

BETWEEN THE STATE INSURANCE
 GENERAL MANAGER

Appellant

A N D PHILLIP JOHN McHALE of
 Lower Hutt, Civil Servant
 and JOYCE McHALE, his
 wife

Respondents

Coram: Cooke P.
 Richardson J.
 Hardie Boys J.

Hearing: 8 and 13 March 1991

Counsel: P.D. Green for Appellant
 Respondents in person

Judgment: 20 December 1991

JUDGMENT OF COOKE P.

The basic facts of this case are that Mr and Mrs McHale, the second mortgagees and former owners of a house, bought it at a first mortgagee's sale on 23 May 1984. The mortgagor had let it to members of the motor cycle gang or club Highway 61. The McHales insured it against fire with the State Insurance Office. On 28 May 1984 Mr McHale gave the occupants notice to quit by 5 June 1984. They did vacate, although leaving some chattels, at the Queen's Birthday weekend ending on Monday 4 June, after a wild or at least vigorous party. Over the following weeks the McHale family carried out work at the property with a view to its sale. On the

night of 7 to 8 August 1984 it was totally destroyed by a fire lit by a person or persons unknown. The insurer declined liability on multiple grounds. The McHales commenced action against the insurer in July 1985. The action was tried by Gallen J. over 12 days in February and July 1989. On 4 August 1989 he delivered judgment in favour of the plaintiffs, 6 A.N.Z. Ins. Cas. 61-022. The judgment was for \$43,500 plus possibly \$3000 for the cost of removal of debris; the plaintiffs were also allowed interest. The insurer appeals. No matter of quantum was argued in this Court.

At the trial one of the allegations of the insurer was that the house had been deliberately burnt down by or for Mr McHale. There was no more than exiguous evidence to support that allegation. The Judge found against it and it has not been resurrected on appeal. That it was ever raised is unfortunate. The other grounds are sundry allegations of non-disclosure, breach of policy conditions and fraudulent statements by the insured. Most of these have been persevered with on appeal, and some raise much more difficult questions.

The difficulty of the case has been compounded by the fact that in both Courts Mr and Mrs McHale have conducted their case in person. On the questions of law arising they were naturally unable to help the Court. On questions of fact it has been little better, by reason of

diffuseness and a tendency to fence with issues. Like the other Judges who have sat on the case, however, I would acquit them of all the allegations of fraud.

From the submissions presented by Mr Green it appeared that the chief reason of the insurer for carrying the case to appeal is that it raises the question of the duty of an insured who knows that his property is occupied by gang members. It is only that question which I propose to discuss. Having had the advantage of reading in draft the judgment prepared by Hardie Boys J., I agree with it on all other matters. To add anything would be superfluous.

Gallen J. found that it was an inescapable conclusion that at least by the time the occupants had left the property after Mr McHale had given them notice to quit he was aware that some of their number were members of the Highway 61 gang. The Judge also found that at the time the proposal was submitted (a fortnight earlier) Mr McHale must have been aware that persons residing in the house were associated with a motor cycle group, 'not necessarily that it was a gang in the pejorative sense in which that word is understood'. On the evidence to which counsel for the appellant directed our attention I think that if anything those findings were generous to the McHales.

It seems to me that the realistic approach to the appeal is to accept that at all material times they knew that the principal occupants of the house were members of a motor cycle gang in the sense in which that word is commonly understood in New Zealand. Though the Judge expressed reservations on this point, it seems probable that some leather jackets or T-shirts with insignia were obvious to Mr McHale on his visits to the property. There was significant evidence from the loss adjuster that after the fire Mr McHale told him that gang members in occupancy before the auction [in May] had made it difficult for the property to be viewed and only one person, himself, was interested in bidding at the auction. Moreover, Mr McHale is a former school teacher, was a provisional appointee as Chief Censor of Films for New Zealand, has written more than 40 plays and more than 100 short stories, has considerable experience in television and film production in New Zealand, has lived in this country since 1955 and must be familiar with the mores and use of language in the community. His references to 'motor cyclists and 'clubs' in relation to Highway 61 I would put in the category of fencing.

Further, on the evidence of Police Officer M.D. Sutherland and Mr T.J. O'Donnell, central area claims manager for the Commercial Union General Insurance Company, as well as that of Mr F.A. Brooker, customer services supervisor for the State Insurance Company at

Lower Hutt, it is plain that knowledge that the house was occupied by members of the Highway 61 gang would have reasonably affected the mind of a prudent insurer in determining whether he would accept the risk, and, if so, at what premium and on what conditions. The police evidence is to the effect that Highway 61 was one of the more moderate gangs in the Hutt Valley but still 'lives by a fairly violent code'.

Effect on the mind of a prudent insurer is in substance the test of materiality applied by the Privy Council in *Mutual Life Insurance Co. of New York v. Ontario Metal Products Co. Ltd* [1925] A.C. 344 and *Marene Knitting Mills Pty Ltd v. Greater Pacific General Insurance Ltd* [1976] 2 Lloyd's Rep. 631; by the English Court of Appeal in a line of cases of which the most important is perhaps *Lambert v. Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485; and by several High Court Judges in New Zealand, including Somers J. in *Avon House Ltd v. Cornhill Insurance Co. Ltd* (1980) 1 A.N.Z. Ins. Cas. 60-429 and Hardie Boys J. in *Guthrie House Ltd v. Cornhill Insurance Co. Ltd* (1982) 2 A.N.Z. Ins. Cas. 60-466. By s.6(2) of the Insurance Law Reform Act 1977 it is the test adopted for avoiding policies for misstatements. That Act does not deal with non-disclosure. So far as the pure question of materiality is concerned, however, I do not think that

the test can be different. Nor is there any doubt that the McHales did not make disclosure here.

