E.R. (Comm) 587 QBD at [6.3].

<sup>57</sup> *Armstrong v Jackson* [1917] 2 K.B. 822 at 829.

<sup>58</sup> *Chitty on Contracts* (2011), Part 21-027.

<sup>59</sup> By Lord Browne-Wilkinson in *Barclays Bank Plc v O'Brien* [1994] 1 A.C. 180 HL at 199.

<sup>60</sup> Per Megarry J. in *Horsier v Zorro* [1975] Ch. 302 Ch.D at 310: “the process of rescission is essentially the act of the party rescinding, and not of the court”—the statement as to the nature of rescission being accurate: even though the decision was overruled in *Johnson v Agnew* [1980] A.C. 367 HL as principles of repudiation should have been applied, since the dispute concerned contractual breach.

<sup>61</sup> *Clarke v Dickson* (1858) 120 E.R. 463.

<sup>62</sup> *Erlanger* (1877–78) 3 App. Cas. 1218.

<sup>63</sup> Poole and Keyser, “Justifying partial rescission in English law” (2005) 121 L.Q.R. 273.

<sup>64</sup> Poole and Keyser, “Justifying partial rescission in English law” (2005) 121 L.Q.R. 273.

<sup>65</sup> *TSB Bank Plc v Camfield* [1995] 1 W.L.R. 430 CA (Civ Div); *De Molestina v Ponton* 1 All E.R. (Comm) 587

<sup>66</sup> “For the party defrauded cannot avoid one part of a contract and affirm another part, unless indeed the parts are so severable from each other as to form two independent contracts”: per Lord Atkinson in *United Shoe Machinery Co of Canada v Brunet* [1909] A.C. 330 PC (Canada) 340.

consideration is not necessarily a bar to severance<sup>67</sup> and it is “a question of construction whether the obligation is entire or divisible”.<sup>68</sup> Whether or not a particular insurance arrangement, arising out of a single negotiation and placement and resulting in a single insurance contract supported by a single indivisible premium, can be severed into separate bargains is a question that gives rise to considerable factual complexity given the nature of the reciprocal performance obligations in question.<sup>69</sup> It is a question that is so difficult for the courts to resolve in favour of severance that some judges have preferred to avoid it entirely<sup>70</sup> by seeking to develop an entirely novel doctrine of severance referable to distinctions in the insurable interests of the various insured parties in the subject-matter of the insurance (i.e. the property, right, liability or defined benefit insured) such that a single insurance contract can be considered composite.<sup>71</sup> Pursuant to this composite approach, while insurers are considered to have a single entire obligation to multiple parties holding an indivisible joint property right—or an indivisible liability—in the subject-matter of the insurance, insurers are considered to owe several discrete obligations to each party having a divisible property right or liability: so that by the composite approach the issue of severance in the insurance contract is not determined by the entire or divisible nature of the contractual bargain made between the underwriters and their assureds but by the relationship of the insured parties inter se. In this context it is as well to note that the JLC Review proposed in their Issues Paper 4 on insurable interest<sup>72</sup> that policies “that combine standard indemnity insurance with life or personal accident benefits in one policy”<sup>73</sup> should “be declared to be separable”<sup>74</sup> to avoid one part of the policy being void by reason of an absence of insurable interest. One further consequence of such a reform would, presumably, be to deny avoidance and/or rescission of both parts of such combined cover—unless the misrepresentation or non-disclosure complained of could be considered material to both of the separable covers—and to permit partial avoidance and/or rescission of each of the separable covers.

## Relevance of affirmation and utmost good faith to avoidance and rescission

Affirmation—being the application of principles of contractual waiver—is a bar to avoidance and rescission. Waiver by the insurers of their rights to avoid as

<sup>67</sup> *Chemidus Wavin Ltd v Société pour la Transformation et l'Exploitation des Resines Industrielles SA* [1978] 3 C.M.L.R. 514 CA (Civ Div) at 523.

<sup>68</sup> *Chitty on Contracts* (2011), para.21-029.

<sup>69</sup> *New Hampshire Insurance Co v MGN Ltd* [1997] L.R.L.R. 24 CA (civ Div); *Arab Bank Plc v Zurich* [1999] 1 Lloyd's Rep. 262 QBD are examples of cases in which such issues ought to have been considered.

