within the exclusion for riot. Again, the word burglary has been given its technical meaning in law.[113]

In *Grundy (Teddington) Ltd v Fulton*[114] it was held that the word "theft" in a goods policy should be construed in accordance with the meaning that it bears in the criminal law.[115] The result might well have been the same even had a less technical definition of theft been adopted; but the point arose more directly in a case in *Lim Trading Co v Haydon*,[116] where the claimants were stockbrokers, who had insured against loss from theft. They were the victims of a confidence trick in which shares were dishonestly obtained from them. It was held that the offence that had been committed was that of obtaining by false pretences, which, technically, did not fall within the term "theft" as used in the policy. The principle that "theft in a policy bears its Theft Act 1968 meaning was confirmed by the Court of Appeal in *Dobson v General Accident Fire & Life Assurance Corporation*.[117] Riot is a technical legal term describing a criminal offence. The common law offence of riot required only the presence of three people executing a disturbance such as might cause alarm to a reasonable person,[118] and it was held that this definition was satisfied.

The scientific meaning of an ordinary word is not necessarily its legal meaning. There may be a technical meaning in a scientific sense. Thus in *Commonwealth Smelting v Guardian Royal Exchange*[119] the Court of Appeal ruled that there was no "explosion" where a piece of metal caused the outer casing of a motor to shatter: some physical or chemical reaction was required before there could be said to have been an explosion in the technical sense of the word. The word "excavation" means any type of work that resulted in a hole being created in the ground, so that an assured who carried out piling work was held to be in breach of a clause requiring carrying out hand-digging to locate services prior to excavation.[120]

3.015 **Departure from technical words.** However, there are cases where the courts have departed from this principle. The technical meaning of the term "bankruptcy" was rejected by the Court of Appeal in *Doheny v New India Assurance Co Ltd*.[121] The claimants here completed a proposal form that contained a declaration to the effect that: "No director/partner in the business, or any Company in which any director/partner have had an interest, has been declared bankrupt". Neither of the claimants had been bankrupt, but they had been directors of three companies that had gone into insolvent liquidation. The Court of Appeal held that the technical meaning of the word

[113] *Chung Nam Medicine Co Ltd v Tai Ping Insurance Co Ltd* [1987] HKLR 397.
[114] [1981] 2 Lloyd's Rep 666, affirmed [1983] 1 Lloyd's Rep 16.
[115] Earlier cases, where an everyday meaning was preferred, were distinguished on the ground that they were decided before 1968, at which time the technical legal term was "larceny".
[116] [1968] 1 Lloyd's Rep, 159 (High Court of Singapore).
[117] [1989] 3 All ER 927, approved by the House of Lords in *R v Gomez* [1993] 1 All ER 1. See also *Peabody v Eagle Star Insurance Co Ltd* December 1998, Worksop County Court.
[118] The Public Order Act 1986 s.1 now provides that a minimum of 12 people is required for the offence of riot.
[119] [1984] 2 Lloyd's Rep 608, followed in *Aegis Electrical and Gas International Services Co Ltd v Continental Casualty Co* [2007] EWHC 1762 (Comm). See also *Martini Investments v McGinn* [2001] Lloyd's Rep IR 374, where it was held that the eruption of a volcano is an "explosion".
[120] *Wing Tai Pilonner Co Ltd v Eagle Star Insurance Co Ltd* [1998] 678 HKCU 1.
[121] [2005] Lloyd's Rep IR 251.

"bankrupt" – which was confined to individual insolvencies – ought not to prevail, given that what was intended was clear in ordinary English usage, and accordingly that there was misrepresentation by the claimants. However, the weight of authority favours the adoption of the technical meaning.

A strict technical construction of an English term of art may also not be appropriate where the policy—although governed by English law—is issued in respect of a foreign risk: in *Canelhas Comercio Importacao e Exportacao Ltd v Wooldridge*[122] the Court of Appeal refused to apply the strict meaning of "robbery" to an English policy issued to a trader in Brazil, given that the word potentially had different meanings in each of those legal systems, and accordingly that the word was to be construed consistently with the meaning that would be ascribed to it by an ordinary commercial person. In *Algemeene Bankvereeniging v Langton*[123] a policy was issued in London in favour of a Belgian bank to cover property in Belgium "lost or destroyed or otherwise made away with by fire, burglary, theft, robbery or hold-up". A manager of a branch of the bank issued bonds to customers without the authority of the bank, and misappropriated the proceeds. The insurers' defence was that this did not fall within the words of the policy as construed in their strict legal sense. The Court of Appeal nevertheless held that the loss was covered. MacKinnon LJ said that a technical construction of the words was inappropriate since the risk was situated in a foreign country.[124] It may be suggested that this argument holds most strongly where the words have a specific meaning in the criminal law.

A further exception arises where technical terms are accompanied by other non-technical terms. In *Algemeene Bankvereeniging v Langton*[125] MacKinnon LJ placed some weight on the presence in the words of coverage of the term "made away with", as this indicated that the words in that clause were to be interpreted in a popular rather than a technical sense. In the same case Maugham LJ noted that the rule does not apply to such words as "hold-up", which do not occur in Acts of Parliament relating to the criminal law, or are not otherwise known to English law as technical phrases.

Again, the technical meaning of words may be ousted by the context. Thus the word "person" in a theft policy has been held to refer only to a natural person and not to a company.[126] In *Glencore AG v Ryan, The Beursgracht*[127] the Court of Appeal refused to give the word "accept" its technical legal meaning in the insuring clause of an open cover, and held that the word meant that the insurers were automatically bound by risks declared by the assured, and not that they had the right to accept or reject them.

[122] [2004] EWCA Civ 984. See the discussion earlier in this chapter of the problem of construction where the risk is a foreign one.
[123] (1935) 40 Com Cas 247.
[124] See also *Nishina Trading Co v Chiyoda Fire & Marine Insurance Co Ltd* [1969] 2 QB 449; *Equitable Trust Co of New York v Henderson* (1930) 47 TLR 90; *Canelhas Comercio Importacao e Exportacao Ltd v Wooldridge* [2004] Lloyd's Rep IR 905; *Rowett, Leakey & Co v Scottish Provident Institution* [1927] 1 Ch. 55.
[125] (1935) 40 Com Cas 247.
[126] *Deutsche Genossenschaftsbank v Burnhope* [1995] 4 All ER 717.
[127] [2002] Lloyd's Rep IR 335. See also *Hanwha Non-Life Insurance Co Ltd v Alba Pte Ltd* [2011] SGHC 271, where it was held that the use of the word "facultative" was not an accurate term to describe an arrangement which was obligatory as far as the reinsurers were concerned.

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3.016 **Precedent.** Many words or phrases, though not otherwise technical legal words of art, have come to have a fixed meaning or a fixed construction in insurance policies.[128] The meaning of such phrases as "civil commotion" and "perils of the sea" have been determined by judicial decisions that are now part of the law of the land. Once a phrase has been given a definite meaning by the courts for a long period, later courts will follow that interpretation, even when not strictly bound to do so under the doctrine of precedent,[129] and not even a court of higher jurisdiction will overrule earlier decisions on the matter.[130] In *Ramco (UK) Ltd v International Insurance Co of Hannover Ltd*[131], Waller LJ, speaking of scope of a property policy secured by a bailee, held that it would be inappropriate for the Court of Appeal to overrule earlier cases which had held that the phrase "goods held in trust or commission or for which he is responsible" allowed the bailee to recover only for goods for which he faced liability, in that:

> "If a form of words has been in use for 80 years which describes one sort of insurance rather than the other, it would be meddlesome for this court to decide that the selected form of words do not achieve their intended purpose, unless there were some real reason for supposing that the form of words is unsatisfactory in practice. The fact that the form of words is the subject-matter of a previous decision of this court is a compelling reason why the courts should not depart from that settled meaning …"

There are two dangers here, however. First, where the wording differs in important respects from that used in earlier formulations, it is dangerous to construe it by analogy with the earlier provisions, since it may well be that the wording has deliberately been altered for the purpose of overcoming the original decision. Secondly, the original decision is binding only as to the use of a particular word in a particular context—it should not be assumed that a word must mean the same in every insurance policy in which it appears if the surrounding circumstances are different. Over-strict application of the doctrine of precedent to the construction of policies is thus to be avoided.[132]

The English courts are reluctant to rely upon US authorities in the determination of the meaning of words used in a contract governed by English law[133] on the grounds both of the sheer number of US authorities and the consumer-friendly attitude of certain US courts, and the Court of Appeal has also held that, in applying New York rules of

[128] Vaughan Williams LJ in *London & Manchester Plate Glass v Heath* [1913] 3 K 411, 416.

[129] *Gale v Lewis* (1846) 9 QB 730; *George Hunt Cranes Ltd v Scottish Boiler and General Insurance Co Ltd* [2002] Lloyd's Rep IR 178; *The Kleovoulous of Rhodes* [2003] 1 Lloyd's Rep 138.

[130] *Becker, Gray v London Assurance* [1918] AC 101; *Thames & Mersey Marine v Hamilton, Fraser* (1887) 12 AppCas 484; *Andersen v Marten* [1908] AC 334.

[131] [2204] Lloyd's Rep IR 27.

[132] *Re Calf and Sun Insurance Office* [1920] 2 KB 366 at 382; *Re Coleman's Depositories Ltd and Life and Health Assurance Association* [1907] 2 KB 798 at 801.

[133] *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] Lloyd's Rep IR 421; *Yorkshire Water Services Ltd v Sun Alliance & London Insurance Plc* [1997] 2 Lloyd's Rep 21; *Pilkington United Kingdom Ltd v CGU Insurance Plc* [2004] Lloyd's Rep IR 891; *Bolton Metropolitan Borough Council v Municipal Mutual Insurance* [2006] Lloyd's Rep IR 15, affirmed [2007] Lloyd's Rep IR 173. In *AstraZeneca Insurance Co Ltd v XL Insurance (Bermuda) Ltd* [2013] EWHC 349 (Comm) Flaux J refused to have regard to a substantive rule of New York law rather than a New York principle of construction, and Flaux J made it clear that a foreign law is not a part of the factual matrix even though the risk is situated in that country. That reasoning was affirmed on appeal, [2013] EWCA Civ 1660.

construction to a policy written in the English market and with international effect, it was to be presumed that the New York courts would come to the same conclusion as the English courts.[134]

3.017 **Context.** Context is relevant in two respects. First, words must not be considered in isolation from the overall structure and purpose of the policy. The importance of context was emphasised by Lord Collins in *Re Sigma Finance Corporation (In Administration)*:[135]

> "An over-literal interpretation of one provision without regard to the whole may distort or lustrate the commercial purpose. This is one of those too frequent cases where a document has been subjected to the type of textual analysis more appropriate to the Interpretation of tax legislation which has been the subject of detailed scrutiny at all committee stages than to an instrument securing commercial obligations."

It is dangerous to rely upon a word without taking account of the context in which it appears. *Young v Sun Alliance*,[136] the facts of which were given above, demonstrates a contextual meaning being preferred to an ordinary or natural meaning. The context rule was applied in the reinsurance context by the House of Lords in *Charter Reinsurance Co Ltd v Fagan*.[137] Their Lordships ruled that the phrase "actually paid' in an excess of loss reinsurance ultimate net loss clause referred not to physical payment by the reinsured, but rather by the reinsured incurring a liability to pay: the prima fade clear meaning of "actually paid" was held to be ousted by the context of the contract itself, which was concerned with payment on the establishment of liability. The courts will, unless there are clear indications to the contrary, construe the same words in different parts of the policy in a consistent fashion.[138]

Secondly, the context and purpose of the policy is also relevant. In *Sargent v GRE (UK) Ltd*[139] a disability policy marketed to persons in the armed forces was held to offer cover to an assured who had become unfit to carry on only his existing occupation even though he remained fit to carry on other occupations, as the policy had been drafted specifically for those employed in the armed forces and was to be construed accordingly. In *McGovern v Direct Travel Insurance*[140] the assured's travel policy provided her with the sum of £50,000 for "a permanent physical disability which prevents you from doing any paid work if you are not in paid work". The clause

[134] *King v Brandywine Reinsurance Co (UK) Ltd* [2005] Lloyd's Rep IR 509.

[135] [2009] UKSC 2.

[136] [1976] 3 All ER 561. But see *Rohan Investments Ltd v Cunningham* [1999] Lloyd's Rep IR 90, where the Court of Appeal held that heavy rainfall which led to ingress of water through the flahings on the assured's roof constituted a flood: there was little attempt by the Court of Appeal to reconcile this decision with that in *Young*. See now *Tate Gallery (Trustees) v Duffy Construction Ltd* [2007] EWHC 361 (TCC), which preferred the wider interpretation of flood.

[137] [1996] 3 All ER 46.

[138] *B+B Construction Ltd v Sun Alliance & London Insurance Plc* (2001) 4 HKCFAR 201; *Barrie Toepfer Earthmoving and Land Management Pty Ltd v CGU Insurance Ltd* [2016] NSWCA 67 (requirement to comply with statutory obligations given a consistent meaning in two separate clauses).

[139] [2000] Lloyd's Rep IR 77.

[140] [2004] Lloyds Rep IR 599.

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continued "we will provide the same cover for any permanent disability which prevents you from doing all your usual activities". The assured was injured in a road traffic accident whilst on holiday, and suffered injuries that prevented her from carrying on her hobby of horse-riding, but that still allowed her to carry on with other activities. The Court of Appeal held that this phrase had to be construed in the context of the policy as a whole, and concluded that the policy was designed to give protection in the event of a catastrophic accident. Furthermore, within the insuring clause itself, it was apparent that the two parts of it were referring to the same level of permanent disability, and accordingly it was appropriate to construe the clause as one that applied only where there was serious disability: it was not sufficient to pick out one activity and to hold that the assured could recover if that single activity could no longer be carried on.

The need to take into account the policy as a whole may also mean that the underlying purpose of the policy is not to be undermined or sidestepped by clauses which are on their face capable of having that effect. In *Outokumpu Stainless Ltd v Axa Global Risks (UK) Ltd*[141] a property policy taken out by a steelworks covered "accidental loss or destruction of or damage to the Property insured." There was an express exclusion for loss caused by radiation, although the policy went on to provide that "the insurance ... is extended to include loss destruction or damage due to contamination caused by the use of radioactive scrap materials utilised in the manufacturing process." The assured by accident contaminated waste material which but for the contamination could have been disposed of free of charge but as contaminated had to be disposed of at a cost of some £6.8 million, that sum being claimed from the insurers under the extension clause. The court ruled that the loss was not covered. The policy itself was a property cover, and although the extension was not by its terms restricted to property and appeared to extend to consequential loss, its correct interpretation was merely as a modification to the exception for radiation losses. Accordingly, as the claim was not for property damage, there was no recovery. The point made by the court was that a minor term was not to be construed as providing for an entirely separate and additional basis of cover outside the terms of the insuring clause itself.

A policy that is issued in a particular statutory context, *eg* a motor policy, is to be construed in accordance with that context. Thus the word "accident" is to be given a broad meaning, and encompasses any incident involving the insured car, even if that incident was deliberately caused.[142] Again, the phrase "knew or ought to have known" is to be construed as requiring either actual knowledge or blind eye knowledge, to accord with EU requirements as to the scope of the liability of the Motor Insurers Bureau to the passengers of uninsured drivers.[143] In *Oakapple Homes (Glossop) Ltd v DTR (2009) Ltd and SJ Catlin Syndicate 2003 at Lloyd's*[144] an insurance policy insuring the assured's liability under contractual warranties was construed consistently with the scope of the warranties.

[141] [2007] EWHC 2555 (Comm).
[142] *Charlton v Fisher* [2001] Lloyd's Rep IR 387.
[143] *White v White* [2001] Lloyd's Rep IR 493.
[144] [2013] EWHC 2394 (TCC).

3.018 **Ejusdem generis.** The most important specific application of the context principle is the ejusdem generis rule of construction, which provides that where general words are linked with particular words they must be construed as limited to the same genus as the particular words applies to policies of insurance. Thus an insurance of a vessel against the perils of the seas, men-of-war, fire, et cetera, and "all other perils", has been held not to cover the explosion of a donkey boiler.[145] So also, the meaning to be attached to a word can often be ascertained by considering the words with which it is linked: noscitur a sociis. In *Watchorn v Langford*[146] it was held that the word "linen" in the indusionary clause "stock-in-trade, household furniture, linen, wearing apparel and plate" could not cover linen drapery goods, as the context suggested that household effects only were to be insured. The same rule may, of course, work to the advantage of the assured if the disputed word appears in an exclusion clause. In *King v Travellers' Insurance Association*[147] the policy excluded, unless separately declared, "jewellery, watches, field-glasses, cameras and other fragile or specially valuable articles". The loss of the assured's fur coat was held not to fall within this exclusion clause, as it did not possess the same fragile qualities as the items expressly mentioned. It will be noted that the clause in *King* concluded with general words, and the case illustrates the further principle that where general words follow a list of specific matters, those matters are to dictate the ambit of the general words.

Where general words are followed by a specific list, by way of illustration of those words, the courts appear to apply the same principle, and will limit the general words accordingly.[148] Two illustrations of the point are provided by *Tektrol Ltd v International Insurance Co of Hannover Ltd*,[149] in which the assured lost two copies of its software program following the downloading of a file infected by a virus, and the remaining three copies were lost when the computers on which they were stored were stolen. The assured had an all-risks business policy that excluded loss of information stored on computer systems "caused deliberately by rioters strikers locked-out workers persons taking part in labour disturbances or civil commotion or malicious persons", and also excluded "erasure loss distortion or corruption of information on computer systems or other records programmes or software". The Court of Appeal held unanimously that the phrase "malicious persons" did not bear its usual meaning of an untargeted malicious act but, by reason of the context of riots, strikes and the like, carried a restricted meaning of a malicious act aimed at the assured's premises: for that reason the corruption of computer data by a random remote hacker was held not to be excluded. As to the burglary, it was held that the word "loss" in a second exclusion also derived its meaning from its context: the context pointed to physical loss of software, and it followed that software could not be said to be lost simply because there had been a theft of the computers on which the data was held.

[145] *Thames & Mersey Marine v Hamilton Fraser, The Inchmaree* (1887) 12 App Cas 484. The standard marine clauses do now, however, cover such perils.
[146] (1813) 3 Cowp 422.
[147] (1931) 48 TLR 53. *Cf. Moir v Passengers Assurance Co Ltd* (1877) 37 LT 356.
[148] *Joel v Harvey* (1857) 29 LTOS 75.
[149] [2005] EWCA Civ 845. See also *Ronson International Ltd v Patrick* [2006] Lloyd's Rep IR 194, affirmed *Patrick v Royal London Mutual Insurance Society Ltd* [2006] EWCA Civ 421, where the word "wilful" in the expression "any wilful, malicious or criminal acts" was held by HH Judge Richard Seymour QC to derive its meaning from the context of the other words in the phrases: it thus referred to "damage deliberately caused, consciously intended."

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The parties to a policy may, however, make it clear that the rule is not to apply.[150] Such a case is *London & Lancashire Fire Assurance Co v Bolands*.[151] Here, the House of Lords chose to give the "riot" its technical legal meaning, even though it appeared in an exclusion primarily concerned with war and associated risks. Nevertheless, in recent years, the context itself has become increasingly significant.

3.019 **Presumption of validity.**[152] The policy must, if possible, be construed to make it an effective legal document. Thus, where it is ambiguous, it will be presumed to be made with the person who had an interest in the subject-matter,[153] and a policy must not, where there are two constructions open, be given a meaning that will render it a wagering contract and therefore unenforceable.[154] Similarly, it is prima facie to be assumed that a motor-vehicle policy affords the cover required by statute.[155] Thus, a word must not be given its technical signification if the effect is to make the provision in which it occurs inoperative. So "legally" in the phrase "legally assigned" was not given its technical meaning, as opposed to "equitably", at a time when legal assignments in this sense were not possible.[156]

The courts will also strive to give sense to a contract term even though its meaning is obscure, as the alternative is to treat the clause as void for uncertainty. The latter approach, however undesirable, may be necessary where the policy contains conflicting terms.[157] In the absence of a clear conflict of this type, the courts will do their best to preserve the agreement. In *Charman v Gordian Run-Off Ltd*[158] a three-year reinsurance contract contained the following premium review clause:

> "The reinsurer reserves the right to increase the Annual Premium at any Anniversary Date during the Term on a pro rata basis, if prior to the Termination Date, there is a material change in the normal underwriting guidelines, classes of business, volume of business or proportion of business, as described in the submission and/or any extraordinary claims developments. Material change to be deemed to be substantial and as mutually agreed."

The clause was heavily condemned by expert witnesses, and Morison J. agreed that the rude comments made about it had been entirely justified. However, Morison J. ruled that it was his duty to give some meaning to the clause, as only in exceptional circumstances was it appropriate to refuse to apply a clause on the grounds of uncertainty and lack of meaning. Morison J. was able to construe the clause as meaning that the reinsurers were entitled to increase the premium in the event that there had been abnormal claims experience and that the words "pro rata" meant "for the balance of the contract". On appeal, in *Charman v New Cap Reinsurance*,[159] the Court of Appeal had less difficulty than the trial judge in amaking sense of the clause, and their view was that it provided for the giving of notice by the reinsurers following which a new premium could—by reference to an objective standard based on the original premium—be fixed for the balance of the contract.

[150] *Sun Fire v Hart* (1889) 14 App Cas 98. [1924] AC 836.
[151] [1924] AC 836.
[152] *Ut Res Magis Valeat Quam Pereat.*
[153] *Sutherland Marine v Kearney and Noonan* (1851) 16 QB 925.
[154] *Coker v Bolton* [1912] 3 KB 315.
[155] *Digby v General Accident* [1943] AC 121 141.
[156] *Dufaur v Professional Life* (1858) 25 Beav. 599.
[157] *Victorson v British Isles Marine & General Insurance Co* 9 Ll LR 511.
[158] [2003] Lloyd's Rep IR 337.