If an insured fails to disclose a fact known by him to be material, the insurer is undoubtedly entitled to avoid the policy. But the position is rather less straightforward if he did not know and ought not reasonably to have known that it was material. It is true that the weight of English authority is to the effect that what the insured knows or ought to know as to materiality does not matter: the insured is held absolutely bound to disclose facts that would be material to a prudent insurer, provided that they are actually known to the insured or (probably) that a reasonable insured in his position ought to know them. But, as MacKenna J.'s survey of the authorities in *Lambert* brings out, there has also been judicial support in England for the view that the duty is to disclose such facts as a reasonable insured would believe to be material. Further, it being settled in marine insurance and probable in other kinds of insurance that the duty extends on the one hand to facts which a reasonable insured ought to know, it seems odd that, according to the prevailing English view, the insured is bound to disclose such facts even though he ought not to know that they are material.

On the last point it is to be noted that in *Blackley v. National Mutual Life Association* [1970] N.Z.L.R. 919, 931, Richmond J. accepted that the duty to disclose material facts extends only to facts which are either known or ought in the ordinary course of affairs to be known to a proponent. There is nothing to the contrary in the judgments on appeal in that case, [1972] N.Z.L.R. 1038, although Turner P. at 1047 and Macarthur J. rejected arguments that a life insurance proponent should disclose his own suspicions about his health.

As the contributor of the title Insurance in the fourth edition of *Halsbury's Laws of England*, volume 25 (1977) para. 370, Professor Hardy Ivamy retains from previous editions the proposition:

If the fact, although material, is one which the proposer did not and could not in the particular circumstances have been expected to know or if its materiality would not have been apparent to a reasonable man, his failure to disclose it is not a breach of his duty.

The proposition is to be found in both the third edition, volume 22, para. 360, and the second edition, volume 18, para. 586. Thus it has the imprimatur of learned and eminent contributors. But in his own book on *General Principles of Insurance Law*, 5th ed. (1986) 127, Professor Hardy Ivamy suggests that the prudent insurer test is the one that should always be adopted.

It appears that the law of Scotland has long adopted the reasonable insured test for the duty to disclose: *Life Association of Scotland v. Foster* (1873) 11 Macpherson 351, 359-60 (Lord President Inglis), 370 (Lord Ardmillan); *MacGillivray and Parkington on Insurance Law*, 8th ed. (1988) 660. The citations in the judgment of Richardson and Hardie Boys JJ. show that at least no higher duty is cast on the insured in the United States. In Australia, as to the insured's duty of disclosure, the test whether a reasonable person in the circumstances could be expected to know the matter to be relevant to the decision of the insurer has been adopted in the Insurance Contracts Act 1984 (Cwth) s.21. For the difference between this form of an objective test and the form recommended by the Australian Law Commission, see Professor Kenneth Sutton's *Insurance Law in Australia*, 2nd ed. (1991) 145 et seq. In New Zealand the Contracts and Commercial Law Reform Committee, while making the recommendations as to misstatements which led to the 1977 Act, postponed consideration of non-disclosure: see their 1975 *Report on Aspects of Insurance Law*, para. 17, and their 1983 Report on the same subject, para. 10.5.

The two Privy Council decisions already cited do not appear to be necessarily decisive of this issue. In the *Mutual Life Insurance* case on the view of the evidence taken by their Lordships neither a reasonable insured nor a reasonable insurer would have regarded the

particular inaccuracy as material. In the *Marene* case there was what was apparently a gross non-disclosure (four previous fires, although the business had moved) and it was obvious that the insured ought to have made disclosure. In neither case was there a clear conflict between what a reasonable insurer would have regarded as material and what a reasonable insured ought to have disclosed.

Apparently there is no decision of this Court on the issue. In *New Zealand Insurance Co. Ltd v. Forbes* (C.A. 178/86; judgment 22 August 1988) there was found to be a breach of good faith by wilful non-disclosure of facts known to the insured: the judgment does not consider the precise extent of the duty of disclosure.

Gallen J. disposed of the issue so far as the present case is concerned by finding that there was no evidence that the particular tenants behaved in such a manner as to require immediate disclosure of their associations, assuming that these were known. For the appellant it is said that this is unsatisfactory to the insurance industry, because as the judgment stands no duty attaches to the insured unless the insured has personal knowledge of the propensity of the particular gang members to do property damage - a test that realistically will almost never be met. I think that there is some force in that submission. Many gang

activities are of course lawful and unobjectionable, but gang occupation of a house carries special risks because of the proclivities of some gang and would-be gang members and also possible action by rival gangs. If insured premises are a headquarters of a gang, that fact should obviously be disclosed; and so, I think, should the fact that insured premises, though not headquarters, are occupied or frequented predominantly by gang personnel (a 'gang house').

But the resolution of this appeal turns on the knowledge of the insured and on New Zealand law in that regard. For the reasons already indicated it does not seem to me that New Zealand law has yet been settled. It may be open to this Court, at any rate if sitting as a Court of five, to adopt the test in *Halsbury* of the duty of disclosure falling on an insured. But sitting as a Court of three, and with no legal argument on one side and no notice to the other side that full argument was required on the issue, I do not think that we should attempt any definitive ruling.