<sup>70</sup> See in particular Staughton L.J. in *New Hampshire Insurance v MGN* [1997] L.R.L.R. 24, when he admitted—in relation to the issue of avoidance against one of several insureds—that “Technically one ought to enquire whether ... [there were] ... as many contracts as there were companies insured”.

<sup>71</sup> See in particular the comments of Rix J. in *Arab Bank Plc v Zurich* [1999] 1 Lloyd's Rep. 262 at 277 that a single policy insuring multiple co-insureds with discrete insurable interests should be treated “as a bundle of separate contracts under which [the co-insureds] are separately insured for their own separate interests”. Also see B.E. Harris, “Insurance policies for multiple insureds: the effect of a composite approach to construction?” (2011) 3 L.M.C.L.Q. 393, criticising this development.

<sup>72</sup> Reforming Insurance Contract Law, Issues Paper 4: “Insurable Interest” (2008), [http://www.lawcom.gov.uk/insurance\\_contract.htm](http://www.lawcom.gov.uk/insurance_contract.htm) [Accessed October 17, 2012].

<sup>73</sup> “Insurable Interest” (2008), para.7.91, [http://www.lawcom.gov.uk/insurance\\_contract.htm](http://www.lawcom.gov.uk/insurance_contract.htm) [Accessed October 17, 2012].

<sup>74</sup> “Insurable Interest” (2008), para.7.92, [http://www.lawcom.gov.uk/insurance\\_contract.htm](http://www.lawcom.gov.uk/insurance_contract.htm) [Accessed October 17, 2012].

against the insured may take effect by the express election of the insurers to continue with the contract notwithstanding their knowledge of the relevant facts and of their right to avoid,<sup>75</sup> being the concept of election at common law. Since, where a party acquires knowledge both of a misrepresentation and of its right in consequence to avoid or rescind the contract,<sup>76</sup> the party has two alternative courses of action open to it (i.e. to avoid or affirm) and must select one course of action or the other and once that choice has been communicated to the other party the election so made is irrevocable.<sup>77</sup> Waiver requires some express, or implied, communication by insurers to the insured that—objectively construed—amounts to an unequivocal statement to the effect that the insurers know of their rights to avoid but will not be asserting them and that, at the time of the relevant communication, the insurers actually did know of the relevant facts and of their right to avoid and had had sufficient time to decide whether or not to avoid.<sup>78</sup> It is clear that “Saying nothing ... and doing nothing are ... equivocal” and will not amount to affirmation under principles of waiver.<sup>79</sup> But a choice to affirm rather than avoid may be inferred from insurers asserting contractual rights (e.g. demanding premium) as the enforcement of the contract is inconsistent with avoidance,<sup>80</sup> or even from insurers failing to assert a right to avoid when fixed with requisite knowledge of their right to avoid as that may amount to an effective election.<sup>81</sup>

Also potentially applicable to both avoidance and rescission are defences based on promissory estoppel (pursuant to which the right to rescind may be denied by reason of one party’s detrimental reliance on another party’s unequivocal representation in words or conduct that it will not seek to rescind)<sup>82</sup> and, applicable only to avoidance, want of utmost good faith (since the insurer cannot avoid in breach of the reciprocal duty of the utmost good faith it owes to the insured).<sup>83</sup> But there appear to be no decided cases in which an insurer’s right to avoid a contract of insurance has been lost by reference to such defences.

<sup>75</sup> *Wing v Harvey* (1854) 43 E.R. 872.

<sup>76</sup> Since “knowledge of the facts which give rise to the right to rescind is not enough to prevent the plaintiff from exercising that right, but he must also know that the law gives him that right yet choose with that knowledge not to exercise it”: per Stephenson L.J. in *Peyman v Lanjani* [1985] Ch. 457 C.A. (Civ Div) at 487.

<sup>77</sup> In *China National Foreign Trade Transportation Corp v Evlogia Shipping SA of Panama* [1979] 1 W.L.R. 1018 HL at 1034 Lord Scarman described the concept of election as follows: “The principle of the common law is well settled. When a man, faced with two alternative and mutually exclusive courses of action, chooses one and has communicated his choice to the person concerned in such a way as to lead him to believe that he has made his choice, he has completed his election.”