3.020 **Custom.** The general custom of the market in which the parties are operating is admissible evidence in two respects: it may be the basis for implying a term into the policy; or it may be an aid to the construction of the policy.[160]

Alleged custom cannot be used to create an entire contract where there was none before: the courts have accordingly rejected the argument that there is some form of customary implied agreement, based on market practice, between a broker and an underwriter under which the underwriter is entitled to view or take copies of documents in the broker's placing and claims files,[161] although such a contract has been held to exist on the grounds of business efficacy.[162]

Where evidence of custom is admissible, the custom will be made out only if it is notorious[163] and followed in practice. It must also be reasonable. In *Carvill America Inc v Camperdown UK Ltd*[164] the suggestion that there was a custom whereby brokerage earned by reinsurance brokers was paid by reinsurers was regarded as unreasonable.[165] A custom will not be permitted to contradict the express words of the agreement.[166] In *Krall v Burnett*,[167] a bill of lading provided that freight was "payable in London". The court rejected evidence that, by custom, this meant "payable in advance in London", as this was regarded as contradictory to the express language. However, this evidence might equally well have been regarded as amplifying the express terms, and it is submitted that the borderline between terms that amplify the written contract and terms that contradict it is, to some extent, a matter of emphasis. Thus in *Mander v Equitas Ltd*[168] Morison J. held that the words "originally allocated to the 1992", when used in relation to the scope of a reinsurance placed at Lloyd's, did not bear their apparent and natural meaning of the initial allocation of a cover to a policy year, but rather bore the meaning that was generally understood in the Lloyd's market, namely the technical act of allocating a risk and premium to a particular year of account following the writing of

[159] [2004] Lloyd's Rep IR 373.
[160] See *Durham v BAI (Run Off) Ltd* [2010] EWCA Civ 1096, where it was not shown that there was an established market custom that employers' liability policies were to be construed as covering the date of exposure rather than the onset ofiInjury. The point did not arise on appeal, *Employers Liability Insurance Trigger Litigation, BAI (Run Off) Ltd v Durham* [2012] UKSC 14.
[161] *Goshawk Dedicated Ltd v Tyser & Co Ltd* [2006] EWCA Civ 54.
[162] *Goshawk Dedicated Ltd v Tyser & Co Ltd* [2006] EWCA Civ 54.
[163] *Thor Navigation Inc v Ingosstrak Insurance, The Thor II* [2005] 1 Lloyd's Rep 547, in which Gloster J. rejected the suggestion that it was customary in the London marine market for the words "sum insured" to be regarded as creating a valued policy: the evidence pointed to the opposite conclusion.
[164] [2005] Lloyd's Rep IR 55.
[165] The Court of Appeal, [2005] EWCA Civ 645, did not comment on this point and held that the matter should go to trial
[166] *Hall v Janson* (1855) 4 E. & B. 500, 509, 510; *Australian Agricultural Co v Saunders* (1875) LR 10 CP 668, 677.
[167] (1877) 25 WR 305.
[168] [2000] Lloyd's Rep IR 520.

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the policy. Similarly, in *Gard Marine & Energy Ltd v Tunnicliffe*,[169] evidence of market practice led Steel J. to conclude that it was practice in the energy insurance market to scale down deductibles to reflect the proportion of the assured's interest in the insured subject matter, so that a reinsurance written on the same terms as the original (which made express reference to scaling) was to be construed in the same way as that is how it would have been understood by those in the market at the time.

3.021 **Superfluous words.** Effect must, if possible, be given to every word in the policy.[170] A reasonable construction must, therefore, be given to each clause in order to give effect to the plain and obvious intention of the parties as collected from the whole instrument.[171] It is no objection to a clause, however, that it is redundant, or inserted out of an excess of caution.[172] It has been said that the courts will lean towards treating words as adding something rather than as mere surplusage,[173] but less so in construing a commercial document than a statute. Devlin J in *SA Maritime v Anglo-Iranian*.[174] Sometimes it is plain that a particular provision cannot apply to the facts of a particular contract.[175] An effort must, however, be made to construe a policy adapted for some unusual subject matter so as to give each provision in it some meaning. Thus, in *Beacon Life v Gibb*[176] a policy framed for buildings was used for the insurance of a ship. It was held that provision against keeping gunpower on "the premises" was applicable, and that evidence of usage relating to the carriage of gunpowder on ships was, therefore, inadmissible. In *Milton Furniture Ltd v Brit Insurance Ltd*[177] the policy contained two independent but partially overlapping exclusions, one relating to theft when a burglar alarm was not operative while the premises were left unattended, and one relating to any form of loss when a burglar alarm was not operative either after business hours or when the premises were left unattended. The Court of Appeal, reversing the trial judge on the point, held that the two exclusions were to be read separately and that there was no basis for reading down the latter to match the former so that cover was removed only if the premises were left unattended. It is only where the result of applying such rules will make a clause meaningless that they may be ignored, as where the word "not" is added in error.[178]

That said, modern forms of drafting—which often consist of cutting and pasting precedents without due regard to how the various provisions in them can be reconciled—may give rise to directly conflicting clauses, and the court may have no option but to recognise that one or other of those clauses is superfluous and that it is

[169] [2011] EWHC 1658 (Comm).

[170] *Joyce v Realm Marine* (1872) LR 7 QB 580, 583; *Yorkshire Insurance v Campbell* [1917] AC 218, 224; *City Tailors v Evans* (1927) 38 TLR 230, 234; *Roberts v Anglo-Saxon Insurance* (1927) 96 LJKB 590, 594; *Commercial Union v Sun Alliance* [1992] 1 Lloyd's Rep 475.

[171] *Borradaile v Hunter* (1843) 5 M & G 639, 657.

[172] *Curtis v Mathews* [1918] 2 KB 825, 830, affd [1919] 1 KB 425.

[173] Somervell LJ in *SA Maritime v Anglo-Iranian* [1954] 1 WLR 492. 495.

[174] [1953] 1 WLR 1379, 1384.

[175] *Harrison v Evans* (1857)7 El. & Bl. 465; *Dudgeon v Pembroke* (1877) 2 App Cas 284, 293; *Hydarnes SS Co v Indemnity Mutual Marine* [1895] 1 QB 500, 509: *Home Insurance of New York v Victoria-Montreal Fire* [1907] AC 59; *Forsikringsaktieselskapet Vesta v Butcher* [1989] 1 All ER 402.

[176] (1862)1 Moo. PC NS 73.

[177] [2015] EWCA Civ 671.

[178] *Glens Trustees v Lancashire & Yorkshire Accident Insurance Co* (1906) 8 F. 915 (Ct of Sess), 917, 918, per Lord Dunedin.

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necessary to consider which should be given priority.[179] In *Chung Nam Medicine Co Ltd t/a Chung B Medicinal Co v Tai Ping Insurance Co Ltd*,[180] a standard form policy which covered theft following actual forcible and violent entry was held to have been varied by an endorsement which required only proof by the assured of the lesser "force in gaining entry". Terms may also be redundant without being in direct conflict. In *King v Brandywine Reinsurance Co (UK) Ltd*[181] a retrocession agreement in relation to pollution cover excluded any loss from pollution on land", although cover was brought back for liabilities incurred by the operator of an offshore facility. The issue was whether the words "on land" applied to pollution emanating from land or to pollution that was deposited on land. Colman J. at first instance held that the exclusion applied in the former case only, as otherwise the saving for pollution emanating from an offshore facility would be redundant. The Court of Appeal was divided on the point and expressed no concluded view, although it was noted that the redundancy argument was of no great sway given that policies often contained redundant terms. A more extreme example is *British-American Insurance (Kenya) Ltd v Matelec Sal*,[182] where insuring and reinsuring terms were contained in the same document, without distinguishing which terms applied to which transaction.

6. Technical Rules of Construction

3.022 **Successive documents.** If a contract is contained in more than one document, greater weight should be given to the later in date:[183] where the later instrument conflicts with the earlier, it is presumed to be the intention of the parties so to vary it.[184] It is only if there is a final and direct inconsistency that the terms of the policy that the terms of the later instrument are to be given priority.[185] Even in that event the court will not allow the insurer to take advantage of a clause in the policy varying the rights of the assured in the proposal where the assured would be entitled to come to the court and claim rectification of the policy.[186]

3.023 **Size of print.** There is no rule that large print is to be preferred to small print, and that a clause must not be ignored simply because it is difficult to read,[187] except in an extreme cases.[188]

3.024 **Recitals and headings.** Where the policy contains recitals, recourse may be had to them in construing an ambiguous clause in the policy,[189] but, where the operative words are unambiguous, the recitals cannot be resorted to to vary their grammatical

[179] Lord Birkenhead in *Mountain v Whittle* [1921] AC 615, at 621.

[180] [1987] 1 HKLR 397.

[181] [2005] Lloyd's Rep IR 509.

[182] [2013] EWHC 3278 (Comm).

[183] *Williams vAgius* [1914] AC 510.

[184] Roche J in *Kaufmann v British Surety Insurance* (1929) 33 Ll. L. Rep 315, 318.

[185] Lord Wright in *Izzard v Universal Insurance* [1937] AC 773, 780.

[186] *Collett v Morrison* (1851) 9 Hare 162; *Wood v Dwarris* (1856)11 Ex 493; *Re Bradley and Essex Accident* [1912] 1 KB 415.

[187] *Koskas v Standard Marine* (1927) 137 LT 165, per Scrutton LJ at 168, 169, and per Bankes LJ at 167.

[188] For such a case see *Harvey v Ventilalorenfabrik Velde*, *Financial Times*, November 11, 1988.

[189] Swinfen Eady LJ in *Blascheck v Bussell* (1916) 33 TLR 74, 75.

meaning.[190] Headings may also be taken into account as descriptive of the purpose of the clause in question.[191]

3.025 **Added words.** Specifically added words will generally prevail over printed words. Insurance policies are most commonly standard form documents. In some cases, however, the standard form will be found inappropriate to the needs of the case, and written or typed amendments will be made. The danger in this practice is that the amendments may introduce inconsistencies into the policy. In such a situation, the court, in pursuance of its objective of giving effect to the intentions of the parties, will allow the amendments to prevail over the standard form clauses. [192] The principle was explained by Atkin L.J. in *Farmers Co-op Ltd v National Benefit Assurance Co*:[193]

> "We are asked by the plaintiffs to confine our attention to the typewritten clause. That does not seem to me to be the proper mode of construing the policy which is partly in print and partly in writing. You must look at the document as a whole, and if, of course, you find that there are printed clauses which are inconsistent with that which has been obviously the particular matter of the agreement as expressed in writing, why then you may fairly and properly eliminate the printed clauses so far as they are inconsistent with the clauses, written or typewritten, which the parties clearly had in contemplation as part of their contract: but if the clauses are not inconsistent, then there is no reason why you should not give full effect to the whole document."

It is helpful to consider some illustrations of this principle. In *Dudgeon v Pembroke*[194] the parties wished to enter into a marine time policy. In fact, they used a standard form voyage policy, many of whose clauses were inconsistent with the nature of a time policy. In these rather unusual circumstances, the House of Lords treated the policy as a time policy only. A rather different situation arose in *Mercantile Marine Insurance Co v Titherington*,[195] where the standard written terms of a marine policy provided that the risk should terminate when "the ship hath moored at anchor twenty-four hours in good safety". A written clause in the policy provided that cover was to continue for 30 days following arrival at the ship's final port of discharge. The ship was lost on the 31st day following arrival at the final port of discharge. The insurer argued that the 30 days clause superseded the printed 24 hours clause; but the court preferred the assured's argument that the clauses were complementary, so that the times should be aggregated so as to provide 31 days' cover. The clauses were not clearly inconsistent, so the court fell back on its first duty in construing documents, namely to give effect to all the terms of the contract wherever possible. In *Admastos Shipping Co v Anglo-Saxon Petroleum*

[190] Lord Russell of Killowen in *Anglo-International Bank v General Accident* (1934) 48 Ll LR 151, 155.

[191] *Digby v General Accident Fire and Life Assurance Corporation Ltd* [1943] AC 121; *Tokio Marine and Fire Insurance Co Ltd v Costain Australia Ltd* [1988] NSWCA 157; *Barrie Toepfer Earthmoving and Land Management Ply Ltd v CGU Insurance Ltd* [2016] NSWCA 67.

[192] *Glynn v Margetson* [1893] AC 351; *Dudgeon v Pembroke* (1877) 2 App Cas 284; *Farmers Co-op v National Benefit Assurance* (1922) 13 Ll LR 530; *Christmas v Taylor Woodrow* [1997] 1 Lloyd's Rep 407. However, typed words in wide terms may be limited by a narrower clause in print that would otherwise be repugnant to them: *Berk v Style* [1956] 1 QB 180.

[193] (1922) 13 Ll LR 530 at 533.

[194] (1877) 2 App Cas 284.

[195] (1864) 5 B. and S. 765. See also *Mountain v Whittle* [1921] AC 615.

Co,[196] a charterparty (which was inaccurately described by the parties as a bill of lading) was expressed to be subject to the United States Carriage of Goods by Sea Act 1936, s.5 of which provides that the US Carriage of Goods by Sea Act 1936 is not to apply to charterparties. The House of Lords held that the misdescription was a mere misnomer, which could be ignored, and that the US Carriage of Goods by Sea Act 1936 s.5 should be disregarded so as to give effect to the manifest intention of the parties, which was to incorporate the provisions of the US Carriage of Goods by Sea Act 1936 into their agreement.

In *Commercial Union Assurance Co plc v Sun Alliance Insurance Group plc*[197] a reinsurance agreement was stated to be of twelve months' duration, but the words "120 days Notice of Cancellation at Anniversary Date" had been added. It was argued that these words, insofar as they sought to make the policy renewable automatically unless cancelled by 120 days' notice, were ineffective, as they conflicted with the 12 months' duration clause. Steyn J held that the words had been inserted for a purpose, and that the obvious purpose was to treat the reinsurance agreement as being subject to tacit renewal in the absence of notice by either of the parties. In *Eurodale Manufacturing Ltd v Ecclesiastical Insurance Office*[198] Andrew Smith J. gave priority to a typed transit clause in preference to the standard wording of the warehouse to warehouse clause in the Institute Cargo Clauses, and held that the assured could recover in respect of the theft of goods from a warehouse even though, under the standard clause, it was probably the case that the transit had come to an end. In *Eagle Star Insurance Co Ltd v Cresswell*[199] the Court of Appeal held that typed added clauses prevailed over the standard terms of a reinsurance agreement, so that a claims control provision overrode an obligation on the reinsurers to follow the reinsured's settlements.

3.026 **Deletions**. There is much authority in general contract law for the proposition that it is permissible for the courts to have regard to deletions from contracts in order to determine that which the parties intended to avoid,[200] although some cases have taken the view that a deletion is to be disregarded because the parties never intended it to form a part of the contract.[201] The Court of Appeal was faced with the inconsistencies in the case-law in *Punjab National Bank v de Boinville*,[202] where one of the questions was the ascertainment of who was the assured under contracts of insurance against, inter alia, political risks. The assured was described as "Punjab National Bank a/c Esal Commodities Ltd". The relationship between the parties was that Esal was an exporter,

[196] [1959] AC 133.

[197] [1992] 1 Lloyd's Rep 475. See also *Christmas v Taylor Woodrow* [1997] 1 Lloyd's Rep 407.

[198] [2003] Lloyd's Rep IR 444.

[199] [2004] EWCA Civ 602. The dominant effect of a claims control clause is in any event established whether or not it has been subsequently grafted on to a standard agreement: *Insurance Company of Africa v Scor (UK) Reinsurance Co Ltd* [1985]1 Lloyd's Rep 312.

[200] Harman J. in *City & Westminster Properties v Mudd* [1959] 1 Ch 129, 140, 141, and cases there cited; *Louis Dreyfus & Compagnie v Parnaso Compaña Naviera SA* [1959] 1 QB 498; *Timber Shipping Co SA v London & Overseas Freighters Ltd, The London Explorer* [1972] AC 1; *Mottram v Sunley* [19721 2 Lloyd's Rep 197. Judicial dicta to the contrary - eg Lord Sumner in *Sassoon v International Banking Corp* [1927] AC 711, 721 and Lord Finlay in *Ambatielos v Anton Jurgens* [1923] AC 175, 185) - are in practice ignored.

[201] *Sassoon & Sons v International Banking Corp* [1927] AC 711; *Samcrete Egypt Engineers Ltd v Land Rover Export Ltd* [2001] EWCA Civ 2019.

[202] [1992] 3 All ER 104.

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and the Bank had agreed to finance Esal's operations. Esal had placed the relevant policies. It was unclear from this wording which of the parties was the assured, and the Court of Appeal, relying upon various deletions that substituted the word "Esal" for "the assured", held that the intention of the amendments was to make it clear that some person other than Esal was the assured. On this reasoning, the Bank was to be regarded as the assured under the policies.

In *Kiriacoulis Lines SA v Compagnie d'Assurance Maritime Aériennes et Terrestres, The Demetra K*[203] brokers presented a slip to underwriters that would, if accepted by the underwriters, have covered the vessel not just for the usual marine perils, but also war and vandalism risks, which are generally not covered. The underwriters had agreed to that proposal in the previous year, but were not prepared to do so again on renewal, and that part of the slip referring to war and vandalism perils was deleted. The vessel was destroyed by fire that had apparently been set maliciously by a third party. Aikens J. assumed that it was legitimate to look at the deletion in order to determine the meaning of the remaining clauses, although, in the event, this was held to take the matter no further as the deletion was held to be insufficient to displace the ordinary meaning of "fire" as being fire from any cause. In *Eagle Star Insurance Co Ltd v Cresswell*[204] a reinsurance contract in its original form contained a claims control provision, compliance with which was expressly stated to be a condition precedent to the right of the reinsured to recover. That clause was deleted and replaced with a clause in different form and not expressed to be a condition precedent. At first instance Morison J held that the change in wording was a powerful indication that the new clause was not a condition precedent, because the parties had—as evidenced by the original wording—plainly appreciated the significance of stating a clause to be a condition precedent. Morison J's construction of the new provision was reversed by the Court of Appeal on appeal,[205] although without adverse comment on this aspect of the trial judge's reasoning. A deletion may be used to show what the parties have failed to agree.

In *Mopani Copper Mines Plc v Millennium Underwriting Ltd*[206] the assured wished to build new copper smelting facilities at a site in Zambia. It was proposed to include in the original slip a condition stating that "The whole contract period is deemed to include all projects incorporated into the Mopani Smelter Upgrade project and cover extends to include Operational All Risks for completed phases of the project up until the final handover certificate is issued". That condition was, however, deleted in pencil to show that it had not been agreed. Subsequently, the slip was amended and it contained the condition but with an ink deletion, as follows: "The whole contract period is deemed to include all projects incorporated into the Mopani Smelter Upgrade project until the final handover certificate is issued". A loss fell within the deleted words, and

[203] [2002] Lloyd's Rep IR 823. See also *Ted Baker Plc v Axa Insurance UK Ltd* [2012] EWHC 1406 (Comm), confirming that it is not permissible to have regard to deletions or omissions in order to change the plain meaning of the words that have been used. Thus, in *Ted Baker* itself, the insuring clause of the policy referred to the dishonesty of employees, and that wording was on its ordinary construction held to extend to theft by employees and it was irrelevant that employee theft specifically fell within a separate section of the policy which the assured had opted not to take up.

[204] [2003] EWHC 2224 (Comm).

[205] [2004] EWCA Civ 602.

[206] [2008] EWHC 1331 (Comm).

the court, ruling that there was no coverage, was of the view that it was permissible to look at the deletion to determine what the parties had agreed that they had failed to agree.

7. Incorporation

3.027 **Achieving incorporation.** The incorporation of the terms of the direct policy into the reinsurance, by means of the full reinsurance clause, was discussed at length earlier in this work, and it was there noted that a term may be incorporated only if: (1) it is germane; (2) it makes sense, subject to permissible "manipulation", altering the names of the parties to match those in the main agreement; (3) it is consistent with its new context; and (4) it is apposite for inclusion.[207]

Although incorporation by means of the full reinsurance clause is the most common form of incorporation into reinsurance contracts, other means of incorporation may be found. In *Edwards v Aberayron Insurance Society Ltd*,[208] which was a case of mutual insurance, it was held that the rules of the mutual insurance society could be treated as incorporated into the policy, notwithstanding that the policy contained no direct reference to them.

A further significant commercial context in which terms are incorporated from one contract into another arises where insurance is arranged in layers, in that the terms of the primary layer policy may be incorporated into the excess layer policies so as to ensure that the coverage is consistent across the layers. Hong Kong *Borneo Services Co Ltd v Pilcher*[209] raised the question whether a clause prohibiting the recovery of interest by the assured contained in the first-layer policy, had been incorporated into the second-layer policy by the words "as per primary insurance". Evans J held that no special principles applied to this type of case, and that the incorporation took effect according to its terms. In *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp*[210] liability cover was arranged in layers. The primary layer policy was written on a claims-made basis, so that notification to the insurers of events which could give rise to a claim were insured, even though the claims themselves did not arise until after the policy had expired. The excess layer policy incorporated the terms of the primary layer policy. Colman J had little difficulty in holding that these provisions had been incorporated into the excess layer policy, as it was invariable practice for claims made policies to be extended to liabilities arising in later years. The incorporation of the terms of the primary layer into the excess layer will, however, depend upon the relevance of those terms to excess layer cover. In *Union Camp Chemicals Ltd v Ace Insurance SA-NV*[211] it was held that a condition precedent contained in a primary layer public liability policy had been incorporated into an excess of loss policy covering

[207] *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co* [2001] Lloyd's Rep IR 234, affirmed [2001] Lloyd's Rep IR 596.

[208] (1876) 1 QBD 563.

[209] [1992] 2 Lloyd's Rep 593.

[210] [2005] Lloyd's Rep IR 135, aff'd on other grounds [2006] Lloyd's Rep IR 45.

[211] [2003] Lloyd's Rep IR 484.

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Trafalgar Trucking Co[118] the assured's building was damaged tortiously by the defendant. The Court of Appeal held that the measure of loss was the cost of obtaining a new building, £390,000. Prior to the trial, the claimant had invested around £100,000 in its new building and had resold it for £690,000, producing a paper profit from the fire of £200,000 rather than a loss of £390,000. The Court of Appeal nevertheless held that the claimant was entitled to £390,000, and stressed that a claimant is not obliged to operate a profit and loss account running from the date at which the loss is to be assessed. Similarly, in *Frewin v Poland*,[119] manuscripts were insured up to maximum of £1,000 "in the event of loss resulting in the necessity for the assured to rewrite". Two manuscripts were lost, and it was agreed that the costs of producing the original manuscripts had been about £860 and that rewriting would cost a similar amount. The court rejected the insurers' argument that they were liable only if the books were actually rewritten, although it was held that the policy insured against the loss of the manuscripts and that the cost of rewriting merely fixed the amount that the assured could recover under the policy up to the ceiling of £1,000.

10.023 *Express provision as to measure of indemnity.* There are frequently clear words which identify the measure of indemnity. In *Brescia Furniture Pty Ltd v QBE Insurance (Australia) Ltd*[120] the policy provided indemnity by reference to reinstatement or repair costs. The insurers' argument that there was an overarching rule that the assured was to be held to the difference between the market value of the property before the casualty and its market value after the casualty, was rejected.