My brothers find it possible to conclude the case by accepting that the knowledge of the McHales about Highway 61 was not shown to be such that they knew or ought to have known that the presence of members in the house would be likely to lead to damage. I would respectfully accept that assessment, while admitting to

some hesitation lest it might seem to be an assessment more of the particular insured than of reasonable insured in their position. The latter would seem to be the correct test: see the discussion in Professor Sutton's book already cited. A test dependent on the characteristics of the particular insured could lead to very dubious insurance claims. Approaching the case, however, by the test of what a reasonable insured ought to have known, I have not been brought to the point of satisfaction on the balance of probabilities in the circumstances of this somewhat confused case that they ought to have known of any special risk. On that short ground I would concur in the dismissal of the appeal, leaving the issue of the extent of an insured's duty of disclosure open in other respects.

The case has shown that the law of this country is in far from a clear or satisfactory state. In 1957 the Law Reform Committee in England recommended legislation as to disclosure adopting the test of what would have been considered material by a reasonable insured. The late Sir Brian MacKenna in *Lambert* at 491 expressed his personal regret that the recommendation had not been implemented. Legislation on those lines has since been introduced in Australia. In effect I follow him in suggesting that it appears to be time that New Zealand did the same.

The Court being unanimous as to the result, the appeal is dismissed. The respondents are entitled to any reasonable disbursements, to be fixed by the Registrar.

R B Cooke P.

Solicitors:

Gibson Sheat, Wellington, for Appellant

BETWEEN THE STATE INSURANCE
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Appellant

AND PHILIP JOHN McHALE of
Lower Hutt, Civil Servant, and
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Respondents

<u>Coram</u>	Cooke P Richardson J Hardie Boys J
<u>Hearing</u>	8, 13 March 1991
<u>Counsel</u>	P D Green for Appellant Respondents in person
<u>Judgment</u>	20 December 1991

JUDGMENT OF RICHARDSON AND HARDIE BOYS JJ
DELIVERED BY HARDIE BOYS J

The principal issue in this appeal concerns the duty of an insured under a fire insurance policy to disclose material facts to his insurer. In the High Court that issue was not to the forefront of the insurer's case. For there it was the insurer's prime defence that the fire damage in respect of which the insured claimed had been

caused by the deliberate act of Mr McHale himself, or his servants or agents. The onus of so proving lay upon the insurer and Gallen J, while satisfied that there had been arson, held that the evidence did not establish that Mr McHale or anybody connected with him was responsible. He also held against the insurer on its alternative defence of non-disclosure and on a subsidiary defence that there had been false statements in connection with the claim, in respect of both of which the insurer also carried the onus. On this appeal, the insurer accepts the Judge's conclusion as to the cause of the fire, but pursues the other matters.

The background facts

The property in question is a house at 8 Buller Grove, Naenae, Lower Hutt. Mr and Mrs McHale acquired it in about 1961 and it was their family home until 1982 when they moved to a new house at Pinehaven, and sold the first house to a Mr Forde and a Ms Hakaria, on terms that enabled part of the price to be paid off over a 12 month period. The purchasers remained in occupation until 1 March 1984, when they let the property to two young men named Williams, or Wanikau, and Billington. The purchasers defaulted under their first mortgage and in respect of the payments due to the McHales. On 20 May the McHales exercised the right of re-entry conferred by the agreement for sale and purchase; and on 23 May they bought in at an auction sale conducted at the instance of the first mortgagee.

Probably on 20 May Mr McHale wrote to Wanikau. It appears that the letter was prompted by concern over repossession of chattels which were included in the tenancy. The letter enclosed the notice of re-entry and said that re-entry was being exercised to protect the tenants against any threatened removal of chattels. It went on to say that they were now the McHale's tenants until the

auction took place, and would so continue unless someone else bought the property.

On 23 and 26 May Mr McHale completed proposals with the State Insurance Office, with which the property had been insured prior to the sale, for houseowners and householders insurance. The proposals, and the policies that were subsequently issued, were, so far as is presently relevant, in identical terms. Malicious damage by tenants was excluded, but not malicious damage by others. In completing the proposals, Mr McHale made it clear that the house was to be tenanted, but did not refer to the fact that the previous owners' tenants were still there. Then on 28 May he wrote to advise the State that after buying the house he "discovered there were occupants ... who claimed they had an oral tenancy agreement with the previous owner", and that he was "in the process of forming a proposed tenancy agreement". An agreement did not eventuate. Indeed, on 28 May Mr McHale delivered a notice to quit addressed to "all present residents or occupiers" of the property. It required possession by 5 June.

The occupants moved out over the Queen's Birthday weekend, 2-4 June, but they left behind a number of items of some value, such as a stereo unit. They had had what the next door neighbour, Mrs Lemalie, described to Mr McHale as a wild party, and the house was in disarray. Over the next five weekends the McHale family cleaned it up and attended to necessary repairs and maintenance to prepare it for sale; making no claim on the insurer for any damage done. The State was informed promptly by telephone that it was unoccupied, and written confirmation was given on 11 July. By late July the property was ready for sale, and there was some market interest. But on the night of 7-8 August the house was burnt down; there was a total loss.