<sup>78</sup> *Morrison v Universal Marine Insurance Co* (1872–73) L.R. 8 Ex. 197.

<sup>79</sup> *Liberty v Argo* [2011] EWCA Civ 1572; [2012] 2 All E.R. (Comm) 126 at [46] per Aikens L.J.

<sup>80</sup> But not a mere administrative act. In *Morrison v Universal Marine Insurance* (1872–73) L.R. 8 Ex. 197 the Court of Appeal declined to set aside a jury’s decision that the formal issue of a policy document after an insurance contract had been concluded did not amount to an affirmation.

<sup>81</sup> *Liberty v Argo* [2011] EWCA Civ 1572; [2012] 2 All E.R. (Comm) 126 at [31] of the judgment of Aikens L.J. referring to the judgment at first instance of Honour Judge Mackie QC.

<sup>82</sup> *Goldsworthy v Brickell* [1987] Ch. 378 C.A. (Civ Div) at 410–411, where the defence of promissory estoppel to equitable rescission on the grounds of undue influence, which succeeded at first instance, was overturned by the Court of Appeal in the absence of an unequivocal representation—by the party claiming rescission—that they would not rescind.

<sup>83</sup> Marine Insurance Act 1906 s.17; and see the observations of Colman J. in *The Grecia Express* [2002] EWHC 203 (Comm); [2003] 1 C.L.C. 401 at 481 that: “Having regard to the equitable origin of the jurisdiction to avoid a policy for breach by the assured of the duty of the utmost good faith, the court should not be inhibited from giving effect by appropriate orders to the insurers countervailing duty of the utmost good faith to the assured” to prevent avoidance for non-disclosure of the fact of allegations that, subsequently, might be proved to have been groundless.

## Relevance of equitable bars to avoidance and rescission

Outside the confines of insurance avoidance a party seeking to enforce a voidable contract against another party seeking rescission may, in the absence of contractual affirmation, seek to establish one of a number of defences in equity: namely, acquiescence, delay, want of “clean hands” and third-party rights, each of which are briefly discussed in turn.

The equitable defence of acquiescence is satisfied where a party proves some reliance to its detriment (i.e. a detrimental change of position) on conduct of the other party that is inconsistent with the other party seeking to rescind the contract.<sup>84</sup> The bar to rescission through delay, which has its origin in the equitable principle of laches,<sup>85</sup> denies a party enforcement of their rights in equity by reason of their own delay in the assertion of those rights, when they have failed to act (despite them having—“if not universally at all events ordinarily”—knowledge of their rights)<sup>86</sup> and their delay has made it “practically unjust”<sup>87</sup> to allow them their remedy. The length of the period of delay must be sufficient, the party claiming rescission must be responsible for the delay and be aware of their rights<sup>88</sup> and, most importantly, the delay must have given rise to an issue of practical injustice.<sup>89</sup> The equitable principle that he who comes into equity must come with clean hands allows a party to defend rescission by satisfying the court that the party seeking rescission is guilty of some misconduct that has “an immediate and necessary relation to the equity sued for”<sup>90</sup> such that rescission should be denied.

Finally, it is a fundamental principle of equity that a third party, acquiring a right or property for value from one party (party A) without notice of another person’s equitable rights, takes that right or property free of any right of a prior contracting party to rescind the transfer of such right or property to party A. This protection of third parties acquiring interests for value without notice of prior equities is clear even in the case of fraud<sup>91</sup> and it clearly applies in the context of misrepresentation.<sup>92</sup> But for the third party to be protected by the principle, it is essential that it has given value for the right or property acquired from party A.<sup>93</sup> It is not enough that the third party entered into the transaction in ignorance of the rights of the prior contracting party if the third party has not provided value<sup>94</sup>; and equity does not require innocent third parties to be protected where they have not given valuable consideration.<sup>95</sup> Where innocent third parties have provided value

<sup>84</sup> *Habib Bank Ltd v Nasira Tufail* [2006] EWCA Civ 374; [2006] 2 P. & C.R. DG14, in particular the judgment of Lloyd L.J. at [20].