In some cases the policy may provide for payment to the assured over and above the amount of his own loss. That will be the case where the assured is a bailee who—as he is entitled to do by law—has insured the subject-matter for its full value rather than merely for the amount of his own potential liability in the event that the subject-matter is lost.[121]

10.024 *Absence of express provision.* In the absence of any policy terms which fix the measure of indemnity, the guiding indemnity principle is to be satisfied by reference to the nature of the loss and the value of the damaged property to the assured immediately before the loss.[122] There is no single measure of indemnity. It was said by Gleeson CJ in *Fire & All Risks Insurance Co Ltd v Rousianos*[123] that the "value" of the insured subject-matter meant "exchange value", which he defined as "the price in cash or in

[118] [1990] 2 All ER 246.
[119] [1968] 1 All ER 100.
[120] (2007) 14 ANZ Insurance Cases 61–740. See also *McConnell Dowell Middle East LLC v Royal & Sun Alliance Insurance plc* [2008] VSC 501, where the policy provided an indemnity on the basis of "market value". In *Parker v National Farmers Union Mutual Insurance Society* [2013] Lloyd's Rep IR 253 it was common ground that, had the issue of indemnity arisen, the policy provided for the lesser of repair costs or diminution in market value.
[121] See the cases on bailment discussed in Ch.17, below and see also *British Traders Insurance Co Ltd v Monson* (1964) 111 CLR 86.
[122] *QBE Insurance (International) Ltd v Wild South Holdings Ltd And Maxims Fashions Ltd, Marriott v Vero Insurance, Crystal Imports Ltd v Certain Underwriters at Lloyds of London* [2014] NZCA 447 at [98]: "We find "subjective" inapt, but it is true that, the contract being one of indemnity, the relevant loss is the loss to the insured, so that the measure of loss may depend on the insured's intentions for the property and reasons for owning it." There is authority rejecting that test, *eg Mercantile Mutual Insurance v Amburla* (1982) 2 ANZ Insurance Cases 60–469, but it is out of line with the general rule of cases.
[123] (1990) 19 NSWLR 57 at [65].

kind, which would be obtained for the property in question in an arm's length dealing between a willing but not anxious seller and a willing but not anxious buyer". Gleeson CJ specifically rejected the suggestion that "value" always meant "market value" because there might not always be a market from which value could be ascertained. It is thus settled that exchange value is appropriate in some circumstances, whereas in others replacement cost is the true measure, particularly in the case of a building where the concept of "exchange" may not be relevant because "there is normally not an exchange value for a building separately from the land on which it stands".[124]

Where the subject-matter has merely been damaged, that is, where a partial loss has been suffered, the assured's measure of indemnity is the cost of restoring the property to its condition immediately preceding the loss, although in the case of goods intended for resale the policy may fix the limit of indemnity by reference to the diminution in value rather than the cost of repair. Where the subject-matter has been totally destroyed, the assured's loss is the market value of the property immediately preceding the loss. There is an intermediate possibility, namely, where the subject-matter has not been destroyed although the cost of restoration exceeds the pre-loss value of the property. This amounts to constructive total loss in marine insurance but in the absence of that possibility in non-marine insurance the loss can be partial only: that said, policy wordings often give the insurer the option to reinstate or to treat the subject-matter as totally lost. In consumer cases, particularly where household goods are concerned, cover is provided on a "new for old" basis. This overcomes problems of calculating the amount of loss, but may well lead to the assured receiving a windfall which, but for the "new for old" provision, would constitute betterment.

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Destruction of or damage to buildings

10.025 *Agreed measures of indemnity.* The measure of indemnity for damage to buildings is a matter for the policy itself. The measure may be based on a number of possibilities which arise where reinstatement is not possible or not opted for by the party with the right to choose[125] whether to reinstate or to pay. The most likely possible measures include market value, the notional rebuilding cost on site, rebuilding on another site or purchase of a new building. Plainly they will give rise to different amounts.

10.026 *Choice of measure of indemnity.* The policy may confer upon the insurers the right to determine the measure of indemnity. Alternatively, the choice may be that of the assured. There is no necessary connection between an option conferred upon the insurer whether to reinstate or to pay, and an option as to the measure of indemnity: the latter may be for the insurer or the assured, depending upon the wording of the policy. In *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd*,[126] where the policy allowed the insurers to reinstate or to pay, and it was held that the exercise of the option to pay did not entitle the assured to reinstatement cost: the policy provided only for market value indemnity, not rebuilding, and a higher premium would have been payable had the assured opted for an indemnity based on rebuilding. However, the wording may give rise to a different result. The wording in two New Zealand cases, *Skyward Aviation*

[124] *General Accident Insurance Asia Ltd v Sakr* [2001] NSWCA 402 at [63].
[125] For the exercise of the option, see below.
[126] [2016] NZSC 158.

2008 Ltd v Tower Insurance Ltd[127] and *O'Loughlin v Tower Insurance Ltd*,[128] was the same. The policies provided that "In all cases [Tower has] the option whether to make payment, rebuild, replace or repair your house". If the house was not reinstated, Tower would pay[129]:

(1) the full replacement value [the costs actually incurred to rebuild, replace or repair your house to the same condition and extent as when new] of your house at the situation; or

(2) the full replacement value [the costs actually incurred to rebuild, replace or repair your house to the same condition and extent as when new] of your house on another site you choose. This cost must not be greater than rebuilding your house at the situation; or

(3) the cost of buying another house, including necessary legal and associated fees. This cost must not be greater than rebuilding your house on its present site, or the present day value, as shown in the certificate of insurance[130]; or

(4) the present day value [the cost at the time of the loss or damage of rebuilding, replacing or repairing your house to a condition no better than new].

The policy also stated that: "We will only allow you to rebuild on another site or buy a house if your house is damaged beyond economic repair" and that Tower was "not bound to pay more than the present day value … value until the cost of replacement or repair is actually incurred. If you choose not to rebuild or repair your house or buy another house we will only pay the present day value …". In each of these cases the house could not be reinstated, and the question was, which of the measures of indemnity was applicable. In *O'Loughlin* it was held that the choice of the competing measures was one for the insurers. That analysis was followed at first instance in *Skyward*. In each decision the phrase- "In all cases … we have the option whether to make payment, rebuild, replace or repair your house"- was held to be determinative, in that it unarguably conferred an initial decision on Tower as to whether to reinstate or pay, and also conferred the consequential right upon Tower, having opted to pay, to choose between the four bases of indemnity in the policy. However, the New Zealand Court of Appeal in *Skyward* disagreed, and held that the option was that of the assured. The wording relied upon by Tower related only to the decision whether to pay or reinstate, and the bases of indemnity themselves were inconsistent with the discretion being that of Tower. Thus the fact that present day value (option (4)) was available only if the assured chose not to rebuild, repair or buy another house, the specific exclusion of replacement cost (option (2)) and the purchase of another house (option (3)) where the house was not damaged beyond economic repair, and the choice of site (option (2)), made sense only if the option was that of the assured in the first place. That aside, the Court of Appeal noted the wider point that the assured was the owner of the building

[127] [2014] NZCA 76, reversing [2013] NZHC 670, affirmed [2015] NZSC 185.
[128] [2013] NZHC 670.
[129] Numbering added for ease of exposition.
[130] It was held by the Court of Appeal that there was no further cap which required the assured to recover only the cost of a house of comparable size, construction, condition and style as its existing house.

and should have the right to determine what was to happen as a result of its loss, at least in the absence of clear wording to the contrary.

The New Zealand Court of Appeal also pointed out in *Skyward* that, if the house was not economically repairable but the choice of indemnity was that of the insurers, they could insist upon the purchase of another house under (3) and, if the assured refused, then the assured would have to settle for present day value under (4). In that way, the assured would be deprived of the right to recover the rebuilding cost.

10.027 *Indemnity based on cost of reinstatement*. As seen from the previous paragraph, the assured may be entitled to recover an indemnity based on the cost of reinstatement even though reinstatement is never actually effected. That will be the case where the policy provides that the assured or the insurer, as the case may be, opts for indemnity on a reinstatement measure or where reinstatement is not possible.

If the policy merely provides for reinstatement without any alternative, it is difficult to see why impossibility should affect the insurers' obligation to indemnify the assured on a reinstatement basis: the loss is assessed by reference to the position immediately before the occurrence of the insured peril, the obligation to pay is divorced from what actually happens to the insurance monies and the obligation on the insurers to pay the insurance proceeds cannot be regarded as frustrated in any way. The point arose in *Anderson v Commercial Union Assurance Co*,[131] the problem in that case being planning restrictions on reinstatement. The Court of Appeal held that, given the impossibility of reinstatement, the proper approach was to construe the contract between the parties to determine whether the insurer was discharged from all liability or whether its liability reverted to payment. The court had little hesitation in holding that the latter was the proper construction. Thus, subject to the terms of the policy, the insurer will be liable on a cost of reinstatement basis even where actual reinstatement is no longer possible, as for instance where the damaged premises have been sold, or where town planning restrictions prevent rebuilding, in which case the cost is assessed on a notional reinstatement basis.[132]

The assured's recovery is limited by any terms in the policy which apply where reinstatement is not effected. Thus in *Kypris v MLC Fire & General Insurance Co Pty Ltd*[133] reinstatement by the assured was impossible because of planning restrictions preventing rebuilding, and it was held that the assured was restricted to recovering the present value of the insured property, the sum payable in the absence of reinstatement.

It will be appreciated that, in circumstances where a policy which provides for payment by reference to the cost of reinstatement despite the fact that reinstatement is not

[131] (1885) 55 LJQB 146.
[132] *Bland v South British Insurance Co Ltd* (1990) 6 ANZ Insurance Cases 60–998 HC NZ; *D'Aloia v Colonial Mutual General Insurance Co Ltd* [1989] VR 161 FC at 168–169, (1990) 6 ANZ Insurance Cases 61–009 SC Vic at 76,744.
[133] (1981) 1 ANZ Insurance Cases 60–451 (CA NSW). Contrast *Cannell v Commercial Union General Insurance Co Ltd* (1985) 3 ANZ Insurance Cases 60–666 (HC NZ) where it was held that the assured was entitled to rebuilding costs but only when rebuilding became possible.

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intended or actually carried out, the figure is a notional one based on estimated rather than actual costs. Where the assured is entitled to indemnity based on the costs of reinstatement, assessment of the cost must relate to the date of the occurrence of the insured peril[134] and not at some later date, *eg* the date on which the assured receives tenders for rebuilding,[135] and although the policy may make express provision for assessment at a later date a policy term which provides that the insurers will pay for the cost "incurred" in repair does not oust the presumption that the policy is one of true indemnity based on costs at the time of the insured peril.[136] It has nevertheless been suggested that where the insurer elects to pay the cost of reinstatement, the cost of the repairs should be assessed as at the date when, having regard to all the relevant circumstances, they can first reasonably be undertaken, rather than at the date of the trial of the action.[137]

10.028 *Measure of indemnity where there is no reinstatement.* If there are a range of possible measures of indemnity where reinstatement cannot be or is not effected then, as is shown by the clauses in *Skyward Aviation 2008 Ltd v Tower Insurance Ltd*[138] and *O'Loughlin v Tower Insurance Ltd*,[139] the maximum sum recoverable maybe fixed at the cost of reinstating on site, minus depreciation. Where the measure of indemnity is capped at the cost of reinstating a building, but the building cannot be reinstated on its original site by reason of damage to the land itself or by reason of regulatory provisions, the question arises as to whether the amount of the assured's indemnity is to be increased so as to take into account the notional higher costs of rebuilding on damaged land. The point arose in *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd*,[140] where the assured was entitled to "the full replacement cost of rebuilding on another site, but capped at the cost of building on the original site". The insurers had also agreed to "pay the reasonable costs for compliance with building legislation and rules". The assured argued that the cost of rebuilding on the original site included sums which would not be incurred by building on the new site. Dobson J, in the New Zealand High Court, disagreed, holding that in order to prevent the assured from recovering a windfall, the correct approach was to look at the actual costs of rebuilding on the new site and to add to them the additional costs required by building legislation and rules. Dobson J noted that the assured's argument was double-edged, because if the costs of building on the new site were actually higher than building on the old site, the limit of indemnity would be capped by reference to the former. The correct approach, therefore, was to look at actual building costs on the new site. Again, in *O'Loughlin v Tower Insurance Ltd*,[141] although the assured was held to be entitled to "the full replacement value of your house at the situation", that obligation was qualified by a further contract term which restricted recovery to "the cost of replacement or repair beyond what is reasonable, practical or comparable with the original". Those words were held by the court to mean that the assured was not entitled to the notional full rebuilding costs at the original site, because such rebuilding would "involve unnecessary work that would not make the house in any way more habitable but greatly add to the cost". Rebuilding on the original site would thus not be reasonable or practical.

[134] *Re Wilson and Scottish Insurance* [1920] 2 Ch. 28.

[135] *Leppard v Excess Insurance Co Ltd* [1979] 2 Lloyd's LR 91; *Sprung v Royal Insurance* [1999] Lloyd's Rep IR 111.

[136] *Tonkin v UK Insurance Ltd* [2007] Lloyd's Rep IR 283.

[137] *Milliangos v George Frank (Textiles) Ltd* [1976] AC 443 at 444; *Dodd Properties (Kent) Ltd v Canterbury County Council* [1980] 1 All ER 928 at 933; *Melin v Mutual Community General Insurance Pty Ltd* (1991) 6 ANZ Insurance Cases 61–057 DC SA at 77,123; *Lumley General Insurance Ltd v Vintix Pty Ltd* (1991) 24 NSWLR 652; *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 at 399.

[138] [2014] NZCA 76.

[139] [2013] NZHC 670. See also: *Rout v Southern Response Earthquake Services Ltd* [2013] NZHC 3262; *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd* [2016] NZSC 158.

[140] *Turvey Trustee Ltd v Southern Response Earthquake Services Ltd* [2012] NZHC 3344; (2012) 17 ANZ Insurance Cases 61-965, approved and followed in *Avonside Holdings Ltd v Southern Response Earthquake Services Ltd* [2014] NZCA 483, affirmed *Southern Response Earthquake Services Ltd v Avonside Holdings Ltd* [2015] NZSC 110.

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10.029 *Absence of agreement: default measurement.* If the policy is silent then, subject to policy limits, the measure of indemnity is to be assessed by reference to the value of the property to the assured immediately before the event causing the loss. The point was expressed in *Canadian National Fire Insurance Co v Colonsay Hotel Co*[142] by the Supreme Court of Canada where, in rejecting the notion that the basis of indemnity was the replacement value of an insured hotel less depreciation, Duff J remarked:

> "...the jury ought to have been told that the pecuniary loss suffered by the insured in the destruction of the hotel was the true and only measure of the indemnity to which it was entitled. It seems to be quite clear that the loss could in the circumstances be measured by the value of the property—not necessarily the selling value, if the insured could establish a value in use greater than the selling value—but I can entertain no doubt whatever that the point upon which a jury should have been told to apply their minds was that of ascertaining the value to the insured of the property destroyed."[143]

In most cases the assured's loss in the event of damage to buildings will be the cost of reinstatement, or if the building is destroyed, market value. Nevertheless, there may be cases in which these measures do not represent the assured's actual loss, and the cases indicate that the rule may be ousted to take account of other considerations. As was said by Dunningham J in *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd*[144] : "the measure of loss for which the insured is indemnified may depend on the insured's

[141] [2013] NZHC 670; [2013] 3 NZLR 275, followed in *Skyward Aviation 2008 Ltd v Tower Insurance Ltd* [2013] NZHC 1856, (a point not in issue on appeal [2014] NZCA 76; [2014] 2 NZLR 713). The same principle was adopted in *Rout v Southern Response Earthquake Services Ltd* [2013] NZHC 3262, but without reference to these cases: in *Rout* the assured unsuccessfully claimed some NZ $500,000 for repair costs on damaged land. But contrast *Zurich Australian Insurance Ltd t/a Zurich New Zealand v Body Corporate 398983* [2013] NZCA 560; (2013) 18 ANZ Insurance Cases 62-002 as regards professional fees which would not in fact be incurred. Again, in *Southern Response Earthquake Services Ltd v Avonside Holdings Ltd* [2015] NZSC 110 the Supreme Court held that the fact that a building could not be replaced did not mean that the assured was unable to recover notional costs that would have been incurred had reinstatement been possible. Such costs included professional fees and the usual 10 percent builder's margin.

[142] [1923] 3 DLR 1001 at 1005. See also: *Vanderburgh v Oneida Farmers Mutual Fire Insurance Co* [1935] 1 DLR 257 at 258; *Scott v Canadian Mercantile Insurance Co* (1965) 49 DLR (2d) 601 at 607; *Edwards v AA Mutual Insurance Co* (1985) 3 ANZ Insurance Cases 60-668 (HC NZ); *Whirlybird Holdings Ltd v National Insurance Co Ltd* (1996) 9 ANZ Insurance Cases 61-316 (HC NZ); *New Zealand Fire Service Commission v Insurance Brokers Association of New Zealand Inc* [2014] NZCA 179; *Michalik v Earthquake Commission* [2015] NZSC 59.

[143] See also *General Accident Insurance Asia Ltd v Sakr* [2001] NSWCA 402, where it was pointed out that "exchange" value might not represent the true measure of indemnity for a building, and in particular one that has been damaged.

[144] [2015] NZHC 1444 at [83]. These comments were approved on appeal, [2016] NZCA 67 at [29]. The point did not arise on appeal to the Supreme Court, [2016] NZSC 158.

repairs have been effected, but that once the policy has come to an end the right to be paid accrues even though repairs have not been effected.[206]

The matter is also covered by the International Hull Clauses 2003 cl.20.2 of which states that:

> "In no case shall the Underwriters be liable for unrepaired damage in the event of a subsequent total loss of the vessel (whether by perils insured under this insurance or otherwise) sustained during the period of this insurance or any extension thereof."

The leading authority in the marine context is *Livie v Janson*,[207] which concerned a situation not expressly dealt with by s.77 of the Marine Insurance Ordinance, but nevertheless one which forms the basis for the merger principle set out in that provision. Here, the insured vessel was holed by ice, and was forced to run aground. Less than 12 hours later the vessel was seized and condemned by the American authorities for breaking an embargo: seizure by American authorities was an express exclusion from cover. The court treated the matter as one of causation, and held that the proximate cause of the loss was seizure rather than a peril of the seas, and on that basis the assured was unable to recover. Lord Ellenborough noted that in the circumstances the assured could not practically have called upon the insurers to make good the partial loss. Lord Ellenborough also stated that the right to recover the partial loss was "extinguished" by the total loss, rather than that it did not ever arise.

10.043 **Non-marine insurance.** It might be thought that there is no obvious reason why the merger doctrine should not apply to non-marine insurance. If the assured has suffered partial loss which has not been repaired, and then a total loss occurs from a different cause, the assured's earlier partial loss is in effect purely notional. As against that, it might be said that a partial loss gives rise to an immediate accrued claim which is not affected by later events. That is, after all, the position in the law of tort: if D damages C's property, then C has a claim for loss against D which is to be assessed at that point,[208] and it would not seem to matter that the property is subsequently destroyed by other means before repairs can be effected. It is also the case in insurance law that the assured has a cause of action against the insurers as soon as the peril occurs. However, insurance involves a contract of indemnity whereby the insurer agrees to make good the assured's actual loss and no more; whereas if damage is inflicted tortiously the victim has a right of damages against the wrongdoer as a matter of law, and it is no concern of the wrongdoer if and how the sum representing their liability is spent by the victim.

In *Wright, Stephenson, and Co Ltd v Holmes*,[209] insurers opted to reinstate a partially damaged vehicle but, before they could do so, the vehicle was destroyed in an earthquake. The New Zealand Court of Appeal held that the insurers, by opting to repair, had converted their obligation into one to reinstate, but that obligation had been

[206] *Rankin v Potter* (1873) LR 6 HL 83; *British & Foreign Marine Insurance Co v Wilson Shipping Co Ltd* [1921] 1 AC 188.
[207] (1810) 12 East 648.
[208] *Coles v Hetherton* [2013] EWCA Civ 1704.
[209] [1932] NZLR 815.

frustrated and accordingly they were discharged from liability. This ruling appears to sidestep the question, in that the effect of frustration could surely not be to terminate the policy itself but only the repairing obligation, so the effect of the earthquake would be to revive the obligation to make payment; at that point the question of merger becomes live. So the decision stops short of deciding the real issue and does not take the point any further forward, although it should be said that the court took the view, obiter, that the merger principle would, but for frustration, have been applicable. As will be seen below, the operation of frustration in this situation appears no longer to be good law.

There was some discussion of the point by the New South Wales Court of Appeal in *Lumley General Insurance Ltd v Vintix Pty Ltd*.[210] Here, a building insured against damage or destruction by earthquake was badly damaged by an earth tremor. Some two months later, while the premises remained unrepaired, further damage was caused by heavy rain, and one issue was whether the insurers were liable for the additional loss so caused. The insurers' contractual obligation was to pay the amount of the damage, but no basis for quantifying this was contained in the policy and it was conceded that the appropriate method was the cost of reinstatement. The insurers were held liable for the additional damage because such loss was covered under the terms of the policy which was still current, but the New South Wales Court of Appeal made some observations on the incidence of liability had this not been the case. The Court regarded the matter as one of causation, with Mahoney JA finding that arguably the earthquake was the effective or dominant cause of the damage, Clarke JA expressing the view that there could be more than one effective cause of the loss, while Meagher JA considered that the cause of the damage was the heavy rain and not the earthquake. The case thus indicates that if there is later damage during the currency of the policy, it is necessary to consider the matter at the later date, which is arguably support for the operation of the merger doctrine.

The issue has been addressed at first instance in New Zealand in two cases, *Ridgecrest NZ Ltd v IAG New Zealand Ltd*[211] and *Crystal Imports Ltd v Certain Underwriters at Lloyd's of London*.[212] In the former, Dobson J rejected the application of merger in non-marine cases, but in the latter Cooper J saw no basis for any distinction between marine and non-marine insurance. The matter was subsequently considered by the Supreme Court of New Zealand in the *Ridgecrest* appeal.[213] and, shortly afterwards, by the Court of Appeal in the *Crystal Imports* appeal.[214] Both decisions were rulings on preliminary issues, and in the absence of clear evidence as to how the principles laid down were to apply to factual situations, so to that extent the analysis was somewhat constrained.

In *Ridgecrest* the events all occurred in the same policy period. The assured's building was insured for NZ $1,984,000 for each "happening", an amount significantly less than

[210] (1991) 24 NSWLR 652 CA.
[211] [2012] NZHC 2954.
[212] [2013] NZHC 3513.
[213] [2014] NZS 117.
[214] *Crystal Imports Ltd v Certain Underwriters at Lloyd's of London* [2014] NZCA 447.