The grounds for declinature

The State's statement of defence to the proceeding the McHales brought to recover under the policy raised a considerable variety of matters, but it is necessary to refer only to those that were seriously canvassed on the appeal. At the forefront is an allegation that Mr McHale failed to disclose to the insurer "the presence of Highway 61 Motor Cycle Gang or gang members as tenants in the property ... ". A secondary allegation is that he failed to disclose "that his financial circumstances were strained". The failure to disclose the first of these matters was, it is said, a breach of the insureds' duty of disclosure. Further, the failure in both respects is said to be a breach of conditions 14 and 10(a) of the policies.

Condition 14 declared that the truth of the statements and answers in the proposal was a condition precedent to the insurer's liability to make payment under the policy. Mr McHale in answer to proposal question 6, "Are you aware of any further information likely to affect the acceptance of this insurance?", had simply answered, "No".

Condition 10(a), which it is said came into play from the time the occupants vacated, declared that unless the sanction of the insurer had been obtained, insurance would cease to attach, "If the nature of the occupation or other circumstances affecting the property be changed in such a way as to increase the risk of loss or damage". Two other breaches of this condition are also alleged: failure to disclose that malicious damage had been done over the Queen's Birthday weekend, and that there had been three burglaries of the premises during July 1984.

These same two failures are said also to constitute breaches of policy condition 2, which required the insured, "Upon the occurrence of any loss or damage to the property insured or any accident giving rise or likely to give rise to a claim under this Policy", immediately to give full particulars to the insurer.

Finally, there is an allegation of breach of policy condition 8, by which policy benefits were forfeited "if any false declaration be made, or used in support [of any claim], or if any fraudulent means or devices are used ... " to obtain any benefit under the policy.

The insured's duty of disclosure

It will be helpful to deal with some relevant legal principles before going into the detail of the breaches alleged against Mr McHale.

The various policy conditions mentioned are no more than expressions of the fundamental principle that the contract of insurance is one of the utmost good faith on both sides. Pursuant to that principle, the insured is bound to make full disclosure of all material facts. The reason is found in the classic statement of Lord Mansfield in *Carter v Boehm* (1766) 3 Burr 1905, 1909; 97 ER 1162, 1164:

Insurance is contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risque, as if it did not exist.

The keeping back such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived, and the policy is void; because the risque run is really

different from the risque understood and intended to be run, at the time of the agreement.

The duty of disclosure is obviously not absolute. As Lord Mansfield recognised, the insurer can expect disclosure only of facts that are within the knowledge of the insured; a person being presumed to know what in the ordinary course of things he would be expected to know.

Materiality is a question of fact. As McKenna J pointed out in delivering the leading judgment of the English Court of Appeal in *Lambert v Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep 485, 487, there are four possible tests of materiality: what the particular assured believes to be material; what a reasonable man would believe to be material; what the particular insurer would regard as material; and what a reasonable or prudent insurer would treat as material. The first has never been accepted. There is a collection of judicial pronouncements rejecting it in Hardy Ivamy's *General Principles of Insurance Law* 5ed 126-128. The third has not gained acceptance either. The second is apparently the test in Scotland: see MacGillivray and Parkington on *Insurance Law* 8ed 660; and seems to have found favour in some English cases, most notably in the judgment of Fletcher Moulton LJ in *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863, 883-884. However it was rejected in favour of the fourth test in the *Lambert* case and it is clear that the latter test now represents the law in England: Hardy Ivamy at 126-127, MacGillivray and Parkington at para 658, *Container Transport International Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd's Rep 476. Until 1984 it was also the test in Australia: *Marene Knitting Mills Pty Ltd v Greater Pacific General Insurance Ltd* [1976] 2 Lloyds Rep 631, 642 (PC). No doubt because of its harshness, it has in that country been replaced by legislation which enacts the

reasonable assured test: see s 21 of the Insurance Contracts Act 1984. And it was adopted by this Court (although the point was not in issue) in *New Zealand Insurance Co Ltd v Forbes* CA 178/86, judgment 22 August 1988, in the words used in 15 *Halsbury's Laws of England* 4ed para 367: "whether the mind of a prudent insurer would be affected, either in deciding whether to take the risk at all or in fixing the premium, by knowledge of a particular fact if it had been disclosed". Further, it is clearly the basis of s 6 of the Insurance Law Reform Act 1977, mentioned later, where it is provided that for the purposes of the relevant sections of that Act a statement is material "only if that statement would have influenced the judgment of a prudent insurer in fixing the premium or in determining whether he would have taken or continued the risk upon substantially the same terms".

It has not been necessary for this Court to consider the differences of approach that have become apparent in applying this particular test: viz, whether the fact is one which would affect the formation of the opinion rather than solely the final decision of the prudent insurer. The former was the approach taken by the English Court of Appeal in *Container Transport International Ltd v Oceanus*, the latter was that taken by the New South Wales Court of Appeal in *Barclay Holdings (Australia) Pty Ltd v British National Insurance Co Ltd* (1987) 8 NSWLR 514. The present case does not raise this issue.

In discussing materiality in para 370, *Halsbury* makes the following statement:

However, materiality is not a question of belief or opinion tested subjectively, and the proposer does not discharge his duty by a full and frank disclosure of what he believes to be material, however

honest his belief; he must go further and disclose any fact which a reasonable man would have thought material. If the fact, although material, is one which the proposer did not and could not in the particular circumstances have been expected to know or if its materiality would not have been apparent to a reasonable man, his failure to disclose it is not a breach of his duty.