<sup>85</sup> *Lindsay Petroleum Co v Hurd* (1873–74) L.R. 5 P.C. 221 PC (Canada).

<sup>86</sup> *Lindsay Petroleum v Hurd* (1873–74) L.R. 5 P.C. 221, per Lord Selborne at 239–240.

<sup>87</sup> *Lindsay Petroleum v Hurd* (1873–74) L.R. 5 P.C. 221, per Lord Selborne at 239–240.

<sup>88</sup> *Armstrong v Jackson* [1917] 2 K.B. 822 at 831.

<sup>89</sup> The sale of goods cases in which buyers have been denied rescission for innocent misrepresentation where they have had time to inspect and would be deemed to have accepted the goods under Sale of Goods Act 1979 s.35 can be seen as examples of the application of the practical injustice concept—see *Leaf v International Galleries* [1950] 2 K.B. 86 CA and, in particular, the analysis of Lord Evershed at 94–95.

<sup>90</sup> Per Eyre L.C.B. in *Dering v Earl of Winchelsea* (1787) 1 Cox Eq. Cas. 318 at 319.

<sup>91</sup> *Load v Green* (1846) 153 E.R. 828, where a third party who acquired title to handkerchiefs from a bankrupt was upheld as against the person who had been induced by fraud to release the handkerchiefs without payment.

<sup>92</sup> *Babcock v Lawson* (1879–80) L.R. 5 Q.B.D. 284 CA.

<sup>93</sup> *Scholefield v Templer* (1859) 4 De G. & J. 429.

<sup>94</sup> “I consider it to be an established principle that a person cannot avail himself of what has been obtained by the fraud of another, unless he not only is innocent of the fraud, but has given some valuable consideration”: *Scholefield v Templer* (1859) 4 De G. & J. 429 per Lord Campbell at 433–434.

<sup>95</sup> *Scholefield v Templer* (1859) 4 De G. & J. 429; although in that case the third-party surety, though innocent of the fraud by the debtor on the creditor was party to the misrepresentation and could not “be heard to complain of any

a court will not give effect to contractual rescission by the prior contracting party unless it is satisfied “that rescission will not harm the rights of third parties”<sup>96</sup> provided that the third party had no notice, actual or constructive,<sup>97</sup> of the rights of the prior contracting party.

However, these equitable principles applicable to rescission hardly ever appear to be referred to by way of defence to avoidance in insurance cases. Avoidance appears never to have been denied by reference to them but only by reference to the principles of affirmation previously discussed. Their absence from the lexical categorisation of defences to avoidance in previously decided insurance disputes makes the case for the avoidance of insurance contracts being a *sui generis* remedy and not a right of equitable rescission.

### Avoidance, rescission and multiple insureds

The application of principles of avoidance or rescission in the context of insurance contracts covering multiple insured parties gives rise to a number of conceptual difficulties relating to: the attribution of knowledge in the context of offending non-disclosures and misrepresentations; the severability of the various insurance obligations; and the defences to avoidance available to joint insureds, several insureds, assignees and loss payees. Self-evidently the insured must have knowledge of the true facts allegedly not disclosed to the insurers, or of the true facts and opinions misrepresented to the insurers, for underwriters to have rights of avoidance. The requirement of knowledge for the purpose of non-disclosure is satisfied not only by actual knowledge but also by statutory deemed knowledge.<sup>98</sup> Invariably the question of whether a corporate insured has the requisite knowledge raises issues of attribution as a corporation acquires knowledge only through the activities of those natural persons acting for it, so that the question for a business insured is whether the natural persons fulfilling the disclosure obligations of the insured had actual knowledge of the material facts in question or ought reasonably to have appreciated the need to discover those material facts.<sup>99</sup> Furthermore material facts in the actual or constructive knowledge of the direct placement broker, as the agent to insure,<sup>100</sup> must also be disclosed. Where multiple insureds are afforded insurance protection under a single policy the knowledge of one insured is sufficient to undermine the interests of all insureds irrespective of whether or not the material facts not disclosed or misrepresented are material to the entire risk. Even if the material fact in question were only to be material to the risk of one of the insureds

result of an act done at his own request, and in consequence of a misrepresentation made, though innocently made, by himself ... here the surety was an actor, and concurred in the representations on the faith of which the release was given”: per Lord Campbell at 434.