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the value of the building. The policy provided for cover based on the estimated cost of restoration (C1) and where replacement was to be effected, the actual cost of such replacement (C2), in each case capped at the figure of $1,984,000. On 4 September 2010 the building was damaged by the first Christchurch earthquake. Some repairs were effected, but it was damaged again by a second earthquake on 26 December 2010. Further repairs were effected, but the building became a total loss in a third earthquake on 22 February 2011 (or possibly by a fourth earthquake in June 2011. The policy was not written on an aggregate basis, so that the assured was entitled to recover for the cost of repairs effected after the first and second earthquakes, and also for the ultimate total loss even though the total exceeded the maximum sum insured. However, the assured's claim was for the full cost of repairs after the first and second earthquakes even though those repairs were not and could never be effected. Dobson J held that the assured could not recover for the unrepaired losses, not on the basis of merger but by reason of frustration. Dobson J rejected the application of merger for two reasons: a marine insurer is liable for loss only when the policy terminates and not when the loss occurs; and a marine policy does not contemplate the repair of the subject-matter following its total loss but rather rests on the assumption that the subject-matter will be abandoned to the insurers, so that the policy ceased to be relevant after a total loss, whereas under a non-marine policy the insurers potentially remained on risk after a total loss if the building could be repaired. Dobson J preferred the view that the total loss frustrated any attempt by the insurers to reinstate the house so that there could be no liability to expend money on unrepaired losses following the final earthquake. The *Ridgecrest* decision was appealed, and was resolved in the insurers' favour on basis that the claim under the policy had been made exclusively under C2, which excluded damage that could not be repaired[215] : the Court of Appeal chose to remain silent on the merger point, but stated that it would have rejected the frustration argument on the basis that any implication of a term to that effect would have been inconsistent with the express terms of the policy.

The question was addressed again, in the same context, in *Crystal Imports Ltd v Certain Underwriters at Lloyd's of London*.[216] Here, Cooper J proceeded on the assumption that there had been an unrepaired partial loss caused by an earthquake, followed by total loss as the result of a second earthquake in the same policy period. The Court could see no reason to distinguish between marine and non-marine insurance,[217] and that the question was one of indemnity[218] :

> "In a contract of indemnity the insurer undertakes, as in this case, to indemnify the insured for the loss or damage. Where a building is damaged in one event and totally lost as a consequence of a second event there is an inherent logic in the proposition that the insured can no longer assert that indemnity involves both payment for the destroyed building and the same building in its previously damaged state. It is, I think, no answer to say that in some circumstances the

[215] [2013] NZCA 291.
[216] [2013] NZHC 3513.
[217] Cooper J noted that the basis for the merger rule was unclear, and that it was explicable either by holding that the assured's loss was to be ascertained at the date of the expiry of the policy or that there was an accrued loss which merged into the subsequent total loss.
[218] *Crystal Imports Ltd v Certain Underwriters at Lloyd's of London* [2013] NZHC 3513 at [55].

> application of relevant provisions of the insurance policy will give the insured rather more than a simple indemnity … In simple terms, it is illogical to characterise as an indemnity, payment for the cost of repairs that will never be carried out because the building has been destroyed…
>
> On that basis, the assured was unable to recover for the notional cost of repairing partial damage when that cost had not actually been incurred at the date of the later total loss. The court in *Crystal* went on to reject the frustration argument, pointing out that if the policy was written on a per event basis then it allowed recovery for successive losses and the doctrine of frustration could not intervene to overturn express agreement."

The issue was revisited by the Supreme Court in *Ridgecrest*, and that Court came down decisively against the application of merger in non-marine insurance. The Supreme Court reversed the Court of Appeal's ruling on the interpretation of the policy, holding that C1 and C2 provided cumulative rather than alternative measures of indemnity, so the fact that repairs could not be effected—thereby disapplying C2—did not prevent recovery under C1 following each "happening" in the form of an earthquake. The Supreme Court classified C1 as providing cover for reduction of value, and on that basis if there was any diminution in value by reason of unrepaired damage then the policy provided cover for it.[219] On that construction the policy covered unrepaired losses and the only question was whether the common law doctrine of merger precluded recovery for such losses. On the merger question, the Supreme Court held that there was a clear distinction between marine and non-marine insurance. The Supreme Court construed dicta in the marine merger cases, *Livie v Janson*,[220] *British and Foreign Insurance Co Ltd v Wilson Shipping Co Ltd*[221] and *Kastor Navigation Co Ltd v AGF MAT*[222] as deciding that the cause of action under a marine policy accrues not when the loss occurs but rather when the policy year ends, whereas in non-marine insurance the cause of action accrues as soon as the loss occurs. Applied to the present case, the Supreme Court held that unrepaired damage constituted a loss in the form of diminution in value, and later events could not reduce the assured's right to claim for that accrued loss. The Supreme Court noted that that might lead to "over-cap recovery", in that the total amount recoverable for successive losses could give rise to an aggregate claim in excess of the per happening limit of NZ $1,984,000, but that was the effect of allowing the assured to recover for each happening. The Supreme Court also noted that there was a need to prevent recovery based on "double counting", where there was recovery for the same damage twice, although it is implicit in the Court's reasoning that that was not a possibility on the facts before it because the unrepaired damage losses from the earlier earthquakes were to be classified as claims for diminution in value.[223]

[219] It might be thought that this reasoning is open to doubt. C1 referred to restoration cost, not reduction in value. By focusing on the latter concept, it became straightforward for the Supreme Court to assert that there had been loss to the assured following each earthquake even though repairs had not been, and in the light of later developments could not be, effected.
[220] (1810) 12 East 648.
[221] [1921] 1 AC 188.
[222] [2004] EWCA Civ 277.
[223] On that reasoning it is difficult to see when the "double counting" limit could ever operate.

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The only cap on recovery was that the aggregate sums received did not exceed the replacement cost of the building, as that would have given the assured more than an indemnity.

It is submitted that the decision of the Supreme Court is unsupportable. Although it was certainly said in the early marine cases that the assured had no claim until either repairs had been effected or the policy period had expired, a distinction is to be drawn between the accrual of a cause of action and the right to receive an indemnity. If a policy provides indemnity for repair costs actually incurred, it is plain that there is no right to seek recovery until that has happened, and the marine cases make the point that if the repair costs have not been incurred by the date the policy expires then the assured nevertheless at that date acquires a right to be paid. The termination of the policy thus crystallises the contingent right to be paid. That is quite different from saying that the assured does not have a cause of action at all until the policy has expired. It is indeed plain that that cannot be right: the right to recover repair costs actually incurred shows that there has to be some anterior claim; and it is also settled that the limitation period runs from the date of the insured casualty and that marine insurers become immediately liable to the assured for unliquidated damages as soon as the casualty occurs.[224] The Supreme Court appears to have allided the separate notions of when a cause of action accrues (the casualty) and when the right to be paid crystallises (actual repair or termination of the cover, whichever is earlier), and to reach the conclusion that marine policies do not respond until the end of the policy year. Lord Ellenborogh's comment in *Livie v Janson* that in the gap between partial loss and total loss the assured could not practically have called upon the insurers to make good the loss, taken by the Supreme Court as meaning that the assured had no right to claim for the partial loss in that case, is equally explicable as a recognition of the fact that nothing could as a matter of fact actually have been done in the 12 or so hours between the two events.

Once that distinction is appreciated, the reasoning in *Ridgecrest* is open to serious doubt. That point aside, the outcome in *Ridgecrest* is far from satisfactory. The assured was not insured for the full value of its building, and although it could be said—and was, by the Supreme Court—that the reasoning did not allow the assured to recover more than an indemnity when measured against the actual replacement value of the building, the fact remains that the assured had not insured for the full replacement value but only for a fraction of that value. Further, the policy did not contain an automatic reinstatement clause whereby cover is reinstated for an additional premium following each loss. Despite the fact that such wordings are very common (as discussed below), the Supreme Court effectively implied into the policy a right for the assured to reinstated cover, based only on the use of the word "happening". To say that an assured is entitled to recover losses following a happening (or for that matter, an event, occurrence or peril) should not imply that there is a right to recover repair costs which were not incurred and which ultimately could not be incurred

[224] *Ventouris v Mountain (The Italia Express)* [1992] 2 Lloyd's Rep 281.

The authority of *Ridgecrest* was further shaken within a matter of days, by the decision of the New Zealand Court of Appeal in the joined cases of *QBE Insurance(International) Ltd v Wild South Holdings Ltd And Maxims Fashions Ltd*, *Marriott v Vero Insurance*, and *Crystal Imports Ltd v Certain Underwriters at Lloyd's of London*.[225] The facts of these cases were somewhat different, in that the policies contained automatic reinstatement clauses under which cover was restored to its original sum following a loss. These cases are discussed fully in the next section. However, Miller J, delivering the judgment of the Court of Appeal, noted that the Supreme Court in Ridgecrest had been dealing with a specific policy wording which provided indemnification for diminution in value rather than repair costs, and that the Supreme Court had been concerned only with merger and not with the wider concept of indemnity. The Court of Appeal accepted that the merger principle was foreclosed by *Ridgecrest*, but held that the principle of indemnity survived *Ridgecrest* and was indeed quite separate given that merger applied only to the single situation in which a partial loss was followed by a total loss whereas indemnity applied to all other situations.[226] Therefore, although a partial loss did not merge into a subsequent total loss in the same policy period, the principle of indemnity prevented the assured from recovering for an indemnity based on the costs of repairing a partial loss where such costs could never be incurred by reason of the subsequent loss. Although this reasoning is ingenious, it is not persuasive: merger is, after all, no more than an application of the indemnity principle in the limited situation where a partial and total loss occur in the same policy period. So saying that merger does not apply but indemnity remains in place is to draw a distinction without a difference, The inevitable conclusion is that the decision of the Court of Appeal is on this point in conflict with that of the Supreme Court in *Ridgecrest*. It is submitted that the decision of the Court of Appeal, consistently with the principle of indemnity, is to be preferred, and that *Ridgecrest* is to be confined to the highly unusual wording of the policy in that case.

Further, even if there is possible recovery for successive losses under *Ridgecrest*, the fact that *Ridgecrest* is subject to the overriding principle of indemnity means that the assured cannot recover for repair costs incurred by earlier partial losses if the policy provides for reinstatement rather than market value. That was the situation in *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd*,[227] where the insured building was damaged by successive earthquakes before becoming a total loss. The assured's policy provided for indemnification but without specifying how the indemnity was to be calculated. Dunningham J at first instance held that the building was held for investment purposes, in the form of rental potential, and that the assured had intended to repair the damage caused by the earlier earthquakes but had no interest in repairing damage following the serious damage inflicted by the final earthquake in February 2011 and wished only to realise the best investment return on the building. Accordingly, the indemnity principle held the assured to recovering only the market value of the

[225] [2014] NZCA 447. See also *Morrison and Cross v Vero Insurance New Zealand* [2014] NZHC 2344, affirmed *Vero Insurance New Zealand Ltd v Morrison* [2015] NZCA 246.

[226] Miller J thus noted that merger did not apply to successive total losses (plainly right, but an issue which can arise only in marine insurance, ie, where a constructive total loss is followed by an actual total loss—see below) nor to a total loss after the policy term has expired (also plainly right).

[227] [2015] NZHC 1444, affirmed on other grounds [2016] NZCA 67.

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building following its destruction. There were losses prior to that point, representing the cost of rebuilding, but those losses were "overtaken by events". By contrast, had the assured intended to repair the building following the final earthquake, there would—in accordance with *Ridgecrest* —have been event by event damage, although the principle of indemnity would have capped recovery at the ultimate repair cost. In those circumstances, a later event may reduce the measure of indemnity. As was said by Dunningham J at first instance in *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd*:[228]

> "If a brick wall was damaged in one event, it might be expensive to repair because such repairs are labour intensive. If it was completely destroyed in a subsequent event so that repair was made impossible, it may be cheaper to install a modern equivalent wall if that is permitted by the policy's terms. In those circumstances, the cost of the cheaper option, which becomes available because the wall has been destroyed, would be the maximum measure of the plaintiff's loss."

This reasoning is powerful evidence for the argument that *Ridgecrest* is probably a unique decision, applicable only where the earlier losses are all in the form of diminution of value. If the final loss gives a right of recovery of repair costs, any earlier loss based on notional repair costs is excluded by the indemnity principle insofar as the costs have to be replicated. The outcome is merger in all but name. It may be noted that the Court of Appeal in *Prattley* reached the same conclusion by the alternative route that the primary measure of indemnity under the policy was reinstatement, so that there was no need to consider the intention of the assured or the feasibility of reinstatement. Successive loss issues therefore did not arise.

Further loss after expiry of policy

10.044 *Marine insurance.* Marine principles allow recovery if a total loss, whether insured or uninsured, occurs after the expiry of the policy period in which the partial losses had taken place, the rule being that the assured is entitled to the cost of repairing any damage unrepaired at the date of the termination of the policy. The doctrine of merger thus does not operate once the policy has expired,[229] even though the assured renews with the same insurers. If the frustration approach adopted at first instance in *Ridgecrest* is correct then it is arguable that the assured could not have recovered for repair costs outstanding at the date of termination, in that the subsequent total loss would have frustrated the ability of the insurers to rebuild. That alone demonstrates the problem with reliance on frustration in the present context, and its rejection by the Court of Appeal in *Ridgecrest*, albeit on the narrow ground that the policy expressly dealt with the point, is welcome.

10.045 *Non-marine policies.* Again, there is no obvious reason why marine and non-marine insurance should be treated differently in this respect, and in the absence of wording to the contrary the assured should not lose the right of indemnity if there is further damage after the expiry of the cover. Non-marine policies, particularly on buildings, are written

[228] [2015] NZHC 1444 at [146].

[229] *Lidgett v Secretan* (1871) LR 6 CP 616; *British & Foreign Marine Insurance Co v Wilson Shipping Co Ltd* [1921] 1 AC 188.

on a repair or reinstatement basis, so that if the assured has the right to demand repair or reinstatement of the building, or the cost thereof following the occurrence of an insured peril, and the policy has expired with no repairs having been effected, the assured would appear to have an accrued right to the cost of making good the damage.

It appears to have been common ground in *Ridgecrest NZ Ltd v IAG New Zealand Ltd*[230] and *QBE Insurance (International) Ltd v Wild South Holdings Ltd And Maxims Fashions Ltd, Marriott v Vero Insurance, Crystal Imports Ltd v Certain Underwriters at Lloyd's of London*[231] that the marine rule that post-policy events are to be disregarded holds good in the non-marine context.

The assumption in the Australian authorities is that there is an accrued right to repair or reinstatement at the end of the policy period. Indeed, the cases go a step further and hold that if the cost of repair is increased by events occurring outside the policy period, the insurers' obligations are not discharged. It was said by Barwick CJ in *GIO (NSW) v Atkinson-Leighton Joint Venture*[232] That:

> "In the case of an insurer's promise to indemnify for damage to property, once the circumstances call for its performance by the payment of money, the insurer will be bound to perform and cannot … excuse himself because the costs of his indemnity are greater as the result of some intervening event against which the insured was not insured but which in fact increased the cost of reparation of the property to the pre-damaged condition."

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The point was considered in more detail by the New South Wales Court of Appeal in *CIC Insurance Ltd v Bankstown Football Club Ltd*.[233] Here, the assured's club-house, which was a licensed bar used for gaming activities, was insured under a policy running from 3 December 1991. The policyprovided indemnity in the event of physical loss or destruction. The premises were severely damaged by fire on 8 January 1992. The fire had been deliberately set, and in July 1992 the insurers denied liability on the ground that the arson was a fraudulent act of the assured. Not being able to afford repairs, the premises were boarded up and abandoned. The policy expired in October 1992. There was a second fire on 18 December 1992, but there was only minor damage. On 3 March 1993 there was a third fire, and the damage was such that the premises were ordered to be demolished by the local authority. A claim was made by the assured, seeking the cost of reinstating the premises. A majority of the New South Wales Court of Appeal held that the insurers were liable for the full reinstatement cost. Kirby P, relying upon what had been said by Barwick CJ in *GIO v Atkinson-Leighton Joint Venture*, and also upon the decision in *Lumley General Insurance v Vintix Pty Ltd*, ruled that the insurers had incurred an obligation to reinstate the premises, and they were obliged to do so even though there had been further loss outside the policy period. Powell JA, dissenting, held

[230] [2014] NZSC 117.

[231] [2014] NZCA 447.

[232] (1981) 146 CLR 206 at 219. This was a dissenting judgment, but the point was not discussed by the remainder of the High Court.

[233] (1994) 8 ANZ Insurance Cases 61-232 (Kirby P, Powell JA; Priestley JA dissenting, although his Honour later withdrew his dissent insofar as it conflicted with the orders made).

that the policy required payment of the costs of reinstatement and did not require the insurers to effect reinstatement, so that they could be liable only for the damage caused by the first fire.[234]

Kirby P's reasoning was approved on appeal by the High Court of Australia.[235] The issue of whether the insurers were liable for the subsequent damage caused by the later fire depended upon the construction of the relevant terms of the policy, and on the wording of the basis of settlement clause the insurers were required to pay the cost of reinstatement, or repair at the time of reinstatement, to a condition substantially the same as, but not more extensive than, its condition when new unless the assured opted for reinstatement. The assured did not do so, and it followed that the insurers were liable for reinstatement costs. That obligation accrued at the date of the damage, and subsequent events did not alter the nature or increase the quantum of that obligation.[236]

Reinstatement of cover following loss

10.046 *Nature of reinstatement of cover clauses.* The policy may provide for reinstatement of cover when a loss has occurred. The effect of such a clause is to allow the assured to reinstate the original sum insured under the policy following a loss in those circumstances where the policy provides that the policy's limits of indemnity apply to the aggregate of successive losses. Indeed, the presence of an automatic reinstatement clause necessarily implies that the common law principle that partial losses can exceed the limit of indemnity has been excluded. In that way, successive losses. are covered irrespective of the initial limits of the policy. Very often, reinstatement clauses are stated to be automatic, and operate subject only to the payment by the assured of a reinstatement premium. Insurers do not always insist upon additional premium, and even if they do then it is not always claimed. A typical wording is found in *Annex Developments Ltd v IAG New Zealand Ltd*:[237]

> "After we have paid a claim under this policy, we will reinstate your sum insured. We may ask you to pay an additional premium for this. If we do, you must pay the additional premium."

Three questions arise here: (i) when does reinstatement take place; (ii) how is the premium calculated; and (iii) what are the consequences of non-payment of the premium?

As to the first matter, reinstatement takes place in accordance with the wording of the clause. In *Annex Developments* reinstatement was conditional on payment of the claim. The assured's building was insured against material damage and business interruption

[234] Priestley JA made no finding on the point in view of his conclusion that a further statutory contract arose under the provisions of the Insurance Contracts Act 1984 (Cth) s.58 and accordingly that the insurers were liable for the subsequent damage under that contract.

[235] (1997) 187 CLR 384 (Brennan CJ, Dawson, Toohey, Gummow and Gaudron JJ).

[236] It is of interest to consider what the position would have been had the insurance been renewed with the same or different insurers: on the High Court's reasoning, the first year insurers would be liable for the full loss, but so would the second year insurers: whether contribution operates as between insurers on consecutive years remains an unresolved issue. See para.00.00.

[237] [2017] NZHC 706.

losses, and was damaged by the September 2010 earthquake. Emergency repairs were effected in the sum of $170,388.05 and loss of rent amounting to $59,358.12 was incurred: both sums were paid. Following the February 2011 earthquake the assured made claims for emergency repairs of $145,696.19 and loss of rent of $394,030.17. Neither claim was paid. On 27 April 2011 loss adjusters appointed by the insurers assessed the indemnity value at $4,795,000. The parties subsequently settled all earthquake claims for $9,430,000. Annex subsequently contended that the settlement figure excluded the two unpaid claims and the assessment of 27 April 2011, on the basis that cover reinstated when the claims ought to have been paid and not when they were paid, so that by the time of the settlement Annex was owed those three sums in addition to the amount of the settlement. The Court's view was that the reinstatement clause clearly provided for actual payment, and was not to be read as: "After we have paid or ought to have paid a claim under this policy ..."

As to the second matter, the amount of the premium, the clause may refer to a pro rata premium. That presumably means the proportion of premium measured against the proportion of the sum insured eroded by the loss. If there is no pro rata clause, and no objective means for calculating the premium, then the outcome appears to be an "agreement to agree", which might in principle render the reinstatement clause void for uncertainty.

As to the final matter, if there is nothing in the policy which fixes a time, or which renders payment of the premium a condition precedent to the attachment of the reinstatement, then presumably the common law rule that time is not of the essence will continue to apply. Accordingly, reinstatement remains in place unless and until the expiry of reasonable notice from the insurer for payment to be made, so that if a loss occurs before the premium has been paid the assured would not—absent express policy wording—be deprived of reinstated cover. A failure by the insurer to demand any additional premium presumably amounts to waiver of any right to ask for premium or indeed any obligation to make payment.

Withdrawal of automatic reinstatement by notice. Some automatic reinstatement clauses make provision for withdrawal of reinstatement by notice. The following clauses are illustrative:[238]

> "In the event of a loss for which a claim is payable ... , and in the absence of written notice by QBE or the Insured to the contrary, the amount of insurance cancelled by loss will be automatically reinstated from the date of loss. The Insured undertakes to pay such pro-rata premium at the rate applicable to the item(s) concerned as may be required for the reinstatement."

> "In the absence of written notice by the Insurers or the Insured to the contrary, the amount of insurance cancelled by loss or damage is automatically reinstated as from the date of loss or damage. The Insured undertakes to pay such pro rata

[238] Taken from *Wild South Holdings Ltd v QBE Insurance (International) Ltd* [2013] NZHC 2781.

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not contracts of indemnity, but are agreements under which a fixed sum is payable on death, so that loss of interest is immaterial.

The effect of *Dalby* is that a person may not insure a life if he has no insurable interest at the outset, and if the interest of the policy holder in the life assured is already covered to its full extent by a policy any subsequent policy taken out by him will be struck down by s.64B of the Insurance Ordinance on the ground that he has no insurable interest left to support it.[30] However, subsequent dealings with a policy taken out on interest are permissible. While the *Dalby* decision paved the way for the growth of life assurance as a commercial commodity, in law at least its results are somewhat curious. In the first place, it is difficult to reconcile the notion that life policies are not indemnity contracts with the provision in s.64D of the Insurance Ordinance that the assured cannot recover any more than the amount of his interest. Second, *Dalby* itself involved reinsurance; this class of cover is indemnity and not life. Third, the decision is open to various forms of abuse which sidestep the notions fundamental to insurable interest, namely, that the assured must not gamble or be put into a position whereby it is in his interests to destroy the insured subject matter for the insurance moneys. Thus, assignment or auctioning of policies is permissible, as is the maintenance of insurance once insurable interest has ceased:

> "...the latter may occur in the case of divorced spouses, a key-man policy on a departed employee and a policy by a creditor on a debtor who has paid off his debt or the debt has become statute barred before the death of the life assured."[31]

It was suggested by Langley J at first instance in *Feasey v Sun Life Assurance Corp of Canada*[32] that the effect of s.64B of the Insurance Ordinance was merely to outlaw life policies that were expressed to be payable with or without interest, given that at the time the measure was adopted in England in 1774 it was believed that life policies were contracts of indemnity and accordingly that the common law itself imposed an insurable interest requirement in the form of the prohibition of wagering agreements.[33] Accordingly, unless the parties were wagering (in which case the policy would be void at law) or a claim was payable on a "policy proof of interest" basis (in which case the policy was rendered void by s.1), the policy was unaffected by the Act. The Court of Appeal rejected this analysis,[34] and held that the absence of an intention to wager was not of itself enough to validate a policy.