The introduction of references to the reasonable man are puzzling in view of the earlier and correct statement, mentioned above, that the proper test is that of the prudent insurer. The authority primarily cited in the footnotes to this passage is the judgment of Fletcher Moulton LJ in the *Joel* case, which concerned answers given to questions as to the assured's state of health. The case turned on its own particular facts, and did not strictly call for a discussion of the tests of materiality: indeed it was only Fletcher Moulton LJ who embarked on the topic. What he said was this:

The duty is a duty to disclose, and you cannot disclose what you do not know. The obligation to disclose, therefore, necessarily depends on the knowledge you possess. I must not be misunderstood. Your opinion of the materiality of that knowledge is of no moment. If a reasonable man would have recognized that it was material to disclose the knowledge in question, it is no excuse that you did not recognize it to be so. But the question always is, Was the knowledge you possessed such that you ought to have disclosed it? Let me take an example. I will suppose that a man has, as is the case with most of us, occasionally had a headache. It may be that a particular one of those headaches would have told a brain specialist of hidden mischief. But to the man it was an ordinary headache undistinguishable from the rest. Now no reasonable man would deem it material to tell an insurance company of all the casual headaches he had had in his life, and, if he knew no more as to this particular headache than that it was an ordinary casual headache, there would be no breach of his duty towards the insurance company in not disclosing it. He possessed no knowledge that it was incumbent on him to disclose, because he knew of nothing which a reasonable man would deem material or of a character to influence the insurers in their action. It was what he did not know which would have been of that character, but he

cannot be held liable for non-disclosure in respect of facts which he did not know.

These observations were considered by Lush J in *Horne v Poland* [1922] 2 KB 364, 367, and his comments upon them were in turn discussed by McKenna J in the *Lambert* case at 490. As McKenna J pointed out, two distinct matters are involved:

... first, what does the applicant know or what can he be taken to know and, secondly, what must he disclose. His knowledge, actual or presumed, will include such inferences as an ordinary person using reasonable care and judgment would draw from the facts known to him, for example, a headache. If the ordinary man would not have inferred a serious malady from a headache, knowledge of a malady cannot be proved.

This is we think as far as the *Joel* case should be taken. The other cases cited in the *Halsbury* footnotes do not take it any further. It follows that in para 370 *Halsbury* does not correctly state the law. In the United States, the position appears to be rather different. There, there is a separation of materiality and duty. Materiality is judged by the prudent insurer test; but the policy can be avoided only if there is concealment, in other words, if the non-disclosure is intentional or fraudulent: see 45 CJS para 473(3). It is on this basis that in a number of cases the law has been stated in terms similar to those in *Halsbury*. An example is *Roberto v Hartford Fire Insurance Co* (1949) 177 F 2d 811, 814 in the United States Court of Appeals, Seventh Circuit, where Duffy J for the Court said:

We think the correct rule is that where, as here, the insurer fails to question the insured, the latter cannot be said to have concealed facts so as to void the policy unless they are facts which he knows, or which a reasonable man should have known, to be material to

the risk and unless he does so for the purpose of obtaining insurance which could not have been obtained after a disclosure of such facts.

Thus what in English (and New Zealand) law is a positive duty of disclosure is in the United States seen as a duty not to conceal.

While there is much to be said for this kind of approach, it is not we think open to this Court to adopt it. In our view, the law is that, given that a fact is within the knowledge, actual or presumed, of the assured, it must be disclosed if the prudent insurer would regard it as material. But materiality being a question of fact, the reasonableness or otherwise of what is claimed to be material will be a relevant consideration in determining whether indeed it is.

It need only be added that the duty of disclosure exists independently of any that may be spelt out in the policy documents. And it is a positive duty, so that it is no answer to an allegation of non-disclosure in a proposal that there was no question specifically directed to the particular point. The fact that both parties are subject to the same duty is emphasised by ss 5 and 6 of the Insurance Law Reform Act 1977, which preclude an insurer from relying on a misstatement in a proposal unless it was both substantially incorrect, and material. And in his submission on the appeal Mr Green proceeded on the basis that the State could not invoke any of the policy conditions upon which it relied unless the particular non-disclosure was material. It is however different with condition 8, which is directed to events subsequent to the loss and which does no more than state the general law: it is fundamental to the obligation of good faith that a claim under the policy be made honestly. That proposition needs no amplification.

This rather lengthy discussion of the principles is necessary because of the way in which aspects of the case were approached both by Gallen J in his judgment and by Mr McHale in his submissions on the appeal: the latter taking a very subjective approach.

The High Court judgment

Gallen J, after dealing with the allegation of arson, first directed himself in accordance with the prudent insurer test, citing in that regard the *Lambert* case. He then held - and there was ample evidence to justify the finding - that "the presence of a motorcycle group which the general public was accustomed to designate by the term 'gang' would be a factor which a prudent insurer would take into account and which should therefore be disclosed"; and that Highway 61 came within this description. However there was no evidence that the house was occupied by the group as such, and so he went on to consider the materiality of the fact, also clearly established, that Wanikau and Billington were members of Highway 61. Proof of that fact, he said, did not dispose of the matter:

The defence contention has to be that membership of a group such as the Highway 61 Club or gang of itself means that such a person constitutes a risk for insurance purposes and his or her presence must be disclosed. This is of course a rather extreme application of the maximum *noscitur a sociis*. It involves a conclusion that membership of itself imports at least the possibility that a person is likely to be involved in the commission of damage which would not be accepted as likely from persons not so associated.

I do not think it is appropriate to classify people in such a way. Certainly the presence of people whose known behaviour is likely to lead to property damage or insured damage would seem to come within the principle. The real question is what kind of behaviour can be expected from the particular persons?