<sup>96</sup> Per Saville, Ward and Phillips L.J.J. in *Lloyd's v Leighs* [1997] C.L.C. 1398 at 1404.

<sup>97</sup> The onus of proving actual or constructive notice being on the party “who claims that the vitiating circumstances affect a person who was not party to the undue influence or misrepresentation”: per Lord Hoffmann in *Barclays Bank Plc v Boulter* [1999] 1 W.L.R. 1919 HL at 1926.

<sup>98</sup> Marine Insurance Act 1906 s.18(1) provides that “the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him”, extending the concept of knowledge beyond actual knowledge to constructive knowledge of those facts that a reasonable business insured would have discovered.

<sup>99</sup> *Arab Bank v Zurich* [1999] 1 Lloyd's Rep. 262.

<sup>100</sup> Marine Insurance Act 1906 s.19 and *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep. 241 CA (Civ Div).

the principles of avoidance require entire agreements to stand or fall in toto. There can be neither partial rescission<sup>101</sup> nor partial avoidance.<sup>102</sup>

If, in the context of rescission, courts were free to apply principles of practical justice to restore the status quo ante for all parties other than the party responsible for the misrepresentation, then practical justice would be a mechanism by which partial rescission might be achieved. Were such extended principles of practical justice to be applied in the context of the avoidance of insurance contracts then partial avoidance against only some—and not all—of the insureds covered by a single insurance contract would be possible when partial avoidance was the most practically just solution. However, the commissioning of a practical justice concept as a judicial tool to enable partial avoidance in contracts for multiple insured parties raises a number of difficult issues. For instance, consider the consequent “justice” of insurers being required to pay indemnities for risks that they would not have accepted had all material facts been disclosed and truthfully represented on placement. Presumably, it could be argued that such a consequence would never be “just” and, were it to be considered “just”, practical justice might require that the insured responsible for not disclosing or misrepresenting material facts should be compelled to indemnify underwriters for their additional liabilities. In recognition of these difficulties, perhaps any commissioned practical justice tool for partial avoidance would need to be confined to situations where undisclosed or misrepresented material facts concerned only the insurance protection to be avoided, and not the insurance cover for other insureds that is to be saved by partial avoidance.

Currently, in the absence of such an extended concept of practical justice, it is impossible—save in two exceptional instances—for avoidance to be used to scissor up the contract of insurance as between innocent and guilty insureds. The first exceptional instance is when the agreed structure for the payment of premium allows the insurance contract to be perceived as a bundle of separate bargains by which insurers may have effectively insured distinct risks for distinct premiums and courts can apply the traditional, albeit blunt and formalistic, doctrine of severance.<sup>103</sup> The second exceptional instance is when courts resort to the device of treating the insurance of several insureds, each having separate insurable interests, as entirely separate contracts, by applying the novel, albeit equally blunt and formalistic, concept of composite insurance.<sup>104</sup>

Any breach of the duty of the utmost good faith committed by a joint insured undermines not only its own insurance protection but also that of its fellow joint insureds even if they were not privy to the breach and had no responsibility for the breach. There need be no analysis as to whether knowledge of the true facts, or of their non-disclosure or misrepresentation to insurers can be attributed to them. The avoidance remedy affords these fellow joint insureds no defence apart from that of affirmation and there can be no affirmation of their entitlement alone but only of the entire contract for the benefit of the innocent and guilty insureds alike.<sup>105</sup> Principles of rescission operate in a similar way save that courts must disallow

<sup>101</sup> *Myddleton v Lord Kenyon* (1794) 2 Ves. Jr. 391 at 408.

<sup>102</sup> *James v CGU Ins. Plc* [2002] Lloyd's Rep I.R. 206 QBD.

<sup>103</sup> *James v CGU* [2002] Lloyd's Rep I.R. 206.

<sup>104</sup> *New Hampshire Insurance v MGN Ltd* [1997] L.R.L.R. 24.