16.005 **Assignment of policy to person without interest.** Assignment of life policies is permitted by virtue of the rule that insurable interest is required by s.64B of the Insurance Ordinance only at the inception of the policy and not at any later date. There is a fine factual line between the case in which an assured, having taken out a life policy,

[30] *Simcock v Scottish Imperial Insurance Co* (1902) 10 SLT 286. See also *Hebdon v West* (1863) 3 B & S.579.
[31] *Garner v Moore* (1855) 3 Drew 277.
[32] [2002] Lloyd's Rep IR 835.
[33] This suggestion is not, however, wholly borne out by the early authorities, some of which were prepared to enforce wagers.
[34] [2003] Lloyd's Rep IR 637.

determines to assign it to a third person without insurable interest,[35] and the case in which the assured procures an own-life policy with the intention of acting for the benefit of a third person who has no insurable interest. The latter situation, but not the former, is a contravention of s.64B. Pollock CB put the matter thus in *M'Farlane v Royal London Friendly Society*:[36]

> "There is nothing to prevent any person from insuring his own life a hundred times ... provided it is *bona fide* an insurance on his own life, and at the time, for his benefit, and ... there is nothing to prevent him from dealing with such policies by assigning them to someone else ... even though at the time he effected the policies he had the intention of so dealing with them ...
>
> But if *ab initio* the policy effected in the name of A is really and substantially intended for the benefit of B and B only ... that is within the evil and mischief of [the Ordinance]."

What is being said here is that it is legitimate to take out a policy with the general intent of assigning it, but it is unlawful to take out a policy with the intention of assigning it to a specified person who does not have insurable interest. All will turn upon the intention of the assured, which may in practice be almost impossible to ascertain on either an objective or subjective basis.[37] The test is whether the insurance was effected by the party nominally insured at the instance of, and for the benefit of, another without interest who was to pay the premiums, in pursuance of an arrangement between them under which that other was immediately to secure the sole benefit of it, by assignment, bequest or otherwise.[38] Thus, where the assured sold for £5 a policy on his own life for £500, which he had not then taken out, the policy was held to be illegal.[39] But it has been held on the other hand that an insurance company lending money may validly agree with the borrower that he shall insure his life to a greater amount than the debt, and assign the policy to the company as security.[40]

16.006 **Payment of premiums by third party without interest.** There may on occasion be some difficulty in ascertaining exactly who is interested in a policy where the policy purports to be an own-life policy but the premiums have been paid by a third party. In *Wainwright v Bland*,[41] a policy was taken out by one Miss Abercrombey, and on her death her personal representative claimed the insurance money. The insurers pleaded that this was in truth an insurance by the plaintiff for his own benefit, evidenced by the

[35] For a description of commercial purchasing of life policies see the facts of *Goshawk Dedicated Ltd v Tyser & Co Ltd* [2007] Lloyd's Rep IR 224, in which the purchasers of life policies themselves insured against the risk that the outstanding premiums payable by them would be greater than the sums recoverable under the policies.
[36] (1886) 2 TLR 755 at 756.
[37] See the facts of *M'Farlane* itself, and *cf Brewster v National Life Insurance Society* (1892) 8 TLR 648. In both cases the assured was held not to have intended at the outset to take out an own-life policy for the specific benefit of a third person.
[38] *Shilling v Accidental Death* (1858) 1 F & F 116. See *Patel v Windsor Life Assurance Co Ltd* [2008] Lloyd's Rep IR 359, in which the plaintiff took assignments of policies on the life of one B before they were even issued, and even though there was no evidence of any insurable interest possessed by the plaintiff. No question of insurable interest was raised by the insurers, although the policy was avoided for fraudulent misrepresentation and also for doubts as to whether B had actually died before a claim had been made.
[39] *Macdonald v National Mutual Life of Australasia* (1906) 14 SLT 173.
[40] *Downs v Green* (1844) 12 M & W 481.
[41] (1835) 1 Mood & R 481.

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fact that there was some doubt as to whether Miss Abercrombey could herself have afforded the premiums. The jury was directed that Miss Abercrombey's impecuniosity was not of itself conclusive, as the plaintiff might have loaned her the money; the policy might thus properly have been regarded as one by Miss Abercrombey on her own life. It will thus be a question of fact as to whether the premiums have been loaned or given to the assured or whether they have been paid by the third party for his own purposes. Where the payer is the parent or spouse of the life assured, the law assumes that the payment is a gift,[42] but in other cases matters may not be so straightforward.

16.007 **Insertion of names of interested persons.** The Insurance Ordinance, s.64C(1) provides that:

> ... no contract of insurance shall be entered into on the life of any person or other event without inserting in the contract the name of the person –
>
> (a) interested in the life or event; or
>
> (b) for whose use or benefit or on whose account the contract is entered into.

Under s.64C(1), a contract of insurance entered into in contravention of subs (1) is void by reason of that contravention. This provision is designed to prevent evasion of s.64B of the Insurance Ordinance by the device of making of what appear to be own-life policies but which are in fact for the benefit of some other person without insurable interest; s.64C(1) requires the name of that other person to be inserted. It is probable that s.64C adds nothing to s.64B in this regard, for in the situation outlined above the policy would in any event fall foul of s.64B. Thus, the leading authorities on s.64C all involve circumstances in which s.64B itself had been infringed.[43] Where s.64C does have some independent impact is the case in which the true assured under the policy does have an insurable interest in the life in question, so that s.64C has not been infringed, but for some reason the name of the true assured has not been inserted into the policy.[44]

One of the most important problems surrounding the operation of s.64C has been removed by s.64C(3). The problem was that it was impossible for an employer to organise a group life scheme providing insurance for present and future employees, as the requirement that the names of all persons within the scheme had to be inserted into the master policy could not be complied with. For this reason, s.64C(3) provides as follows:

> (3) Subsections (1) and (2) shall not invalidate a contract of insurance for the benefit of unnamed persons from time to time falling within a specified class or description if the class or description is stated in the contract with sufficient particularity to make it possible to establish the identity of all persons who at any given time are entitled to benefit under the contract.[45]

Further, s.64C caused difficulties in respect of policies on property, but the decision in *Mark Rowlands Ltd v Berni Inns Ltd*[46] has now confirmed that the insurable interest rules in the Insurance OrdinanceInsurance Ordinance do not extend beyond non-indemnity insurance.[47]

16.008 **Amount recoverable.** Section 64D of the Insurance Ordinance provides as follows:

> Where the insured under a contract of insurance has an interest in a life or event, no greater sum shall be recovered from the insurer under the contract than the amount of value of the interest of the insured in that life or event.

This provision does not stand easily alongside the principles that life insurance is not indemnity insurance and that the assured need not prove loss at the date of the death of the life assured, the agreed sum being payable on the occurrence of the contingent event. Reconciliation of these rules would appear to give rise to the following results:

(1) Where there is an unlimited insurable interest, as in the cases of own-life insurance and of insurance by one spouse on the life of the other, s.3 has no application and the sum insured may be recovered;

(2) Where the assured has a limited insurable interest in the life assured, as in the cases of financial dependence within families and of "key-man" insurance by an employer on the life of an employee, the assured may not recover more than the amount of his interest measured at the inception of the policy. Where, therefore, a policy was taken out to the full value of the assured's insurable interest, a subsequent policy was void.[48] As life policies are always in the form of an agreement by the insurer to pay a stated sum on the death of the life assured, and are thus quasi-valued policies, the sum agreed between the parties is conclusive of the value of the assured's initial interest unless there is some fraud on the assured's part or the sum insured is so grossly excessive as to amount to a wager, contrary to s.1. It cannot be the proper test of indemnity

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[42] *Crabb v Crabb* (1834) 1 My & K 511; *Moate v Moate* [1948] 2 All ER 486; *Shepherd v Cartwright* [1955] AC 481; *Pettitt v Pettitt* [1970] AC 777.

[43] *Wainwright v Bland* (1835) 1 Mood & R 481; *Shilling v Accidental Death* (1858) 1 F & F 116; *Downs v Green* (1844) 12 M & W 481.

[44] *Evans v Bignold* (1859) LR 4 QB 622; *Forgan v Pearl Life Assurance Co* (1907) 51 SJ 230.

[45] In *Feasey v Sun Life Assurance Corp of Canada* [2003] Lloyd's Rep IR 637, it was noted that this provision would be pointless had s.64B independently outlawed a policy under which the persons insured were not identified.

[46] [1985] 3 All ER 473.

[47] The difficulties in relation to land concerned the inability of the assured to insure his own interest and that of another person without inserting the name of that other person. The insurable interest provisions of the Insurance Ordinance have never applied to goods and merchandises, which are expressly excluded by s.64E. This exemption has been used by the courts to uphold motor policies providing liability cover for persons driving with the assured's permission. Identification of such drivers from the outset clearly being impossible (such policies have been classified as goods rather than liability policies) and to uphold a group policy insuring personal effects of a number of a group of trade union members, cash having been regarded as "goods" for its purposes; see *Prudential Staff Union v Hall* [1947] 1 KB 685.

[48] *Hebdon v West* (1863) 3 B & S 379, as explained by the Court of Appeal in *Feasey v Sun Life Assurance* [2003] Lloyd's Rep IR 637.

to measure interest at the date of death, for that would introduce an indemnity element into life insurance, the existence of which was denied in the *Dalby* decision;

(3) Where the interest consists of a debt owing to the assured that debt need not be made up in full at the time the insurance is taken out, so that where A was obliged to maintain B and entitled to be repaid the maintenance money, it was held that his insurable interest extended to each sum of money as it was successively expended[49] and not merely to sums already expended at the time the policy was taken out.

Consequences of lack of insurable interest

16.009 *General rule; illegality of contracts.* Section 64B of the Insurance Ordinance does not stipulate the legal consequences of a contract falling within its terms being made without interest, other than in providing that "no insurance shall be made" and that any contravening policy is to be "null and void". *Prima facie* it might be thought that failure to refer to illegality in s.64B implies that the contract is merely void. The difference between a contract of insurance which is simply void and one which is illegal concerns not its enforcement, but the availability of restitution of premiums: under a void contract premiums are recoverable for a total failure of consideration,[50] but under an illegal contract the maxim *in pari delicto potior est conditio defendentis* prevents a restitutionary action on the basis that the plaintiff cannot mount his action without pleading his own illegality.[51] In *Harse v Pearl Life Assurance Co*,[52] the assured, having paid premiums under a policy on the life of his mother suggested to him by the insurer's agent, was held on her death not to be able to recover either the sum insured or the premiums. In the view of the Court of Appeal, the wording of s.1 was sufficiently indicative of an intention to impose the illegality sanction to life insurances without interest. The law has, however, been transformed by the decision of the Supreme Court in *Patel v Mirza*.[53] There is no longer a general rule that illegality bars restitution, and the court may allow a return of premiums despite the illegality, taking into account the purpose of the illegality, public policy and proportionality. It is almost certain that disallowing recovery of premiums for illegality under the Insurance Ordinance would be a disproportionate response, and probably also one inconsistent with the purpose of the legislation. Before *Patel v Mirza* the courts had developed a series of exceptions to the in pari delicto principle, none of which remain relevant in the light of that decision.

16.010 *Inequality of guilt.* First, return of premiums was allowed where the insurer bore a greater degree of responsibility for the illegality than the assured, as where the insurer's agent was responsible for the making of the contract. The trend of cases before *Patel v Mirza* was to be generous to a person who had been induced to enter into an illegal contract.[54] However, a harsher view had been taken in insurance cases. In *Harse v Pearl*

[49] *Barnes v London Edinburgh & Glasgow Life Assurance Co* [1892] 1 QB 864, 867, *per* AL Smith J.

[50] Marine Insurance Ordinance, s.84(1), although recovery is denied where the policy was made by way of gaming or wagering: s.84(3)(c).

[51] Cases decided under the English Marine Insurance Act 1745, which provided for illegality in respect of want of interest, demonstrate the point: *Andree v Fletcher* (1789) 3 TR 266; *Morck v Abel* (1802) 3 Bos & P 35; *Lubbock v Potts* (1806) 7 East 449; *Allkins v Jupe* (1875) LR 2 CP 375.

[52] [1904] 1 KB 558.

[53] [2016] UKSC 42.

[54] *Kiriri Cotton Co Ltd v Dewani* [1960] AC 192; *Re Cavalier Insurance Co Ltd* [1989] 2 Lloyds Rep 430.

Life Assurance Co itself the Court of Appeal was unimpressed by the assured's argument that the policy had been induced by the insurer's agent, for it went on to hold that in the absence of some form of fraud by the agent, he was not to be expected to have any better knowledge of the law than the assured, so that the parties remained equally guilty. In practice, inequality of guilt proved hard to demonstrate.[55] After *Patel v Mirza* it is likely to be very difficult for an insurer to argue that it should retain the benefits of an illegal contract entered into by an improperly trained agent.

16.011 *Repentance.* Secondly, where an illegal contract was executory, the law permitted the innocent party to repent of the unlawful purpose and to claim restitution of any property transferred by him to the other. The exception, which appears to derive from the judgment of Buller J in *Lowry v Bordieu*,[56] a marine insurance decision, led to intricate case law on two issues. The first was whether there had to be repentance, and doubts remained as to whether the claimant must genuinely have had a change of heart or whether the fact that he wished to withdraw—whether for moral or commercial reasons—was enough. In *Tribe v Tribe*[57] the Court of Appeal adopted the genuine repentance test. The second was the point at which the contract ceased to be executory. In the only life insurance case in which Buller J's exception was considered, *Howard v Refuge Friendly Society*,[58] the argument that the contract remained executory until the death of the life assured was rejected by the court, which appears to have decided that repentance is not possible once the premium has been paid.

16.012 *Mistake.* Thirdly, restitution was possible where a party to an unlawful contract was under a mistake of fact that, if it had been correct, would have led to the contract being lawful.[59] This principle seems to underlie *British Workman's Assurance Society v Cunliffe*.[60] The policy was unlawful as it involved the insurance of subject matter belonging to an enemy alien, but the court nevertheless permitted recovery of the premiums on the ground that the assured had been unaware at the date of the policy that war had been declared In *Kleinwort Benson Ltd v Lincoln City Council*[61] the House of Lords removed the old distinction between mistake of fact and mistake of law, and held that restitution is possible in both situations. This exception is no longer needed.

Examples of insurable interest in lives: personal and family relationships

16.013 *Own life.* The assured is conclusively presumed to have an unlimited insurable interest in his or her own life,[62] and this is the case even if the insurance is for a portion only of his life.[63] The nature of that interest is a matter of some controversy and becomes

[55] *Phillips v Royal London Mutual* (1911) 105 LT 136; *Elson v Crooks* (1912) 106 LT 462; *Howarth v Pioneer Life* (1912) 107 LT 155; *Goldstein v Salvation Army Assurance Society* [1917] 2 KB 291. But contrast the decision of the Court of Appeal in *Hughes v Liverpool Victoria Friendly Society* [1916] 2 KB 482, in which the assured was persuaded by an agent of the insurer to reinstate life policies which had previously been validly held by a third person but which had lapsed. The court here found that the agent had acted fraudulently, in the knowledge that the policies would be illegal, and restitution was permitted.

[56] (1780) 2 Doug KB 468.

[57] [1995] 4 All ER 236.

[58] (1886) 54 LT 644.

[59] *Oom v Bruce* (1810) 12 East 225; *Hentig v Staniforth* (1816) 5 M. & S. 122.

[60] (1902) 18 TLR 425 affirmed (1902) 18 TLR 502. See also *Phillips v Royal London Mutual* (1911) 105 LT 136.

[61] [1998] 4 All ER 513.

[62] *Wainwright v Bland* (1835) 1 Mood & R 481.

[63] *Wainwright v Bland* (1835) 1 Mood & R 481.

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important to determine where the assured has for some reason been deprived of the benefit of the policy.[64] In *McLellan v Fletcher*,[65] the assured's interest was classified as pecuniary. In that case the plaintiff's solicitors had negligently failed to procure a life policy, and on the plaintiff's death his personal representatives brought an action against the solicitors seeking to recover from them the amount which would have been payable under the policy, minus the premiums which would have been payable. Lincoln J allowed the action, on the basis that the assured had lost his contingent pecuniary interest in the policy. A different view was taken by Phillips J, on similar facts, in *Lynne v Gordon, Doctors & Walton*,[66] the court ruling that an assured's interest in his own life could not be classified as pecuniary so that it could not be said that depriving him of the benefit of a life policy caused him a pecuniary loss. Phillips J also rejected an alternative argument that, had the plaintiff successfully procured a life policy during his lifetime, it would have increased in value, so that a loss would have been suffered during the plaintiff's lifetime.

16.014 *Spouses*. A husband is presumed to have an unlimited insurable interest in his wife's life,[67] and a wife is presumed to have an unlimited insurable interest in her husband's life.[68] The reciprocal rights and duties created by the marriage tie are alone sufficient to support both interests,[69] irrespective of their pecuniary relationship.[70] In both cases the presumption is conclusive. Thus, evidence to show that either husband or wife stands to gain by the death of the other is inadmissible in rebuttal of this presumption.

The above rules are supplemented by the Married Person Status Ordinance (Cap.182), s.13.[71] The section reads as follows:

> (1) This section applies to a policy of assurance or endowment expressed to be for the benefit of, or by its express terms purporting to confer a benefit upon, the wife, husband or child of the insured.
>
> (2) The policy shall create a trust in favour of the objects therein named.
>
> (3) The moneys payable under the policy shall not, so long as any part of the trust remains unperformed, form part of the estate of the insured or be subject to his or her debts.
>
> (4) If it is proved that the policy was effected and the premiums paid with intent to defraud the creditors of the insured, they shall be entitled to receive, out of the moneys payable under the policy, a sum equal to the premiums so paid.
>
> (5) The insured may by the policy, or by any memorandum under his or her hand, appoint a trustee or trustees of the moneys payable under the policy, and from time to time appoint a new trustee or new trustees thereof, and may make provision for the appointment of a new trustee or new trustees thereof, and for the investment of the moneys payable under any such policy.
>
> (6) In default of any such appointment of a trustee, such policy, immediately on its being effected, shall vest in the insured and his or her legal personal representatives, in trust for the purposes aforesaid.
>
> (7) The receipt of a trustee or trustees duly appointed, or in default of any such appointment, or in default of notice to the insurer, the receipt of the legal personal representative of the insured, shall be a discharge to the insurer for the sum secured by the policy, or for the value thereof, in whole or in part.

The effect of this section is that a policy taken out by a husband for the benefit of his wife or children, or by a wife for the benefit of her husband or children, creates a statutory trust of the policy in the hands of his or her executors, free of debts. This is significant because a trust is created even though the ordinary requirements for the making of an express trust are not satisfied: providing that the policy is "expressed to be for the benefit of" a spouse or child, there is no need for a formal declaration of trust. The section does not apply to joint names policies,[72] nor does it confer rights upon divorced spouses,[73] although it does extend to all forms of life and accident insurance so that it is irrelevant that benefits are payable on events other than death[74] and the children of existing and previous marriages may benefit from the trust.[75] It is immaterial that other beneficiaries are named,[76] and that the benefits provided under the trust are contingent.[77] Where a statutory trust operates, the beneficiaries acquire an immediate vested interest in the proceeds of the policy as soon as it is taken out, so that on the death of any beneficiary that interest passes to his or her estate rather than reverting to the assured's own estate.[78] A policy which includes the name of the spouse under the list of beneficiaries is "expressed" to be for the benefit of the spouse.[79]

The statutory trust may fail where it can be shown that its object was to defraud creditors: this is specifically stated s.13(4). Further, if one spouse is guilty of murdering the other, the statutory trust is ousted as the murderer is unable to obtain any benefit from the crime. In such a case, there is a resulting trust of the proceeds of the policy for the deceased's estate.[80]

The beneficiary under a policy governed by s.13 is not given a direct claim against insurers. That right vests only in the trustee appointed by the assured under s.13(5), and

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[64] Where the unexpired term of a life policy is lost through the insolvency of the insurer, statutory valuation principles apply.
[65] (1987) 3 PN 202.
[66] (unrep., *The Times*, 17 June 1991).
[67] *Griffiths v Fleming* [1909] 1 KB 805, although only Vaughan Williams LJ was prepared to so hold. The husband's insurable interest was not questioned in *Murphy v Murphy* [2004] Lloyd's Rep IR 744.
[68] *Reed v Royal Exchange Assurance Co* (1975) Peake Add Cas 70; *Murphy v Murphy* [2004] Lloyd's Rep IR 744.
[69] Manning J in *Rombach v Piedmont Life* (1883) 48 Am Rep 239.
[70] Kennedy LJ in *Griffiths v Fleming* [1909] 1 KB 805, 820–823.
[71] Based on the English Married Women's Property Act 1882, s.11, which was passed to reverse the common law rule that a woman had no capacity to contract in her own right *Cahill v Cahill* (1883) LR 8 App Cas 420.