The Judge then discussed the evidence of neighbours as to the conduct of the occupants in the period prior to the McHales taking over the property in May 1984, when the proposals were completed, and held that there was

... nothing in the way of the kind of gang behaviour which would give rise to fears for property and nothing to suggest that the persons present were likely to constitute a particular insurance risk other than their membership of a particular motorcycle organisation generally described as a gang. If membership of a doubtful organisation were all that was sufficient many ordinary citizens would have to report the return home of members of their family who belonged to student organisations which were involved in some capping activities and the like. This cannot be the law. The concern which an insurance company is entitled to express must depend upon behaviour and control. In this situation there does not seem to have been any serious failure in respect of either. It follows that the evidence falls short of establishing that the particular tenants behaved in such a manner as to require immediate disclosure of their associations assuming these were known.

In the context of materiality, we take this to be a finding that membership of a gang is material only if the member has exhibited behaviour such as to constitute an insurance risk over and above that posed by any other kind of occupant.

The Judge next proceeded to discuss the question of the insureds' knowledge and concluded:

I think that Mr McHale must have been aware at the time the proposal was submitted that persons residing in the house were associated with a motorcycle group, not necessarily that it was a gang in the pejorative sense in which that word is understood. Any subsequent knowledge and the consequences of that knowledge must be separately considered in relation to the particular allegation that in terms of the policy a subsequent disclosure should have been made on the acquisition of additional knowledge.

This finding would be sufficient to dispose of the defence based on the answers given in the proposal; but Mr Green challenged its validity and it will therefore be necessary to return to it. As to knowledge subsequently acquired, the Judge considered it "an inescapable conclusion that at least by the time the occupants had left the property after Mr McHale had given them notice to quit he was aware that some of their number were members of the Highway 61 gang". But as it was his view that behaviour rather than gang membership was the relevant material fact, he then turned to the evidence of the occupants' behaviour following the completion of the proposals, and held that leaving aside the events of the last night of their occupation, there was no evidence of any behaviour likely to have an effect on the risk. As to that last night, concerning which there was strongly conflicting evidence, he found that some damage requiring repair was done. But with reference to condition 10(a) held that whatever was involved in the incident, there was not a change in the nature of the occupation or other relevant circumstance within the terms of that provision; and he held that condition 2 was inapplicable because the McHales made no claim in respect of the damage.

The Judge then proceeded to deal with the various other allegations of non-disclosure and concluded with a summary in which he first said this:

Having regard to the circumstances I think the evidence falls short of establishing that Mr McHale knew or ought to have known that the persons concerned were such as by their actual or likely behaviour to be persons whose presence would increase the risk over and above that which could be said to be present in the case of ordinary tenants of their age and kind. That situation did not change subsequent to the initial proposal but even if Mr McHale did become aware of additional material, it was not sufficient to create a situation contemplated by the policy where disclosure became necessary.

Then he turned again to the law, pointing out the great changes both in society and in the nature of the insurance contract, and in the nature and degree of the risk, that have occurred since *Carter v Boehm*. He concluded:

I think it is not inappropriate to take judicial notice of the fact that insurance companies are able to assess the risk on a statistical basis much more generally than was previously the case. It follows in my view that the assessment of the obligation of disclosure must be considered in relation to the much more widespread ownership and insurance cover than was previously the case. While the obligation for disclosure still remains, whether or not it has been complied with must to some extent at least depend upon the way in which the majority of members of society see their obligations.

Materiality

The final sentence in the passage just quoted suggests at least partial adoption of the reasonable assured test. While the New South Wales Court of Appeal in the *Barclay Holdings* case has been described as taking the bold decision of asserting an independent stand (see the article "Common Law Materiality - an Australian Alternative" by Yeo Hwee Ying in the March 1990 issue of the Journal of Business Law, p 97), that Court did not suggest the abandonment of the prudent insurer test. It needed legislation to accomplish that. The same must we think be so in New Zealand. The prudent insurer test is so well established that it would be wrong for the Court, with no data indicating need or consequences, to strike out in a new direction. Nonetheless there is considerable validity in the earlier part of what Gallen J said, for what was material to a prudent insurer 200 or even 20 years ago may not be material now; and conversely there will be matters that are now material that once were not. The ascertainment of these matters is part of the fact finding exercise to be undertaken in a claim of this kind. The evidence to which the Judge made specific reference in expressing his conclusion that occupation by a

gang itself, as for example for a gang headquarters, will be a material fact was that of Mr Brooker, a senior officer of the State, who said that his company would not insure a property occupied by a gang. Although this witness made no specific reference to members of gangs as distinct from gangs themselves, many of the reasons he gave - damage by occupants and visitors, increased fire hazard from motor cycles brought inside, attacks by members of other gangs and reprisals against the owner by disaffected former occupants - would apply whether or not the premises were used as a headquarters. Of course the attitude of the particular insurer does not indicate that of the prudent insurer. But there was other evidence, notably that of a Mr O'Donnell, claims manager of another insurance company. He was quite specific that a prudent insurer would regard it as material "that the house was being rented to gang members or to persons who have a close association with gang members". The witness noted that for a reason already mentioned occupation by gang members is material not only while they are in occupation but also, depending on the circumstances of their departure, after they have gone. This evidence was not contradicted and must be accepted.