<sup>105</sup> *James v CGU* [2002] Lloyd's Rep I.R. 206.

rescission unless they can restore the parties to their original pre-contract position—the status quo ante—by applying practical justice and it may be that rescission ought to be disallowed where innocent parties cannot be so restored.<sup>106</sup> It is interesting to compare the protection from rescission arguably afforded by equity towards innocent contracting parties with that proposed by the JLC Review for innocent joint co-insureds when loss is caused by the deliberate wrongdoing of a fraudulent joint insured,<sup>107</sup> in which circumstances the JLC Review proposes that innocent joint co-insureds should not lose their right to indemnity where they can prove that they were not parties to fraud.

Where the co-insured interests are not joint but several, principles of avoidance operate in the same way as they do in the context of joint insureds save for the increased possibility of severance. Severance becomes a more likely prospect where multiple insured parties have several—as distinct from joint—insured interests. They are susceptible to being severed into separate promises of insurance for each of the various insured parties by one of three mechanisms. First, the traditional consideration mechanism by which discrete consideration must be seen to support each separate promise to insure,<sup>108</sup> as is likely to be the case where each of several insureds is liable to pay a distinct premium referable to their own interest. Secondly, the modern interpretative mechanism by which discrete free-standing promises to insure may be seen to be supported by a common consideration,<sup>109</sup> as may be considered to be the case where distinct, separable, insurance obligations can be seen to have been agreed in relation to each of several insureds even though a single entire premium is payable for all the insured risks. Thirdly, the composite approach to policy construction, which sees each severally insured person as insured under a separate policy of insurance<sup>110</sup>; but the composite approach adds little to the modern interpretative mechanism already described and may simply serve to obscure proper analysis as to whether there is one or more distinct insurance bargains. Principles of rescission would again afford increased protection for innocent parties not only by disallowing rescission unless the innocent parties can be restored to their original pre-contract position—the status quo ante—by the application of practical justice but also by affording protection to innocent third parties acquiring their interest for value without notice<sup>111</sup> and by allowing rescission to be defeated by those other equitable bars already discussed.

Invariably assignees and loss payees are not privy to any breach of the duty of the utmost good faith on placement. However, applying traditional principles of avoidance they are as likely as the original insured to have their interests undermined by some non-disclosure or misrepresentation of material facts on placement. Avoidance operates against them just as it might operate against a wholly innocent joint or several co-insured, albeit without possibility of their interests being severed from the interest of the original insured on which their own interest depends and, of course, in this respect the beneficiaries of any statutory transfer of rights under a third party liability policy are in substantially the same

<sup>106</sup> *Barclays Bank v O'Brien* [1994] 1 A.C. 180.

<sup>107</sup> Issues Paper 7: *The Insured's Post-Contract Duty of Good Faith* (July 2010), paras 7.44 to 7.46.

<sup>108</sup> *United Shoe v Brunet* [1909] A.C. 330 at 340.

<sup>109</sup> *Chemidus Wavin* [1978] 3 C.M.L.R. 514 at 533.

<sup>110</sup> *Arab Bank v Zurich* [1999] 1 Lloyds Rep. 262.

<sup>111</sup> *Scholefield v Templer* (1859) 4 De G. & J. 429.

position as assignees and loss payees.<sup>112</sup> As the concept of avoidance is now recognised as being an avoidance of a valid contract, the traditional doctrine has to recognise the right to avoid as one subsisting in equity only capable of operating against an assignee by reason of the assignee acquiring its contractual rights subject to prior equities.<sup>113</sup> Nonetheless the traditional doctrine of avoidance turns its face against the insurer's equitable right to avoid being defeated by the interest of an assignee or loss payee notwithstanding the assignee or loss payee having acquired its interest for value and without notice of the insurer's right to avoid.<sup>114</sup> In contrast principles of rescission require innocent third parties who have acquired their interest for value without notice to be protected and will result in rescission being disallowed where it would cause prejudice to such third-party interests.<sup>115</sup> But in insurance cases of avoidance the interests of third parties—as third parties—are not taken into account by courts when addressing the right to avoid. Courts confine their examination to the issue of affirmation of the contract by the insurers notwithstanding their right to avoid and, in the absence of such affirmation, avoidance is permitted notwithstanding the consequent prejudice caused to third parties for value and without notice of the insurer's right to avoid.<sup>116</sup>

## Conclusion

A case can certainly be made to the effect that the avoidance concept requires further reform either as to the nature of the remedy or as to the execution of the remedy.