[72] And not a joint names policy; *Griffiths v Fleming* [1909] 1 KB 805.
[73] *Re Browne* [1903] 1 Ch 188.
[74] *Re Gladitz* [1937] Ch 588; *He Xianna v Yip Tsz Bun* [2015] HKDC 1116 (group life policy covering total and permanent disablement as well as death).
[75] *Re Davies* [1892] 1 Ch 90; *Re Griffiths* [1903] 1 Ch 739.
[76] *Re Clay* [1937] 2 All ER 548.
[77] *Equitable Life Assurance of the United States v Mitchell* (1911) 27 TLR 213; *Re Iokanides* [1925] 1 Ch 403; *Re Fleetwood* [1926] Ch 48; *He Xianna v Yip Tsz Bun* [2015] HKDC 1116.
[78] *Cousins v Sun Life Assurance Co* [1933] Ch 126.
[79] *Lim Lina v Estate of Quick Cheng Gee* [2011] SGHC 267.
[80] *Cleaver v Mutual Reserve Fund Life Association* [1892] 1 QB 147.

in default of such appointment the claim must be brought by the assured's personal representatives under s.13(6).[81]

16.015 *Parents and children.* The common law rule that a parent has no insurable interest in a child[82] in the absence of proof of pecuniary interest[83] has been reversed in law by s.64A of the Insurance Ordinance. Grandparents, by contrast, so do not have a presumptive insurable interest in the lives of grandchildren, although they can insure on proof of pecuniary interest. It remains the case that a child does not have a presumptive insurable interest in the life of a parent. Thus, an adult son was held to have no insurable interest in the life of his pauper father whom he supported,[84] and a son was held to have no interest in the life of his mother, whom he supported, even though she in fact performed the duties of housekeeper for him.[85] But an infant child entitled to be supported by his parents[86] would no doubt have an insurable interest in the life of both of them. An illegitimate child has no greater interest in the life of its mother than one born in wedlock.[87]

16.016 *Funeral expenses.* It has been debated how far one has an insurable interest on the life of another on account of the expenses of burying him. Since every householder in whose house a dead body lies is bound by common law to inter the body decently,[88] it would seem to follow that he has an insurable interest in the lives of those living with him.[89]

16.017 *Other family relationships.* In all other cases involving family relationships there is no presumption of any insurable interest, and some sort of financial reliance must be shown. The general rule relating to relatives is that where one relative, who effects an insurance on the life of another, is so related to that other as to have against him a claim for support enforceable by law, the relationship gives an insurable interest. But natural love and affection arising out of kinship, however close, does not by itself do so and unless there is some pecuniary interest enforceable by law, one relative cannot validly insure the life of another. Thus, a family relationship such as brother or sister, does not give rise to insurable interest.[90]

Insurable interest in lives: business relationships

16.018 *Partners.* Partners have an insurable interest in each other's lives up to the amount of loss which might potentially be caused following withdrawal of capital in the event of the death or retirement of a partner.[91]

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81 *Chan Mei Chi v Ing Life Insurance Co (Bermuda) Ltd* (unrep., 2003, HKDC).
82 *Halford v Kymer* (1830) 10 B & C 724; *A-G v Murray* [1904] 1 KB 165. That is the case irrespective of the sum expended on the child's education: *Worthington v Curtis* (1876) LR 1 Ch D 419, 423, *per* Mellish LJ.
83 *Law v London Indisputable Life Insurance Policy Co* (1855) 1 K & J 223.
84 *Shilling v Accidental Death* (1858) 1 F & F 116. See also *Howard v Refuge Friendly Society* (1886) 54 LT 644, 646; *Elson v Crookes* (1911) 106 LT 462; *Shilling v Accidental Death* (1858) 1 F & F 116.
85 *Harse v Pearl Life Assurance Co* [1903] 2 KB 92. See also *Goldstein v Salvation Army* [1917] 2 KB 291.
86 See AL Smith J in *Barnes v London, Edinburgh & Glasgow Life Assurance Co* [1892] 1 QB 864, 866.
87 *Re Swainbank and Co-operative Insurance* [1953] 1 AC 29.
88 *R v Stewart* (1840) 12 Ad & El 773.
89 Phillimore LJ in *Tofts v Pearl* [1915] 1 KB 189, 194.
90 *British Workman's Assurance v Cunliffe* (1902) 18 TLR 502. See generally: *Howard v Refuge Friendly Society* (1886) 54 LT 644; *Elson v Crooks* (1912) 106 LT 462; *Evanson v Crooks* (1912) 106 LT 264.
91 *Griffiths v Fleming* [1909] 1 KB 805.

16.019 *Employer and employee.* An employee may insure the life of his employer, but his insurable interest is limited to a sum representing his contractual rights against the employer, namely the minimum notice period or the amount of the unexpired term of a fixed-term contract.[92] Insurance for any greater sum is on an expectation and is thus wagering. Conversely, an employer has an insurable interest in the life of his employees. It would seem as a matter of strict law that any such interest is limited to the duration of the notice period or unexpired part of a fixed-term agreement, as anything beyond that is a mere expectation.[93] This is, however, a clearly unrealistic approach to measuring the value of an employee as it omits a variety of factors, the most important of which is the cost of training a new employee to the same levels of skill and competence. Consequently, it has become the practice for insurers to issue key-man policies on senior employees; these are in effect valued policies, the insurer agreeing to pay the agreed sum on the death or retirement of the employee. Such policies have never been challenged as unlawful and it has been held that it is legitimate to insure a senior employee for the full value of his actual worth to the employer.[94]

16.020 *Creditor and debtor.* A creditor may insure the life of his debtor for the amount of the debt,[95] although he may not insure the general assets of the debtor over which he holds no security.[96] The creditor must have some right against the thing itself, such as a right in rem against a vessel,[97] in order to support an insurance of it. There is nothing, however, to prevent the creditor insuring against the insolvency of the debtor caused by the loss of the debtor's assets,[98] or against default in payment.

A mere expectation that a creditor will not call in a debt during the creditor's lifetime does not give the debtor an insurable interest in the creditor's life.[99]

A creditor has an insurable interest in the life of any other person whose death will or may take away from the creditor some security which, but for the death, would have been available to satisfy the debt.[100] So also a surety has an insurable interest in the life of his co-surety to the extent of the co-surety's proportion of the debt,[101] and also in the life of the principal debtor,[102] and a joint debtor has an insurable interest in the life of the other joint debtor.[103] A creditor has an insurable interest in any property of his debtor over which he has a lien[104] or similar interest[105] or which has been mortgaged to

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92 *Hebdon v West* (1863) 3 B & S 579.
93 *Simcock v Scottish Imperial Insurance Co* (1902) 10 SLT 286; *Turnbull & Co v Scottish Provident Institution* (1896) 34 SLR 146.
94 *Fuji Finance Ltd v Aetna Insurance Co Ltd* [1996] 4 All ER 608.
95 *Anderson v Edie* (1795) 2 Park 14; *Lindenau v Desborough* (1828) 8 B & C 586; *Law v London Indisputable Life* (1855) 1 Kay & J 223; *Branfoot v Saunders* (1877) 25 WR 650 (co-debtors); *Ingo International Ltd v Canadian Eastern Life Assurance Ltd* (unrep., HCA 19675/1999, 4 May 2005).
96 Buller J in *Wolff v Horncastle* (1798) 1 Bos & P 316; *Stainbank v Penning* (1851) 11 CB 51; *Macaura v Northern Assurance* [1925] AC 619.
97 Walton J in *Moran, Galloway & Co v Uzielli* (1905) 2 KB 555.
98 *Waterkeyn v Eagle Star* (1920) 5 Ll LR 42, 43, *per* Greer J.
99 *Hebdon v West* (1863) 3 B & S 579. See also *Lea v Hinton* (1854) 5 De GM & G 823 (surety in life of debtor).
100 *Henson v Blackwell* (1845) 4 Hare 434.
101 *Branfoot v Saunders* (1877) 25 WR 650.
102 *Lea v Hinton* (1854) 4 De GM & G 823.
103 *Davitt v Titcumb* [1989] 3 All ER 417; *Dunbar v Plant* [1997] 4 All ER 289.
104 Buller J in *Wolff v Horncastle* (1798) 1 Bos & P 316 at 323; Walton J in *Moran, Galloway & Co v Uzielli* (1905) 2 KB 555, 562, 563.

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him to secure payment of the debt, and it makes no difference whether or not the debtor has insured such property.[106]

16.021 *Liability to indemnify third party for death or personal injury.* It is an obvious proposition that a liability insurer has insurable interest in his liability to the assured, so as to support a reinsurance. In *Feasey v Sun Life Assurance Co of Canada*,[107] the insurer's insurable interest was expressed by the policy to be in the lives of employees and other persons injured who might make claims against the assured. The Court of Appeal by a majority held that there was no objection to the insurer's insurable interest being classified as a contingent one on the lives of the assured's employees rather than as a simple liability cover. The majority approach was that the policy was not simply a life policy under which the P&I club was to receive a fixed sum in the event of the death or injury of an employee, but rather was designed as a policy that covered the Club for losses that it would suffer as an insurer of its members' liabilities over a three-year period. In those circumstances the Club had a clear insurable interest capable of pecuniary evaluation, and the policy itself was capable of being construed as covering that interest. Ward LJ's dissent was based on the argument that the policy was a life policy and could not extend to cover the Club's own insurable interest, which was confined to its own liability.

Reform of the law

16.022 In December 2011 the English and Scottish Law Commissions published a Consultation Paper, *Reform of Insurance Law*. The 2011 Document confirmed the importance of insurable interest, noting that the concept was important in order to draw a clear distinction between gambling and insurance, to protect insurers from moral hazard in the form of deliberate destruction of insured subject matter and to establish a link between the insured subject matter and the jurisdiction which regulates and taxes the insurance.

In April 2015 the English Law Commission, following consultation, published proposals on the reform of insurable interest. Those proposals were given draft statutory effect by the Insurable Interest Bill 2016, published in April 2016. The proposals for life and accident insurance repeal the UK equivalent of the insurable interest rules in the Insurance Ordinance and replace them with a consolidated and more up to date regime.

First, there is a suggested new concept of "life-related insurance", defined by cl.1 of the 2016 Bill as meaning "a contract of insurance under which the insured event is the death, injury, ill-health or incapacity of an individual, or the life of an individual continuing". As explained in paras 1.4 to 1.11 of the accompanying explanatory notes, the definition is intended to bring all forms of life and accident insurance within the life regime, including insurance-linked investment products and annuities as discussed in paras 2.28 to 2.31 of the accompanying notes.

[105] *Briggs v Merchant Traders' Association* (1849) LR 13 QB 167.
[106] Lord Halsbury LC in *Westminster Fire v Glasgow Provident* (1888) LR 13 App Cas 699, 709.
[107] [2003] Lloyd's Rep IR 637.

Secondly, the requirement for insurable interest at the date of the policy—although not at the date of the life assured's death—is retained. However, by cl.2(1) of the 2016 Bill, the sanction of illegality is removed and instead the contract is merely void. That means that the premium will generally be recoverable if the policyholder proves not to have had insurable interest. However, there is a restriction on premium recovery in cl.4. By cl.4(1), if the policyholder under a non-consumer policy makes an untrue statement about the insurable interest concerned and does so knowing that the statement is untrue or not caring whether or not it is untrue, the premium is irrecoverable. In the case of a consumer policy (including a policy which is subsequently assigned to a business), cl.4(2) disapplies the prohibition on recovery of premium in cl.4(1) and allows the court to order return of premium to the extent that it would be unfair to the policyholder if the insurer was to retain the premiums.

Thirdly, there is no exhaustive definition of insurable interest, but cl.2(2) lists a series of cases where insurable interest is deemed to exist. These are stated by the Law Commission in para 2.8 of the accompanying explanatory notes to be based on the current law, but with some extensions.

(a) The individual is the insured. The principle that an individual has an unlimited interest in his or her own life is thus retained.

(b) The individual is, or is treated as, the child or grandchild of the insured. This is a change to the law, which recognised insurable interest only on proof of some economic interest. Earlier proposals had toyed with the ideas of imposing a statutory cap on the sum insured and a minimum age of 18, but those restrictions have been abandoned and parents are to have an unlimited right to insure their children above and beyond funeral and bereavement costs. As the Law Commission commented in para 2.14 of the explanatory notes, insurability will become a question for the market. The Law Commission has rejected the converse possibility that a child should have an automatic insurable interest in parents or grandparents, e.g., in respect of the costs of long-term care, commenting in paras 2.23 to 2.27 of the accompanying notes that there are moral hazard issues where policies may be taken out on the lives of vulnerable people. However, it remains possible for insurance to be taken out under point (f) below where the necessary economic need can be shown.

(c) The individual is the spouse or civil partner of the insured or lives with the insured as a spouse or civil partner. This modifies the existing law in that any form of cohabitation is to suffice: a previous suggestion for a 5 year period of cohabitation was abandoned as arbitrary. It will thus be for the courts to determine whether there is true cohabition for the purposes of the Bill.

(d) The individual is a member of a pension or other group scheme and the insured is a trustee of the scheme. The effect is that a group policy may lawfully be taken out by a trustee for the benefit of employees or other group members. Such policies have long been taken out, and the provision is designed to remove any uncertainty as to their legal status.

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(e) The contract is for the benefit of the individual, or a nominee of the individual. This provision confers upon an employer an unlimited interest in the lives of its employees when entering into a group scheme whose purpose is to provide benefits for its employees or their families.

(f) There is a reasonable prospect that the insured will suffer economic loss if the insured event occurs. This is a catch-all provision, picking up cases where there is no insurable interest under (a)-(e) above but where economic benefit can be shown. There is no change in the law here, as the validity of policies on key employees and by debtors on co-debtors and creditors, or by creditors on debtors has long been recognised. As under the previous law, family relationships resting not on mutual love and affection but on economic dependency will give rise to insurable interest even though the family relationship taken alone would not. The "reasonable prospect" test in the 2016 Bill is more generous than the earlier suggestion that there had to be a "real probability" that economic loss would be suffered, an approach which emerged during the consultation process.

The Insurable Interest Bill does not impose a statutory limit on the amount for which the policyholder may obtain insurance over the life insured. This marks a change from the earlier suggestion that there should be a reasonable assessment of value. The Law Commission thought that that was often not possible.

3. Assignment of Life Policies

16.023 **Assignability.** Life policies are to be considered something more than contracts. They are choses in action[108] and are treated as securities for money[109] payable at an uncertain but future date which is bound to occur. Apart from the operation of an excepted peril, the insurers will be bound to pay the sum insured at some date, and the original contract is therefore to be considered as the purchase of a reversionary sum in consideration of the payment of an annuity.[110] Even the present "surrender" value of the policy is computable actuarially. Insurance offices will usually accept surrender for such a consideration, and banks will therefore lend money on it to this amount. If a life policy is in the possession of a third party on the death of the assured, his personal representatives can maintain an action against the third party to recover possession of it.[111] If the insurance is upon the assured's own life, the right to the policy moneys will devolve on his personal representatives on his death, who will be bound to treat it as money owing to him and forming part of his estate.[112]

Life policies are freely assignable whether they are expressed to be payable to the assigns of the assured[113] or not.[114] The assignment may take the form of sale, mortgage,

[108] *Re Moore* (1878) 8 Ch D 519.
[109] *Stokoe v Cowan* (1861) 4 LT 675, 685.
[110] *Fryer v Morland* (1876) 3 Ch D 675, 685; *Re Harrison and Ingram Ex p Whinney* [1900] 2 QB 710, 718.
[111] *Rummens v Hare* (1876) 1 Ex D 169.
[112] *Petty v Wilson* (1869) LR 4 Ch 574.
[113] *Williams v Thorp* (1828) 2 Sim 257.

settlement or gift. An assignment passes a right to the insurance moneys whether or not the assignor[115] or the assignee[116] has an insurable interest in the life assured, provided that the assurance was valid in the first place. The free assignability of a life policy thus means that the assignee is able to recover under it following the death of the life assured or the occurrence of the event specified in the policy merely on proof that he is the assignee.[117] The general law imposes only one limitation on the assignability of life policies, which is that assignment may not be used as a method of overcoming the rule in s.64B of the Insurance Ordinance. To this end, the courts have established the rule that a policy is void if it is taken out by a person having insurable interest with the immediate intention of assigning the policy to a specific person without insurable interest. By contrast, the policy is valid if the assured simply has a general intention to assign in the future, or if the intention to assign to a specified person is formed at some later date.[118]

The right of the assured to deal with the policy as he chooses is subject to any condition in the policy to the contrary. The policy may permit assignment only with the consent of the insurer or by means of a specified procedure, so that an assignment in breach of those provisions is of no effect. In *Leung Wai Ming v Massmutal Asia Ltd*[119] T purchased a life policy which included critical illness cover. Some years later she transferred the policy to her son L, but did not complete the policy formalities for assignment. L subsequently surrendered the policy for cash value. T died soon afterwards and a claim for critical illness was brought on her behalf, based on medical evidence that the illness had occurred about two months before surrender. The court refused to strike out the claim, holding that it was at least arguable that the assignment was void and that L had no right to surrender the policy. In the same way, a condition forbidding assignment has been held to make a policy non-assignable at law.[120] A court would be slow, however, to construe such a condition in such a way as to prevent an assignee's interest from being enforceable in equity, nor will it affect the interest of a beneficiary under a declaration of trust. In the same way, a restriction on the assured's ability to assign his "rights, powers or obligations" under a policy cannot preclude him from agreeing with a third party how the recoveries under the policy will be applied.[121] Further, the assignment of a claim on a policy after loss is not a breach of a condition against alienation of the property insured.[122] A life policy which is not assignable is not in fact the full property of the assured at all, but comprises the type of insurance in which he has only a limited power of appointment of funds standing to his credit.

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[114] *Haas v Atlas Insurance* [1913] 2 KB 209.
[115] *Dalby v India & London Life* (1854) 15 CB 365; *Law v London Indisputable Life* (1855) 1 K & J 223.
[116] *Ashley v Ashley* (1829) 3 Sim 149.
[117] See *N M Rothschild & Sons (CI) Ltd v Equitable Life Assurance Society* [2003] Lloyd's Rep IR 371, where the insurers wrongly refused to accept assignments as evidence of the assignee's title and caused loss to the assignee who was unable to surrender the policies at the most favourable time.
[118] *M'Farlane v Royal London Friendly Society* (1886) 2 TLR 755; *Brewster v National Life Insurance Society* (1892) 8 TLR 648.
[119] [2016] HKDC 1225.
[120] *Re Turcan* (1888) 40 Ch D 5; *Floods of Queensferry Ltd v Shand Construction Ltd* [2003] Lloyds Rep IR 181.
[121] *Cf Freakley v Centre Reinsurance International Co* [2005] Lloyd's Rep IR 284 (liability insurance).
[122] *Garden v Ingram* (1852) 23 LJ Ch 478; *Randall v Lithgow* (1884) 12 QBD 525.

16.024 **Payment of proceeds.** It is common in the case of insurances on the assured's own life, for the assured to nominate a beneficiary at the time of taking out a policy. At common law the person nominated, by reason of his status as a stranger to the contract, has no remedy at law against the insurers. Further, such a nomination does not by itself, constitute the assured a trustee of the proceeds.[123] Accordingly, the property in the policy will pass to the personal representatives of the assured on his death and the nominee has no rights whatsoever,[124] unless: (a) the nomination amounts to a declaration of trust;[125] (b) the person taking out the policy is merely the agent of the nominee;[126] (c) the nomination is made under s.13 of the Married Persons Status Ordinance; or (d) the nomination creates a binding contract between insurer A and B to pay C on an event or contingency, so that B can use the equitable remedy of specific performance against A to obtain an order against him to pay what may be due to C.[127]

4. Utmost Good Faith

The following facts have been found to be material for the purposes of pre-contract disclosure.

16.025 **Age.** The proposer's age is material since it affects his life expectancy, and in the case of an endowment policy, it may affect the date on which the policy is to mature.[128]

16.026 **Residence and domicile.** In the absence of a warranty the failure by the assured to disclose his domicile[129] is not normally fatal, though such omissions might be so were the occupation of the assured a particularly dangerous one, or had he been for a long period in an unhealthy climate. The term "residence" in a proposal for insurance means the place where the proposer is living or residing at the time of making the proposal, and not where he has been residing before or where he is going to reside afterwards. It is a matter of fact whether the assured's imprisonment is material and therefore to be disclosed.[130]

16.027 **Health.** Life insurance is peculiar in that the assured is often ignorant as to the fact most material in assessing the premium, the state of his own health. Though he may have a general idea as to his own physical well-being, he may well be unaware of an incipient but deadly disease within his system that a doctor might have diagnosed. A man might not even know, it has been held, that he has gout.[131] And if an assured may be ignorant as to his own health, one who takes out a policy on the life of another is even less in a position to inform the insurers accurately as to the state of that other's health. The rule

[123] *Re Engelbach's Estate* [1924] 2 Ch 348 (wrongly decided: *Beswick v Beswick* [1968] AC 58); *Re Burgess's Policy* (1915) 85 LJ Ch 273; *Re Schebsman* [1944] Ch 83. *Cf Green v Russell* [1959] 2 QB 226; *Bowskill v Dawson (No 2)* [1955] 1 QB 13.

[124] *Re Sinclair's Policy* [1938] Ch 799; *Re Clay's Policy* [1937] 2 All ER 548.

[125] *Johnson v Ball* (1851) 5 De G & Sm 85; *Pedder v Mosley* (1862) 31 Beav 159; *Re Keen's Estate* [1937] 1 Ch 236; *Re Gordon* [1940] Ch 851; *Re Webb* [1941] Ch 225; *Re Foster's Policy* [1966] 1 WLR 222. *Cf Re Independent Air Travel Ltd* [1961] 1 Lloyd's Rep 604.

[126] *Re Scottish Equitable Life Policy 6402* [1902] 1 Ch 282.

[127] *Beswick v Beswick* [1968] AC 58.

[128] *Keeling v Pearl Assurance Co* (1923) 129 LT 573; *Hemmings v Sceptre Life Association Ltd* (1905) 92 LT 221.

[129] *Grogan v London and Manchester Industrial Assurance* (1855) 2 TLR 75.

[130] *Huguenin v Rayley* (1815) 6 Taunt 186.

[131] *Fowkes v Manchester and London Life* (1863) 3 B & S 917.

is, warranties apart, that the insurers may avoid the policy if the assured knowingly misrepresents his state of health, or that of the life insured. Similarly he is bound to disclose no more than he actually knows,[132] though he is bound to disclose a serious disease of which he is aware.[133] Insurance companies therefore put upon applicants for life insurance the responsibility of disclosing the true state of their health or that of the life assured by asking them questions in the proposal on this matter, and by giving the assured's answers to them the force of warranties by means of a declaration in the proposal and a reference to it in the policy. By the employment of such a scheme the assured is made responsible for the absolute truth of his answers,[134] irrespective of their materiality,[135] if they are not true, they will afford the insurers a ground for repudiating liability on the policy, even though he gave them innocently.

Independently of this development, courts the world over have been slow to construe such answers as stating anything more than the belief of the assured,[136] but unless the questions are so framed as to require him to answer as to his own knowledge only, he is advised to qualify his answers in this respect.[137] Where the assured warrants his answers to questions to be put to him in the future by the company's medical examiner to be true, this binds him to do no more than tell the truth to the best of his knowledge, and will be construed accordingly.[138] In fact it may be said in general that, unless the insurers put the matter beyond all doubt by using the clearest language in their policies, it is the accuracy of the assured's knowledge and not the truth of his answers that the assured warrants in life insurance.[139]

16.028 **Medical history.** Information as to past illnesses and medical attendance is plainly material, as it may impact on life expectancy.[140] However, express questions on this matter are in a different position from questions as to present state of health, since from their nature the insurers can expect the answers to be true in fact, and not mere matters of belief.[141] But even such questions have been construed to have a limited meaning.[142] Thus, a question as to how long it was since the assured had been "attended" by a doctor

[132] *Swete v Fairlie* (1833) 6 Car & P 1; Lord Campbell in *Wheelton v Hardisty* (1857) 8 El & Bl 232, 269–273; *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863.

[133] *British Equitable Insurance Co v Musgrave* (1887) 3 TLR 630. See also *Godfrey v Britannic Assurance Co* [1963] 2 Lloyd's Rep 515; *Winter v Irish Life Assurance plc* [1995] 2 Lloyd's Rep 274.

[134] Blackburn J in *Macdonald v Law Union* (1874) LR 9 QB 328, 332–333; *Hutton v Waterloo Life* (1859) 1 F & F 735.

[135] *Pawson v Watson* (1778) 2 Cowp 785.

[136] Burton J in *Sceales v Scanlan* (1843) 6 Ir LR 367, 401; Cockburn CJ in *Fowkes v Manchester and London Life* (1863) 3 B & S 917, 925–926; *Life Association of Scotland v Foster* (1873) 11 M 351; *Thomson v Weems* (1884) LR 9 App Cas 671. But see *National Mutual of Australasia v Smallfield* [1922] NZLR 1074.