Mr McHale's response to this evidence, and to Mr Green's submissions based upon it, was to emphasise the lack of specificity about the word "gang". Obviously it can be used with a variety of nuances. In present day New Zealand, it usually, but by no means invariably, carries the pejorative sense of a group with anti-social or criminal tendencies. This is particularly so when it is used in conjunction with the names of certain groups or with the words "motor cycle" or "bikie". However it is not the word "gang" that is important to the issue of materiality. Rather, it is the fact that the persons concerned belong to a group whose members are likely to behave or cause others to behave in the way the witnesses described: for it is the likelihood of that behaviour that affects the risk.

The materiality of the presence of such persons cannot depend on whether they themselves exhibit that behaviour, for then there would be no duty of disclosure until the damage was done. And in any event it is the risk of damage by others that is equally significant to the insurer. Therefore we are unable to accept the Judge's conclusion as to the materiality of Wanikau's and Billington's membership of Highway 61. The evidence that this was material was unequivocal.

Knowledge

In order to make good its claim of non-disclosure, the State had to establish that the McHales knew that Wanikau and Billington were members of Highway 61; and further that Highway 61 was a group whose members were likely to behave or cause others to behave in a way that could damage the property. This we see as the real issue in this part of the case, and we think it was to this issue that the Judge was really directing many of the remarks that we have set out. His findings of fact in this regard may be summarised in this way: when he signed the proposals, Mr McHale knew that some of the occupants belonged to a motorcycle group, but in the absence of untoward behaviour on their part he did not appreciate the nature of the group and hence the possible behavioural problems that might arise; and that at the time they left he knew they were members of Highway 61 but still had no awareness of any behaviour problems. This lack of awareness would on this line of reasoning lead to the conclusion that Mr McHale did not appreciate the relevant significance of membership of Highway 61. However the Judge did not address the further question whether knowledge of the name coupled with knowledge that it was a motor cycle gang amounted to knowledge actual or presumed as to the likely characteristics of its members or those having to do with them. This was not a topic that was explored in evidence either. The McHales

conducted their own case, as they did in this Court, and had obvious difficulty in identifying and concentrating on the issues raised in this part of the case, where the State was taking every point possibly open to it. The answers under cross-examination of Mr McHale in particular tended to be pedantic and to give the impression of evasiveness. Yet throughout his evidence he insisted that he never had any idea that the occupants of the house posed any risk. Mrs McHale when asked whether "Highway 51" (they both said this was the name of which they first became aware) meant anything to her, said that it did not. She said that she asked a Police officer who came to the house after the occupants had left about Highway 51 and that he corrected her as to the name and said that they were no problem, "they are good blokes, we don't have any trouble with them".

In this connection, it may be noted that evidence of the Lower Hutt Police officer whose duties were largely gang-related was that Highway 61 had the reputation of being, comparatively, one of the more moderate of the gangs in the district, tending to "keep themselves on a low key footing".

It is to be remembered that the prime allegation being of arson, the whole case focussed on the honesty of the McHales, Mr McHale in particular. The trial extended over 12 sitting days, and as the Judge observed, over all that time Mr McHale was before him either as witness or as advocate. There was a more than usual opportunity to assess his personality and his credibility. The Judge noted a tendency to volubility, and to a manner of expression that could easily lead to the various inconsistencies that became apparent in what was said and what was written. To this assessment might be added a degree of ingenuousness coupled with a considerable suspicion, which may well have been brought about by the arson allegation, as to the motive behind the questions he was asked. Gallen J was

not prepared to make an adverse finding on credibility. It was not only his view that Mr McHale had not behaved fraudulently, but overall he accepted the genuineness of his conduct and of his evidence. It would therefore run counter to the Judge's assessment of him to hold that his knowledge of Highway 61 was such that he knew or ought to have known that the presence of members in the house could lead to damage being done to it.

Mr Green pointed to a number of passages in the evidence that suggested that the McHales' increasing awareness of the associations of the occupants of the house occurred at an earlier stage than they acknowledged and on that basis he challenged the Judge's assessment of the McHales and their evidence. It is not necessary to go into detail. Suffice it to say that having considered these matters, the inconsistencies, and the explanations, we are not persuaded that we should make a different assessment and as a result conclude that the State had established that the McHales had the requisite knowledge to put them in breach of their duty of disclosure so far as the identity of the occupants was concerned.

Non-disclosure of other matters

As mentioned, the State asserted a failure to disclose that malicious damage had been done over the Queen's Birthday Weekend, and further that there had been three burglaries during July 1984.

The first of these matters falls for consideration in respect of both condition 2 and condition 10(a). We agree with Gallen J that condition 2 is to be construed as applicable where a claim is made in respect of the damage concerned. It is unnecessary to set out the full text of the condition; it clearly relates to the making of a claim for particular damage and understandably requires that prompt notice

and full particulars of that damage be given; failing that, the claim will not be met. To read it so as to require notice of any and every occurrence, whether or not a claim is to be made in respect of it, would lead to harsh and absurd results that cannot possibly have been intended.

As to condition 10(a), we again agree with the Judge's conclusion. The occurrence of damage was not of itself a change in the nature of the occupation or other circumstance in terms of the condition. At best, it was evidence of the behaviour of the occupants and their visitors and so was relevant to the question of gang membership, which has already been considered. We do not see it as a separate matter in terms of the duty of disclosure. Once the conclusion is reached that the McHales had not been proved to have the requisite knowledge in that respect, what occurred prior to the occupants' departure becomes of no relevance.