As to the nature of the avoidance remedy, there is a central ambiguity requiring resolution as to whether the consequence of avoidance is that the insurance contract is void, voidable by rescission or voidable otherwise than by rescission. Reform of this nature would need to consider if avoidance should: be restored to what appears to have been its original iteration as an avoidance of a void contract, be made the subject of a reiteration as a rescission of a voidable contract, or be re-codified in its current iteration as an apparent *sui generis* remedy of avoidance of a voidable contract not subject to the normal rules of rescission. None of these options appear particularly attractive. To attempt to unwind the remedy back towards its status in the 18th century would be a regressive step entirely out of step with the current nominative contractual principles of English common law and not in conformity with international common law jurisprudence. To subsume avoidance within the developed concept of rescission may introduce an increased degree of uncertainty into the central insurance speculation—given that avoidance would then only be permissible where all parties could be restored to their original pre-contractual status and would be subject to the usual equitable bars to rescission

<sup>112</sup> Pursuant to the Third Parties (Rights Against Insurers) Act 1930 (or The Third Parties (Rights Against Insurers) Act 2010 as and when it comes into force); albeit s.1(4) of the 1930 Act expressly provides that “the insurer shall, subject to the provisions of section three of this Act, be under the same liability to the third party as he would have been under to the insured ...”.

<sup>113</sup> *MacGillivray on Insurance Law* (2008), para.17-032.

<sup>114</sup> *William Pickersgill & Sons Ltd v London and Provincial Marine and General Insurance Co Ltd* [1912] 3 K.B. 614 KBD where Kennedy J. expressed the view, at 621, that to allow assignment of a policy of insurance free of the insurers right to avoid for breach of the duty of the utmost good faith in placement “would involve upsetting the business of insurance and inflicting unwarrantable hardship upon underwriters”.

<sup>115</sup> *Scholefield v Templer* (1859) 4 De G. & J. 429.

<sup>116</sup> *Spriggs v Wessington Court School Ltd* [2004] EWHC 1432; [2005] Lloyd's Rep. I.R. 474, a case concerning a statutory transfer of a liability policy—effectively for value—to a third-party claimant.

including those relating to the protection of third-party rights. To re-codify its present logically impure status as a *sui generis* remedy would only be sensible were the insurance industry to put forward a convincing case that the well-being of the market could be compromised by the current lack of clarity in the status of the remedy. Perhaps the resolution of this central ambiguity, created by the common law, as to the nature of the remedy should be left to the common law for the time being, as the Supreme Court is just as well placed as the legislature to declare avoidance a *sui generis* remedy, or indeed to adopt one of the other two options.

As to the execution of the remedy, there are aspects of the current law that appear to obstruct the just disposal of cases. Insurers may seek to achieve avoidance as against guilty insureds while protecting the interests of innocent co-insureds but they can only do so consensually by agreement with all parties (e.g. by agreeing to both avoid the entire risk against all parties *ab initio* and reinstate *ab initio* in favour of the innocent insureds) and the courts cannot assist such a just disposal of the dispute. No doubt there are a number of routes that could be taken to better equip the courts to give practical justice in such cases when a consensual settlement cannot be achieved. One might be the expansion of the equitable concept of practical justice in rescission to embrace partial rescission as against guilty parties and its application also to avoidance of insurance contracts for multiple insureds. Another would be the introduction of more flexibility in the doctrine of severance to allow courts to untangle independent insurance obligations for multiple insured parties in a single contract of insurance. The courts ability to provide practical justice by severance ought to be dependant upon neither the interpretation of the agreed mechanism by which premium becomes due (i.e. as payment for an entire cover for all parties jointly or for discrete covers for each of the insured parties severally) nor the interpretation of the insured interests (ie as being of a joint or several nature). Instead severance could be made possible where the nature of the insurance obligations can be seen to be discrete and the premium is capable of apportionment. Reforms of such nature might do much to better equip courts to give practical justice—in cases of avoidance of contracts of insurance for multiple insured parties—for insurers and their insureds alike.