[137] *Wheelton v Hardisty* (1857) 8 El & Bl 232, 271–273.

[138] *Delahaye v British Empire Mutual Life* (1897) 13 TLR 245.

[139] Fletcher Moulton LJ in *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863, 884.

[140] *Ashby v Bates* (1846) 15 M & W 589; *Wheelton v Hardisty* (1858) 8 El & Bl 232; *Fowkes v Manchester and London Life* (1863) 3 B & S 917; *Winter v Irish Life Assurance plc* [1995] 2 Lloyd's Rep 274; *Ma Kim Ying v Manulife (International) Ltd* [2012] HKEC 885 (failure to disclose liver disorder).

[141] *Huckman v Fernie* (1838) 3 M & W 505; *Metropolitan Life v Madden* (1941) 117 Fed Rep 446.

[142] In *Kumar v Life Assurance Co of India* [1974] 1 Lloyd's Rep 147 the deceased had a Caesarian operation, consulted a doctor and was prescribed an oral contraceptive. She had taken out a life policy, declaring that she had not consulted a medical practitioner and had not had an operation. Kerr J held, in an action on the policy, that it could be avoided. *Quaere*, whether a Caesarian is usually thought of as an operation, or seeking a prescription for a contraceptive at "consulting" a medical practitioner.

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the vehicle to be driven by the defendant, and was injured when the vehicle in which she was a passenger was involved in an accident. The vehicle was uninsured, as the policy extended cover only to the plaintiff and her mother, and according the plaintiff – having obtained a judgment against the first defendant – sought to enforce the judgment against the UK Motor Insurers Bureau.[231] Simon Brown J held that the words "any person" in s.6(1)(b) of the Motor Vehicles Insurance Ordinance extended to any passenger, including the plaintiff herself.[232] In *Churchill Insurance Co Ltd v Wilkinson, Evans v Equity Claims Ltd*,[233] it was held that if the victim passenger is himself the policyholder he is nevertheless entitled to be treated to the fullest extent as a passenger and is entitled to recover from the insurers.

19.024 *Volenti non fit injuria.* The position of passengers is a matter of common law weaker than that of other persons injured by a negligent driver, in that the driver was entitled to absolve himself from liability towards a passenger by contract or by a disclaimer of tortious liability. There was even a possibility that a passenger in a vehicle might have been regarded by the common law as voluntarily assuming the risk of negligence by its driver. Consequently, while the road traffic legislation required that insurance of the driver's liability would exist for the benefit of passengers, the common law operated in many cases to prevent the driver's liability towards the passenger from arising.[234] These possibilities were removed by s.12(2) to (3) of the Motor Vehicles Insurance Ordinance, which is in the following terms:

> (1) Where a person uses or causes or permits any person to use, a motor vehicle in such circumstances that under section 4(1), there is required to be in force in relation to his use of it such a policy of insurance or such a security in respect of third party risks as complies with this part of this Ordinance, then, if any other person is carried in or upon the vehicle while the user is so using it, any antecedent agreement or understanding between them (whether intended to be legally binding or not) shall be of no effect so far as it purports or might be held–
>
> (a) to negative or restrict any such liability of the user in respect of persons carried in or upon the vehicle as is required by s.6(1) to be covered by a policy of insurance, or
>
> (b) to impose any conditions with respect to the enforcement of any such liability of the user,
>
> and the fact that a person so carried has willingly accepted as his the risk of negligence on the part of the user shall not be treated as negativing any such liability of the user.
>
> (2) For the purposes of subsection (2) –

231 Which had nominated the second defendant to act on its behalf in respect of the claim.

232 *Limbrick* reflects the position demanded by the Motor Insurance Directives, that the owner of the vehicle who is a passenger at the time of the accident is entitled to the same protection as any other passenger: *Candolin v Vahinkovakuutusosakeyhtio Pohjola* (unrep., Case C-537103, June 2005).

233 Case C-442/10 [2011] EUECJ.

234 See generally: *Dann v Hamilton* [1939] 1 KB 509; *Nettleship v Weston* [1971] 2 QB 691; *Owens v Brimmell* [1977] QB 859.

> (a) references to a person being carried in or upon a vehicle include references to a person entering or getting on to, or alighting from, the vehicle, and
>
> (b) the reference to an antecedent agreement is to one made at any time before liability arose.

The main effect of s.12(2) is to remove the possibility of any defence against the injured passenger based on *volenti non fit injuria*. The scope of this was tested in *Pitts v Hunt*.[235] The events, in this case, arose following a drinking spree at a discotheque by P (then aged 18) and H (aged 16). They left for home on a motorbike driven uninsured by H. Witnesses saw the motorbike speeding and swerving from side to side in an apparent attempt to frighten oncoming traffic: both P and H were shouting in apparent enjoyment. Ultimately the motorbike was involved in a collision with a car driven by J. H was killed and P was partially but permanently paralysed. P initiated proceedings against H's estate and against J for negligence, although the action against J proved to have no basis. One of the questions was whether H's estate had a defence against P based on *volenti non fit injuria*. The Court of Appeal, following the decision of the Court of Session in *Winnick v Dick*,[236] held that s.12(2) prevented reliance on this defence, and the degree of the passenger's recklessness was immaterial to the operation of the section.[237]

The subsection does not affect the validity of any agreement between user and passenger after the accident has occurred, as there is no public policy objection to the victim entering into a settlement contract with the user, or waiving any rights against the user.

19.025 *Public policy.* The Motor Vehicles Insurance Ordinance makes no mention of the common law principle that the victim of a negligent driver may be precluded from bringing an action against the driver by reason of the public policy rule *ex turpi causa*. A claimant will lose his action only where his conduct is such that the court regards it as inappropriate to award a remedy. That will be the case when, in accordance with the authorities on public policy as they affect tort claims, the claim is inextricably linked with the criminal activity, and the criminality is reprehensible or grossly immoral and the claimant is both aware of the nature and quality of his act and that what he was doing was wrong.[238] In the case of a passenger in a motor vehicle, what is generally required is some participation in a common illegal enterprise with the driver rather than mere knowledge of some criminality on the part of the driver. This is, in essence, the same test for the question whether a passenger is "using" the vehicle on his own account, in which case compulsory insurance has to attach to his actions and he will be precluded, by virtue of his capacity as user, from recovering from the "MIB" where the actual driver is uninsured.

235 [1990] 3 All ER 344.

236 1984 SLT 185.

237 The Court of Appeal was also influenced by the undesirability of English law not conforming to Scots law on this matter: rights were not to depend upon which side of the border the vehicle happened to be when the accident occurred.

238 See, for extensive discussion, *The Illegality Defence in Tort*, Law Commission, Consultation Paper No.160, 2001. The Law Commission, after consultation and a rash of important decisions, concluded that the matter was best left to the courts: *The Illegality Defence*, Law Commission, Report No.320, 2010.

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proper apportionment is to be made.[250] The acceptance of a lift with a drunken driver is potentially contributory negligence, although the point was left open in *Pitts v Hunt*.

Control of policy terms

19.027 *Perils which cannot be excluded.* Section 12(1) of the Motor Vehicles Insurance Ordinance sets out a list of perils, liability for which cannot be excluded by the insurer.[251] In each of these cases, however, the prohibition extends only to compulsory insurance; if the policy relates to risks which do not fall within the Ordinance – such as first party risks – liability for loss arising from all or any of the listed matters may be excluded by the insurer. The list, which is exhaustive,[252] is as follows:

(1) *The age or physical or mental condition of persons driving the vehicle.* This does not extend to a condition requiring the assured to exercise reasonable care and to employ only steady and sober drivers,[253] but conditions prohibiting driving by persons under the influence of drugs or alcohol are outlawed;[254]

(2) *The condition of the vehicle.* Such restrictions are common outside the context of compulsory insurance and exclude the insurer's liability, *inter alia*, if the vehicle is unroadworthy;[255]

(3) *The number of persons that the vehicle carries.* This provision does not cover the case in which a policy imposes a weight, as opposed to a numerical, limit on passengers. Interesting enough, in *Houghton v Trafalgar Insurance Co Ltd*,[256] the Court of Appeal held that the phrase "any load in excess of that for which the vehicle is constructed" did not apply to the case in which the car carried a number of passengers greater than that for which the car was

[250] The trial judge had made a deduction of 100 percent, a decision overturned on appeal. The Court of Appeal did not need to decide what the appropriate deduction might have been on the facts in *Pitts v Hunt*, given its ruling that, on public policy ground, the plaintiff had no cause of action.

[251] It was commented by Goddard J in *Zurich General Accident and Liability Insurance Co Ltd v Morrison* [1942] 2 KB 53 that the statutory requirement for compulsory insurance was of little value if it was open to insurers to freely exclude liability for common risks.

[252] *Gray v Blackmore* [1934] 1 KB 95.

[253] *National Farmers' Union Mutual Insurance Society Ltd v Dawson* [1941] 2 KB 424.

[254] *HKSAR V Law Wing Fai* [2017] HKCA 380; *Tan Ryan v Lua Ming Feng Alvin* [2011] SGHC 151. *See Louden v British Merchants' Insurance Co Ltd* [1961] 1 Lloyd's Rep 154 for the construction of such a clause.

[255] Where those words are used, the assured is in breach only where the vehicle is unroadworthy at the start of the journey during which the accident occurred: *Barrett v London General Insurance Co Ltd* [1935] 1 KB 238. The reasoning in this case, insofar as it was based on an analogy with the marine implied seaworthiness warranty contained in the Marine Insurance Ordinance, s.39(1), was rejected by the Privy Council in *Trickett v Queensland Insurance Co Ltd* [1936] AC 159. However, in *Clarke v National Insurance and Guarantee Corp Ltd* [1964] 1 QB 199, the Court of Appeal, in effect, reinstated the analogy and held that a vehicle which was overloaded was unroadworthy. See the discussion below. Other forms of wording may be used, *eg* an obligation on the assured to maintain the vehicle in efficient condition: *Taylor v National Insurance and Guarantee Corp* [1989] 6 CL 248. In *Lefevre v White* [1990] 1 Lloyd's Rep 569, the assured's obligation to "take every reasonable precaution" to maintain the vehicle in a safe condition was held not to require him to have the brakes tested on the vehicle which he had just purchased, but did oblige him to change tyres which he knew to be in a worn condition. The test for breach of a roadworthiness clause is whether the assured has acted reasonably: *Amey Properties Ltd v Cornhill Insurance Plc* [1996] LRLR 259; *Conn v Westminster Motor Insurance Association* [1966] 1 Lloyd's Rep 407.

[256] [1954] 1 QB 247.

designed. A *Houghton* clause is thus permitted by the Ordinance insofar as it applies to persons, but not insofar as it applies to goods; see (4) below;

(4) *The weight or physical characteristics of the goods that the vehicle carries.* This provision does not outlaw a condition against the use of a vehicle for social or domestic purposes only, so that it will not provide relief to an assured who carries business goods in contravention of such a condition;[257]

(5) *The times at which or the areas in which the vehicle is used*;[258]

(6) *The horsepower or cylinder capacity or value of the vehicle*;

(7) *The carrying on the vehicle of any particular apparatus*; and

(8) *The carrying on the vehicle of any particular means of identification other than any means of identification required to be carried by or under this Ordinance or under the Road Traffic Ordinance (Cap.374).*

The proviso to s.12(1) states that if an insurer is liable on any of these grounds, it has a right of recourse against the insured person in respect of the payment to the third party.[259] The right of recourse may also be provided for in the policy.[260] The fact that the insurers are not entitled to refuse to indemnify the third party does not mean that the assured is driving with insurance, and he still commits an offence if he breaks a policy term which cannot be relied upon by the insurers in the face of a third party claim.[261]

It is apparent from the drafting of s.12(1) that the law contemplates that certain forms of exclusion clause in a motor policy are valid even in respect of third party claims. The Ordinance thus does not seek to prevent the operation as against a third party of one of the most common restrictions in motor policies that of use of the vehicle for social, domestic or pleasure purposes only. Other conditions outside s.12(1) include conditions relating to: the mode of carrying passengers[262] and restrictions on particular forms of use.[263] Rix LJ in his dissenting comments in *Charlton v Fisher*[264] assumed much the same, as his view was that a policy could legitimately restrict cover to "accidents".[265]

19.028 *Breach of condition by the assured.* By virtue of s.9 of the Motor Vehicles Insurance Ordinance, if the assured breaks a condition of the policy after the happening of the insured event giving rise to a claim, and the effect of the breach of condition would

[257] *Piddington v Co-operative Insurance Society Ltd* [1934] 2 KB 236.

[258] See *Palmer v Cornhill Insurance Co Ltd* (1935) 52 Ll LR 78 for an example of such a clause. In *Yau Shun Po v Oriental Insurance Co Ltd* (unrep., 1985), it was held that this clause covered the situation in which the assured was using the vehicle in contravention of time limits imposed by a provisional licence.

[259] See *Liverpool Corp v Roberts* [1964] 2 Lloyd's Rep 219. If that right is not exercised, the insurer's payment is to be treated as *ex gratia*, thereby precluding contribution proceedings from any other insurer on risk: *Legal and General Insurance Society Ltd v Drake Insurance Co Ltd* [1992] 1 All ER 238.

[260] *Liberty International Insurance Ltd v Yeung Kai Chung* [2017] HKDC 1224.

[261] *Singh v Solihull Metropolitan Borough Council* [2007] EWHC 552 (Admin).

[262] *Bright v Ashfold* [1932] 2 KB 153.

[263] *Samuelson v National Insurance and Guarantee Corp* [1985] 2 Lloyd's Rep 541.

[264] [2001] Lloyd's Rep IR 387.

[265] The majority view was that the word "accident" was to be construed against the statutory background, and should be construed as meaning any loss suffered by the victim at the hands of the assured.

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otherwise have been to prevent the insurer's liability from arising or to have put an end to its liability under the policy, the breach is to be regarded as having no effect for the purposes of compulsory insurance.[266] However, under the proviso to the section, if the insurer is required to meet a claim by reason of this provision, it may seek an indemnity from the assured if the policy so provides.[267] The object here is clearly to counteract the effect of late claims, failure by the assured to provide the necessary proofs and assistance to the insurer, or the assured's admission of liability to the third party, in contravention of the terms of his policy.[268] It should be stressed that s.9 of the Ordinance is confined in its operation to post-loss breaches of condition: if the assured has broken a condition of the policy prior to the loss, *eg* in the case of a motorcycle, carrying passengers other than in a sidecar,[269] or using a car for the purposes of the motor trade contrary to the provisions of the policy,[270] the section will not prevent the insurer from denying liability. There is no statutory right of recourse against the assured for sums which the insurers have been obliged to pay under s.9 of the Ordinance despite a breach of the condition by the assured: if there is to be recovery, there must be a right in the policy itself.[271]

2. Actions for the Proceeds of Compulsory Motor Policies

19.029 **Forms of proceedings.** Section 10 of the Motor Vehicles Insurance Ordinance confers upon the victim of a negligent driver a mechanism to enforce any judgment which the victim may obtain against the driver. The essence of the procedure is that, once the judgment has been obtained, the victim may bring proceedings against the insurers for payment of the amount in the judgment insofar as the liability is one which was required to be covered by insurance. As discussed earlier in this chapter, the insurers cannot rely upon breach of policy conditions by the assured, and there are also restrictions imposed upon the right of insurers to rely upon the defences of misrepresentation and non-disclosure.

It was argued in *Charlton v Fisher*[272] that s.6(2) of the Ordinance, under which the insurers are liable "to indemnify the persons or classes of persons specified in the policy in respect of any liability which the policy purports to cover in the case of those persons or classes of persons", had the effect of allowing the victim of an insured user to bring a direct action against the user's insurers. The Court of Appeal held that the section was concerned with allowing a user whose liability was covered by means of

[266] If the liability is excluded from the scope of compulsory cover, *eg* because it is a claim by an employee for injuries arising out of the course of his employment, then the condition is unaffected by s.9: *Hui Ting Hang v Grand Union Motor Insurance Co Ltd* [1988] 2 HKLR 502.

[267] Compare the position where liability arises under a specified risk, where the right of recourse is statutory rather than contractual.

[268] *Revell v London General Insurance* (1935) 152 LT 258; *Bright v Ashfold* [1932] 2 KB 153; *Croxford v Universal Insurance* [1936] 2 KB 253.

[269] *Bright v Ashfold* [1932] 2 KB 153.

[270] *Gray v Blackmore* [1934] 1 KB 95.

[271] *Phoenix Assurance Public Co Ltd v Ho Fung Ching* [1987] 1 HKC 1, where the clause was held not to be appropriately worded to permit recovery.

[272] [2001] Lloyd's Rep IR 387.

policy extension to recover from the insurers, and said nothing about the rights of a victim.

The direct action operates irrespective of the assured's financial position. The Third Parties (Rights against Insurers) Ordinance (Cap.273), reversing the common law, confers upon the third party victim of the assured's wrongful conduct a right to proceed directly against the assured's liability insurers in the event of the assured's insolvency. This is a general measure which applies to all forms of liability insurance, although in its origins it was devised in England as the Third Parties (Rights against Insurers) Act 1930 to accompany the introduction of compulsory motor insurance under the Road Traffic Act 1930 and to provide a means whereby the victim had direct access to the driver's insurers if a judgment was obtained against the driver which was not satisfied by him. The significance in England of the Third Parties (Rights against Insurers) Act 1930 to motor insurance claims was all but removed by Road Traffic 1934, which contained the provisions now enacted as s.10 of the Motor Vehicles Insurance Ordinance, allowing the victim to bring an action against the driver's insurers if a judgment was unsatisfied whether or not the driver had become insolvent. Consequently, s.11 of the Motor Vehicles Insurance Ordinance provides that the Third Parties (Rights against Insurers) Ordinance has no effect on the direct enforcement action under the former. It was held in *Lung Siu Wing v Lo Wai Ming*[273] that motor insurers were entitled to be joined to proceedings against the assured in order to defend the claim in tort against the assured.

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Right to proceed against the user's insurers

19.030 *Conditions for direct action.* For an enforcement action to be brought under s.10, four conditions must be satisfied.

First, the victim must have obtained a judgment against the assured. Section 10 is an enforcement mechanism only, allowing the victim to bring a direct action against the insurers to satisfy a judgment left unsatisfied by the user.

Second, the insurers must have issued a certificate of insurance. It was held by the Privy Council, on appeal from Barbados, in *Motor & General Insurance Co Ltd v Cox*[274] that this requirement is satisfied in a case in which the certificate is issued to the assured between the date at which the assured's liability arises and the date of the judgment against him, notwithstanding that s.6(3) of the Ordinance provides that the policy is of no effect until the certificate has been delivered. If the certificate has not been issued, it would seem that the assured has the right to demand a certificate from the insurer, on the basis that the contract with the insurer was for a policy complying with the Ordinance. If *Cox* is followed in Hong Kong, the effect of the demand is to preserve the rights of the plaintiff third party against the insurer.

[273] [2009] HKDC 317.

[274] [1990] 1 WLR 1443.

Third, the liability incurred by the assured must be one in respect of which insurance was required by the Motor Vehicles Insurance Ordinance. If any of the conditions for compulsory cover are not met – *ie* if the claim does not arise out of the use of a motor vehicle on a road – then no direct action is possible. In *Tan Chou v March Insurance Co Ltd*,[275] it was held that the phrase "any liability" was unrestricted, so that where an employee was injured in the course of his employment by the negligence of an insured driver, and the employer was liable to pay compensation to the employee under the Employees' Compensation Ordinance, the employer was entitled to bring proceedings under s.10 of the Motor Vehicles Insurance Ordinance to recover the sum paid.

Finally, the policy must have covered the use in question. This condition is modified by s.12 of the Ordinance, discussed above, which prevents insurers from relying upon various forms of policy limitation or exception. It was held by a majority of the Court of Appeal in *Charlton v Fisher*[276] that a deliberate running down is a use which must be covered by compulsory insurance. This means that the victim of a deliberate running down has a direct action against insurers under s.10. There is a fundamental issue here as to whether this requirement is concerned with the terms of the policy itself, so that if there is a restriction on liability not permitted by s.12 it is arguable that s.101 relieves the insurers from liability. It is submitted that the only sensible interpretation of s.10 is that it refers to those terms of the policy which are enforceable under the Ordinance.

19.031 *Liability of insurers to meet judgments against insured users.* Under s.10(1) of the Ordinance, the insurers are required to satisfy any judgment which "is obtained against any person who is insured by the policy". Policies frequently provide that any person may drive the assured's vehicle with his consent, so that such persons are within the scope of s.10(1); as noted earlier, the effect of s.10(1) is to require the insurer to pay the proceeds of the policy to any third party entitled to the benefit of a judgment against the assured or any person covered under the policy "notwithstanding that the insurer may be entitled to avoid or cancel, or may have avoided or cancelled, the policy".

A majority of the Court of Appeal in *Charlton v Fisher*[277] concluded that, in the case of a direct action by the victim against the assured's insurers, any public policy bar which prevents the assured recovering under his policy does not extend to a direct claim by the third party against the insurers under s.10(1). Here, the assured had deliberately rammed his vehicle into a stationary vehicle in which the victim had been sitting. The Court of Appeal was unanimous that the assured was himself unable to recover from his insurers, as his claim was precluded by the public policy rule that insurers are not liable for the natural consequences of deliberate acts by the assured. However, the majority view was that the public policy bar was personal to the assured, and did not operate to prevent the victim from bringing a direct claim against the insurers under s.10(1). This ruling was *obiter* as the injuries had not been inflicted on a road, and thus were outside the compulsory insurance provisions of the legislation were inapplicable. Rix LJ, dissenting on the public policy point, preferred the view that s.10 operated only where the claim was one within the policy itself.

[275] [1991] HKLY 603.
[276] [2001] Lloyd's Rep IR 387.
[277] [2001] Lloyd's Rep IR 387.

The majority view was adopted by Tugendhat J in *Bristol Alliance Ltd Partnership v Williams*,[278] the learned judge ruling that property damage caused by a driver in an attempt to commit suicide by deliberately driving into building gave rise to a liability which had to be insured under the Ordinance and thus any judgment given against the driver in respect of that liability had to be satisfied by insurers under s.10. However, the learned judge was reversed on appeal, in *EUI Ltd v Bristol Alliance Ltd Partnership*.[279] The view of the Court of Appeal, based on an historical analysis of the provision, was that it did not prevent the use of and reliance on exclusions other than those set out in s.12 of the Ordinance. Ward LJ noted that the Cassel Committee, reporting on the operation of the legislation in 1937, had recommended the repeal of the then version of s.12 and its replacement, with a more extensive list of prohibited exclusions, a suggestion which had not been accepted. Accordingly, the plain intention of the section was to permit other exclusions. The effect, therefore, was that s.10 did not preclude an exclusion of liability other than one set out in s.12. The approach of Rix LJ in *Charlton v Fisher*, insofar as it recognised that policy exclusions for deliberate acts were valid, was thus endorsed by the Court of Appeal in *EUI Ltd v Bristol Ltd Alliance Partnership*.[280] The reasoning in *Williams* was followed by HH Judge Tindal QC in *Allen v Mohammed*[281] in which s.10 was held to have no application to a case where the injuries were inflicted by a person permitted by the assured to drive the car but the policy was restricted by its coverage to the assured herself.