The Judge dealt with the allegation concerning the burglaries by finding that the evidence was equivocal. The Police were called three times by Mrs Lemalie, but only once was anyone found and this was Wanikau, claiming to be collecting property he had left behind. The Judge had reservations about this neighbour's evidence generally, and we see no reason to differ from his conclusion that the evidence was not sufficiently clear to enable the State to rely upon condition 10(a) in this regard.

Finally under this head is the allegation of non-disclosure by Mr McHale that his financial circumstances were strained. Particularly in the absence of any questions on the proposal form or other inquiry concerning the financial circumstances of the proponent, the Judge expressed some surprise at the contention that there was nonetheless an obligation to disclose what Mr O'Donnell

described as "high financial stress". The obvious difficulty with such an obligation, if there be one, is its inherent lack of precision; which is illustrated by the difference between the words Mr O'Donnell used and those pleaded by the State: high financial stress in the one instance and strained financial circumstances in the other. The Judge found it unnecessary to decide whether the obligation existed, for he was satisfied on the evidence that the McHales' financial position was in any event not such as to require the disclosure contended for. We agree with that conclusion. There were 3 mortgages on their Pinehaven house, and their income was modest, but they had been able to obtain the mortgage finance needed to buy back the Buller Grove property, it was tenanted, and, later, their efforts to sell it seemed likely to be successful. Assuming that there is an obligation such as is contended for - and we prefer to express no concluded view upon that - it must on the evidence of Mr O'Donnell arise where there is what can fairly be described as "high financial stress". The evidence did not disclose that in this case. Financial benefit is often the motive for arson, and an inquiry into the McHales' circumstances was no doubt very relevant to that - the major part of this case. But we see no justification for relying upon them when it became necessary as an alternative defence to fall back on the policy conditions.

False or fraudulent means

Mr Green's written submission mentioned a number of respects in which it was said there had been a breach of condition 8. The Judge considered them all, and dismissed them for various reasons: the alleged false statement had not been proved; it was not demonstrably false; it was of little significance; the necessary fraudulent purpose had not been established. While not abandoning his submission that the Judge was in error in treating them in this way, Mr Green did

not press the point, and in that we think he was justified, for in our opinion the Judge was well entitled to reach his conclusions upon them.

Mr Green did, however, press one point. It concerns an affidavit which Mr McHale swore on 11 November 1987. He had commenced these proceedings on 26 July 1985. On 13 November 1987 in an apparent endeavour to expedite the matter, he lodged in the High Court Registry an application for summary judgment on the issue of liability, asserting that the State had no defence and that the allegations it had made against him were "unsworn and scandalous". The affidavit was lodged in support of the summary judgment application. However both documents were subsequently rejected. They were not served on the State or its solicitors. The affidavit traversed the allegations in the statement of claim and the statement of defence, and it made specific answer to the pleaded grounds for declinature. In particular it asserted (in para 21):

(a) Members of the Highway 61 gang were not tenants in the house. Because of this they could not be known by me to be tenants in the house.

(d) As far as I was aware, there was no malicious damage to the house by anyone.

The affidavit did not come to the attention of the State or its advisers for some time, for it was not until January 1989 that they sought and obtained leave to file an amended statement of defence invoking it as a further ground for declinature.

In this Court Mr Green submitted that as the Judge had made factual findings contrary to these assertions, the affidavit must be viewed as a fraudulent means or device to obtain a benefit under the policy.

Gallen J apparently thought that the affidavit had not been filed: and in one sense perhaps it was not. But that was not the reason for his holding that it did not amount to a breach of condition 8. He thought it not surprising that as the affidavit was intended for use in these proceedings, the material in it was "somewhat polemical in character". And because it was made at a time when it was clear to all that the State did not accept the facts as asserted by the McHales, he was not, he said:

prepared to find that an affidavit made in circumstances such as these at the stage of the proceedings which these had reached could properly be described as a fraudulent attempt to obtain a benefit under the policy.

Clearly, the emphasis in this passage is on the word "fraudulently". We do not understand the Judge to have considered that the wilful giving of false evidence in proceedings to recover under a policy would not be a breach of the duty of good faith; although the point is unlikely to arise at all often, as if the evidence is false the claim is likely to fail. However the essence of a breach of condition 8 is dishonesty. The allegation of fraud is a serious one and the Court is entitled to require clear persuasion before accepting it. We have already indicated Gallen J's assessment of Mr McHale's honesty and genuineness. His conclusion on this part of the case follows naturally and properly from it. He had an unusually extensive opportunity to judge the character and personality of this man and his judgment upon him is entitled to be upheld unless it was plainly wrong. We are far from persuaded of that.

Conclusion

Apart from the proper test of materiality, this case was essentially one of fact. The resolution of factual issues is in our legal system essentially the function

of the trial Judge. Because it does not have his advantage in observing the various witnesses as the case unfolds, an appellate Court is reluctant, except on a clear case, to assume that function itself. This case, where the McHales appeared in person, and concentration on the essential issues was obviously difficult to maintain, is outstandingly one where the impressions and conclusions of the trial Judge who had patiently sat through many hearing days, and most conscientiously worked through the material put before him in order to come as close to the truth as he could, ought to be upheld.

For these reasons we would dismiss the appeal.

We conclude this judgment by noting, as the President has, that the law in New Zealand as to materiality and the duty of disclosure is not satisfactory. It can lead to uncertainty and injustice. It is unfortunate that it was not addressed when the 1977 reforms were enacted. The test of the reasonable assured has much to commend it. The Australian legislation adopting that test, which we have already mentioned, could well be followed in this country.



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