19.032 *Extent of insurers' liability.* The Ordinance permits an insurer to impose a per event financial limit of $10 million for all death or injury arising out of any one event, so that liability under s.10(1) cannot, if the policy so provides, exceed that sum. Thus, s.10(2)(d) provides that no sum shall be payable by the insurer in respect of any sum adjudged to be payable under the judgment against the assured in excess of the amount covered by the policy of insurance.

The insurer's liability under s.10(1) extends to the costs of the third party insofar as the aggregate liability towards the third party does not exceed the financial limits of the policy.

19.033 *Liability to meet judgment against unidentified users.* Section 10 of the Ordinance requires the insurer to satisfy a judgment against the user of the vehicle. The question in *Cameron v Hussain*[282] was whether it was possible for s.10 to be used in the unusual situation where a judgment had been given against an unidentified user of an identified vehicle. In that case the claimant was injured and her vehicle written off in a collision with a car registered to the defendant but not at the time being driven by him. The defendant refused to identify the driver, but it was clear that whoever the driver might have been the policy did not cover his or her use of the vehicle. It was also the case that the policy had been obtained by fraudulent misrepresentation as to the identity of the named assured, although the insurers had not taken any steps to avoid the policy within the time limits laid down by s.10(3) of the Ordinance. The claimant brought

[278] [2011] EWHC 1657 (QB).
[279] [2012] EWCA Civ 1267.
[280] [2012] EWCA Civ 1267.
[281] 12 September 2016, Birmingham County Court.
[282] [2017] EWCA Civ 366.

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proceedings against the unidentified driver and, having obtained judgment, sought to enforce it against the insurers of the vehicle. The Court of Appeal by a majority held that the claimant was entitled to recover. The majority view was that the scheme of the Ordinance was that the insurer of a vehicle faced liability to satisfy any judgment in favour of a victim, irrespective of the identity of the user, other than in the limited case where the policy had been cancelled. While there was a fallback right to bring proceedings against the MIB in cases where the tortfeasor was unidentified, that right was less beneficial to a victim in a number of procedural respects when compared to the direct enforcement of a judgment. Accordingly, the insurers should face liability in all circumstances other than those specifically provided for by the Ordinance. The main objection of the insurers to this procedure was that it deprived them of the benefit of a recourse action against the uninsured user under s.10(4) of the Ordinance, discussed below. The majority response to that argument was that recourse actions were frequently of little value, and that the scheme of the legislation imposed upon the insurers rather than the victim the risk that the tortfeasor was unidentified, insolvent or otherwise unable or unwilling to satisfy a judgment.

19.034 *Right of recourse.* The Ordinance attempts to shift the insurer's statutory liability to a third party back on to the assured. Where the insurer is required to make payment to a third party under a policy which was voidable or cancellable as against the assured, the insurer is given a right of recourse against the assured to recover from him the amount of its payment to the third party.[283] If an insurer has a right of recourse against the assured, and fails to exercise it, his payment to the third party is to be regarded as voluntary and the insurer will be unable to exercise contribution rights against any other insurer in respect of the payment.[284]

Defences of insurers to an enforcement action

19.035 Section 10 of the Motor Vehicles Insurance Ordinance gives an insurer immunity from liability under a direct enforcement action brought by the holding of an unsatisfied judgment, if any of the following defences are made out:

(1) The insurer has not been given due notice of the proceedings against the assured (s.10(2)(a));

(2) Enforcement of the judgment obtained by the victim has been stayed (s.10(2)(b));

(3) The certificate of insurance has been surrendered (s.10(2)(c)); or

(4) The insurer has obtained a declaration of its right to avoid the policy for breach of the duty of utmost good faith by the assured (s.10(3)).

Although no mention of this is made in the legislation, an insurer will not be liable if there never was a policy in existence. That unusual possibility arose in *China Taiping Insurance (HK) Co Ltd v Tang Tze Wai*,[285] in which the assured purchased and insured a vehicle but it was later discovered that the engine had been changed before the assured

[283] Section 10(4). See *Royal & Sun Alliance Plc v Hume* [2009] CSIH 24.
[284] *Legal and General Insurance Society Ltd v Drake Insurance Co Ltd* [1992] 1 All ER 283. That proposition was, however, doubted by the Court of Appeal in *Drake Insurance v Provident Insurance Co* [2004] Lloyd's Rep IR 277.
[285] [2013] HKCA 78.

had acquired it. The trial judge, whose factual findings were upheld by the Court of Appeal, concluded that the change was so fundamental that the vehicle insured did not exist and accordingly that there never was a valid insurance. The Court of Appeal noted that vehicles have a variety of characteristics, and that the relevance of features "to the factual identification of a vehicle is a matter of degree and extent, and is a matter of evidence depending on the circumstances of each case, including the nature of the contract involved."

19.036 *Notice of proceedings.* Section 10(2)(a) provides:

> No sum shall be payable by an insurer ... in respect of any judgment, unless before or within 7 days after the commencement of proceedings in which the judgment was given, the insurer had notice of the bringing of the proceedings.

It is the duty of the defendant to inform the third party, when the claim is made, whether or not he is insured and whether he would have been insured but for the cancellation of the policy: failure to comply is a criminal offence.[286]

Proceedings commence when the writ is issued rather than when it is served. However, where the insurer's liability arises under a counterclaim, the relevant date is the date of the counterclaim.[287] In principle, while there is a seven-day cut-off point for the service of notice, there is no equivalent anterior restriction and notice may be given at any time between the accident giving rise to liability and the statutory cut-off. Thus in *Robson v Marriott*[288] the Court of Appeal raised no objection to notice of proceedings being given in February 1993 even though the claim form was not issued until June 1994. In *Stinton v Stinton*,[289] the Court of Appeal indicated that the greater the gap between the notification and the commencement of proceedings the easier it will be for the court to find that the notification did not fulfil the requirements for statutory notice.

There have been a number of decisions on the meaning of "notice". The Court of Appeal in *Wylie v Wake* recognised that the cases were not fully consistent, and laid down the following guidelines based upon the decided cases:

(1) *To show that the insurers had notice of the proceedings there had to be more than evidence of a casual comment to someone who at time acted as an agent for the insurers.* In *Herbert v Railway Passengers Assurance Co*,[290] the victim mentioned in a casual conversation with the insurer's agent that he was bringing an action against the insurers, and this was held not to be sufficient notice. However, in *Wylie v Wake*[291] the Court of Appeal doubted the result in *Herbert* as what had been said was specific and enough to constitute notice. Notice may be given by the assured or by an authorised agent, *eg* his

[286] Motor Vehicles Insurance Ordinance, s.13. See also s.16 as to the production of the certificate.
[287] *Cross v British Oak Insurance Co Ltd* [1938] 2 KB 167.
[288] (unrep., 1997).
[289] [1999] Lloyd's Rep IR 305.
[290] [1938] 1 All ER 650.
[291] (unrep., 2000).

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solicitors,[292] and it may be that if the insurers receive notice from any reliable source then the statutory requirements are satisfied.[293] It was said by the Court of Appeal that a notice to the insurers which was sufficiently specific could come from any source. It was accepted by the Court of Appeal in that notice to the insurers' solicitors satisfied statutory requirements, and in *Nawaz and Hussain v Crow Insurance Group*[294] it was held that notice to the secretary of the solicitor acting for the insurers was sufficient as it could be assumed that an experienced legal secretary would pass the information to the solicitor. It should be said, however, that notice to the assured's brokers will not suffice, as the brokers are not to be regarded as the agents of the insurers, unless the insurers have authorised the brokers to act for them in the handling of the claim;

(2) *Any notification relied upon could not be subject to a condition which might or might not be fulfilled, eg where notification simply states that the victim has been advised to commence proceedings, but if the only condition was one which required action from the recipients which they chose not to take then by making that choice they rendered the notice unconditional and thus effective.* In *Ceylon Motor Insurance Association Ltd v Thambugala*,[295] the insurers were advised by the victim's solicitors that unless the claim was settled by a given date proceedings would be commenced: this was held to be enough to amount to notice. By contrast, in *Harrington v Link Motor Policies at Lloyd's*,[296] the solicitors merely informed the insurers that unless the claim was settled they would be advising their client to commence proceedings, and the Court of Appeal held that the letter failed to amount to a statutory notice as it did not specifically state that proceedings were to be commenced. The distinction between these authorities is technical rather than substantive, and in *Robson v Marriott*[297] the Court of Appeal held that a solicitor's letter stating that if the claim was not settled it would be necessary for proceedings to be commenced was held to be indistinguishable from *Thambugala*;

(3) *The notice could be oral and it need not have emanated from the plaintiff himself – it could be given before the proceedings had commenced, and it did not have to be specific as to the nature of the proceedings.* In *Ceylon Motor Insurance Association Ltd v Thambugala*, the Privy Council regarded it as immaterial that the notice did not indicate the name of the court or the number of the action. This reasoning was doubted by the Court of Session in *McBlain v Dolan*,[298] in reliance on the apparent unhappiness of Lord Woolf with *Thambugala* in *Harrington v Link Motor Policies at Lloyd's*.[299] In *Harrington* the Court of Appeal indeed held that a vague notification would not suffice,

[292] *Robson v Marriott* (unrep., 1997).
[293] This was the view of the Court of Appeal in *Harrington v Link Motor Policies at Lloyd's* [1989] 2 Lloyd's Rep 310.
[294] [2003] Lloyd's Rep IR 471.
[295] [1953] AC 584.
[296] [1989] 2 Lloyd's Rep 310.
[297] (unrep., 1997).
[298] [2001] Lloyd's Rep IR 309.
[299] [1989] 2 Lloyd's Rep 310.

and in *Robson v Marriott*[300] the Court of Appeal emphasised that even if omission of these details was not a prerequisite the information should be given if available;

(4) *Whether in any given case it was shown that the insurer had notice of the bringing of proceedings (as opposed merely to making a claim) was a matter of fact and degree.* This distinction was drawn by Lawton J in *McGoona v Motor Insurers' Bureau*.[301] In *Desouza v Waterlow*,[302] the victim wrote two separate letters to the insurers stating that he intended to sue the assured, and subsequently telephoned them with the same information. This was held to be notice of proceedings rather than a claim. As long as the notice conveys the appropriate message it is immaterial that the notice was given unintentionally: in *Nawaz and Hussain v Crow Insurance Group*[303] the insurers' solicitors were contacted by a trainee solicitor acting for the plaintiff. The purpose of the call was to obtain the address of the driver so that service could be effected upon him. The Court of Appeal held that it was clear from what the trainee had said that proceedings were to be issued and the fact that the trainee had been unaware of the requirements of s.152 did not prevent what had been said from amounting to a notice under the section. By contrast, in *Wylie v Wake*[304] itself, the commencement of proceedings had been preceded only by the assertion of a claim, and for that reason it was held that the statutory notice had not been given; and

(5) *The essential purpose of the requirement of notice was to ensure that the insurer was not suddenly faced with a judgment which he had to satisfy without having had any opportunity to take part in the proceedings in which the judgment was obtained.* This point is illustrated by *Weldrick v Essex & Suffolk Equitable Insurance Society*,[305] in which the victim contacted the insurers only to seek confirmation that they did not intend to make payment: plainly this did not give them the ability to participate in the proceedings. In *Stinton v Stinton*[306] the insurers were told by the victim's solicitors that the victim had obtained legal aid and that medical evidence was to be obtained: once again, this was held not to amount to notification of proceedings.

Insurers can in appropriate circumstances be taken to have waived their right to rely upon the absence of proper notice. In principle there may be a waiver or estoppel in either of two ways: (a) conduct by the insurers prior to the commencement of proceedings which indicates that they have waived notification; and (b) post-claim conduct which indicates that they do not wish to rely upon a failure to notify in good time.

[300] (unrep., 1997).
[301] [1969] 2 Lloyd's Rep 34.
[302] [1999] RTR 71.
[303] [2003] Lloyd's Rep IR 471.
[304] (unrep., 1999).
[305] (1949) 83 Ll LR 91.
[306] [1999] Lloyd's Rep IR 305.

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The former situation was considered in a Scottish decision, *McBlain v Dolan*.[307] Here, the victim of a motor accident gave notice to the insurers two months after proceedings had been commenced, in contravention of the seven-day requirement in s.10(2)(a). The insurers had nevertheless been aware of the likelihood of proceedings for some 10 months, in that the victim had to the insurers' knowledge applied for legal aid. The insurers applied for a declaration that, due to the victim's failure to give timely notice, they were not liable. The Court of Session held that the insurers were not entitled to the relief sought, and that it was appropriate to allow to go to trial the issue whether the insurers, having been aware of the proceedings but not having received the proper statutory notice, were able to rely upon the absence of notice, by reason of a personal bar.[308]

Post-claim conduct was considered by the Court of Appeal in *Wylie v Wake*.[309] In this case a letter of claim had been written to the assured's insurers, and their solicitors had subsequently requested medical evidence of the plaintiff's injuries, which was duly provided. Proceedings were commenced some months later. No formal notice of the commencement of proceedings had been, and insurers were finally informed of the proceedings some nine weeks after the issue of the claim form, in February 1997. This was clearly out of time, but no objection was taken until May 1999, while preparations were being made for the trial: this was so because of an oversight on the part of the insurers' then legal advisers. The Court of Appeal rejected that the insurers' conduct prevented them from relying upon s.10(2)(a), on the factual basis that the insurers had not been aware of their rights at the relevant time and thus could not be taken to have waived them. The Court of Appeal went somewhat further, and doubted whether it was possible to treat insurers as having waived their statutory entitlement under s.10(2)(a) by choosing not to rely upon the point until the very last minute: the section was not so much a statutory defence but rather a condition precedent to the insurers' liability which had to be met by the plaintiff, and – at least in the absence of a statement to the contrary which could give rise to an equitable estoppel – the insurers were entitled to defend the action on behalf of the first defendant right up to judgment and then for the first time raise the s.10(2)(a) notice point. This reasoning implicitly casts some doubt upon the approach in *McBlain*.

19.037 *Stay of execution.* Section 10(2)(b) provides:

> No sum shall be payable by an insurer … in respect of any judgment, so long as execution thereon is stayed pending an appeal.

19.038 *Surrender of certificate.* The certificate of insurance plays a central role in the operation of the Ordinance. The rules relating to the surrender of a certificate are of great significance to the potential liability of insurers to meet unsatisfied judgments incurred by users of vehicles. If there has been a claim against the assured, and the assured is in possession of a certificate of insurance, the insurers are liable to indemnify

[307] [2001] Lloyd's Rep IR 309.
[308] Waiver or estoppel.
[309] (unrep., 2000).

the victim in a direct enforcement action under s.10(1) even though the policy has been cancelled by mutual consent or by reason of its terms. It is thus essential for the insurers to secure the surrender of the certificate following the cancellation of the policy. Section 10(2)(c) sets out the situations in which the insurer can escape liability under a direct enforcement action where the policy has been cancelled:

> (1) before the happening of that event the certificate was surrendered to the insurer, or the person to whom the certificate was delivered made a statutory declaration stating that the certificate had been lost or destroyed;
>
> (2) after the happening of that event, but before the expiration of a period of 14 days from the taking effect of the cancellation of the policy or security, the certificate was surrendered to the insurer, or the person in whose favour the certificate was issued made such a statutory declaration; or
>
> (3) either before or after the happening of the said event, but within that period of 14 days, the insurer has commenced proceedings under this Ordinance in respect of the failure to surrender the certificate.

The effect of these provisions is that if the policy has been cancelled but the assured is in possession of the certificate at the date of the insured peril, and is allowed to retain it beyond a period of 14 days from that date, then the insurers are treated as being on risk in respect of the third party claim even though the policy is otherwise to be regarded as having terminated on the expiry of the notice of cancellation. Possibility (3) deals with the case in which the assured has failed to surrender the certificate, as it is then in the hands of the insurers to avoid their liability by commencing proceedings for recovery of the certificate within the time limits allowed. In *Re Drake Insurance Plc*[310] the assured was given notice of cancellation following the insolvency of the insurers. Neuberger J held that the assured was entitled to restitution of his premium for the unexpired period of the policy, that period running from the date on which the notice of cancellation expired rather than the date on which the assured actually surrendered his certificate: Neuberger J's choice of this date was based on the fact that it was open to the insurers – by bringing proceedings to recover the certificate – to ensure that their liability came to an end on the expiry of the notice of cancellation, and if they failed to do so and the assured wrongfully retained the certificate the continued operation of the policy was a problem of their own making and ought not to prevent restitution of the premium from the date on which the certificate could have been rendered ineffective.

19.039 *Declaration as to entitlement to avoid policy.* Section 10(3) sets out a procedure whereby the insurer is permitted to seek a declaration as to its entitlement to avoid the policy. The procedure has been described as a "fair compromise"[311] between the interests of the victim and the rights of the insurers. A number of elements are involved in this procedure:

[310] [2001] Lloyd's Rep IR 643.
[311] *Merchants and Manufacturers Insurance Co Ltd v Hunt* (1941) 68 Ll LR 117, 120, *per* Scott LJ.

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(1) The insurer must obtain a declaration[312] from the court[313] of its entitlement to avoid the policy or, where the policy has previously been avoided, the insurer must obtain from the court a declaration that it was entitled to do so.[314] If the person driving the vehicle at the time of the accident was not the assured person, the legislation does not require the driver to be joined to the avoidance proceedings;[315] It was held in *China Taiping Insurance (HK) Co Ltd v Tang Tze Wai*[316] that this procedure can be used where the insurers assert that there was never a binding policy because the vehicle described to them was not the vehicle used by the assured.

(2) The reason for the avoidance must be a material misrepresentation or failure to disclose a material fact on behalf of the assured. "Material" in this context bears its ordinary meaning of a fact of such a nature as to influence the judgment of a prudent insurer in determining whether it will take the risk and, if so, at what premium and on what conditions;[317]

(3) The policy must have been "obtained" by a material misrepresentation or a material failure to disclose. This wording has been taken to mean that it is not enough for the insurer to show that a prudent insurer might have been influenced in its judgment; the insurer in question must go on to demonstrate that it was actually influenced by the assured's breach of duty.[318] After decades of uncertainty, the House of Lords confirmed in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*[319] that the two-limb test of materiality and inducement represents the general law;

(4) The declaration must be obtained by the insurer either before or within three months of the commencement of the action in which judgment for the third party was given;[320] and

(5) Even if the insurer has obtained a declaration, it may not rely upon it unless it has given to the plaintiff in the liability proceedings, before or within seven days of the commencement of the proceedings, notice of its intention to rely upon it: s.10(3).[321] The notice given by the insurer under s.10(3) should specify every instance of non-disclosure or misrepresentation on which the insurer proposes to rely, as he will not be able to rely upon further instances not so specified as against the third party,[322] but only against the assured. The plaintiff in the liability proceedings is entitled to be made a party to the

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312 *National Farmers' Mutual v Tully* 1935 SLT 547.
313 Not from an arbitrator: *AXA General Insurance Hong Kong Ltd v Lai Hoo Cheung* [2004] HKEC 95.
314 It was held in *Guardian Assurance v Sutherland* [1939] 2 All ER 246 that a declaration may be made in the absence of the assured.
315 *Colonial Fire and General Insurance Co Ltd v Harry* [2008] Lloyd's Rep IR 382.
316 [2011] HKCFI 1736.
317 Section 10(5). For illustrations of materiality, see below.
318 *Zurich General Accident and Liability Insurance Co Ltd v Morrison* [1942] 2 KB 53; *Merchants' and Manufacturers' Insurance Co v Davies and Owen* [1938] 1 KB 196.
319 [1994] 3 All ER 581.
320 *Croxford v Universal Insurance* [1936] 2 KB 253.
321 See *Colonial Fire and General Insurance Co Ltd v Harry* [2008] Lloyd's Rep IR 382.
322 *Contingency Insurance Co v Lyons* (1939) 65 Ll LR 53; *Zurich v Morrison* [1942] 1 All ER 529.

declaration proceedings if his own action was commenced beforehand. The admissions of the assured are not evidence as against the third party in an action by the insurer for such a declaration.[323]

Since the right to avoid for non-disclosure or misrepresentation of a material fact does not arise out of the policy itself, the better view appears to be that a clause to the effect that nothing in the policy is to affect third party rights under the legislation does not affect the insurer's right to a declaration under section.[324]

3. Uninsured and Untraced Drivers: The Hong KongMotor Insurers Bureau

19.040 **History and legal framework.** Although compulsory motor insurance was introduced in Hong Kong in 1951, the problems raised for the compensation of victims of uninsured and untraced drivers were not addressed for some 30 years.[325] Following the UK model, on 10 December 1980 the motor insurance industry incorporated the Hong Kong Motor Insurers Bureau as a company limited by guarantee, under an agreement with the Government reached on 27 June 1980 (the Principal Agreement). In 1981 the HKMIB and the Government signed the First Fund Agreement. All motor insurers in Hong Kong are required to join the HKMIB as a condition of authorisation for the carrying on of motor insurance business in Hong Kong.[326]

Under the First Fund Agreement, if a judgment for damages for death or personal injury arising out of the use of a motor vehicle on a road in Hong Kong (*ie* in circumstances where insurance is compulsory under the Motor Vehicles Insurance Ordinance) is not satisfied within 28 days, the HKMIB accepts liability to meet the judgment. The HKMIB's liability is thus triggered where the defendant is not insured at all, or where the defendant is insured but his insurers have a defence to satisfying the judgment under the Ordinance. The First Fund Agreement binds insurers to provide adequate funds to satisfy the HKMIB's liabilities, and this is achieved by a one percent levy on all motor policy premiums. Claims handling by the HKMIB is set out in the Domestic Agreement, dated 1 February 1981 between the HKMIB and its members.

It was also seen above that the liability of an insurer for losses arising from any one event may be limited to $100 million.[327] On 29 June 1995 the HKMIB gave an undertaking to the Government that it would meet all liabilities in excess of this sum to the extent that the assured himself could not do so.

The scope of the HKMIB's liability was further extended by a Supplemental Memorandum of Agreement of 24 June 2002 between itself and the Government.

323 *Merchants and Manufacturers Insurance Co Ltd v Hunt* [1941] 1 KB 295.
324 Atkinson J in *Zurich v Morrison* [1942] 1 All ER 529, 535; *Merchants' Assurance v Hunt* [1941] 1 KB 295.
325 The UK was similarly dilatory: motor insurance became compulsory but the problems raised by uninsured drivers were not addressed until 1946, and those raised by untraced drivers were not addressed until 1969.
326 First Fund Agreement, cl 12.
327 Motor Vehicles Insurance Ordinance, s.6(1)(b); Motor Vehicles Insurance (Third Party Risks) Regulations, reg 27.