Breach of Warranty in Hong Kong: In Theory and in Practice - *Leung Yuet Ping v Manulife*

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Where an insured fails to provide his insurer with accurate information at the time of taking out an insurance policy, Hong Kong law provides the insurer with a number of potential remedies including: (i) the right to avoid the contract, and possibly to claim damages, for misrepresentation; (ii) the right to avoid the contract on the ground of non-disclosure, which arises out of the duty of utmost good faith; and (iii) the right to terminate the contract for breach of a warranty, which is effectively a pre-contractual promise that a fact is as stated.

Warranties are commonly used for three purposes: (i) to define the initial risk undertaken; (ii) to enable the insurer to take precautions in managing the risk; and (iii) to enable the insurer to avoid the liability under the contract should there be a change in the risk.

Under Hong Kong insurance law, any breach of a warranty will result in the contract being discharged automatically, which means that an insurer is not liable for any claims arising after the breach. Though English insurance law is in many aspects similar to Hong Kong insurance law, this draconian effect is to some extent ameliorated by the courts in England which tend to interpret warranties strictly so as to reduce any unfairness to policy holders that may result from this approach.

The High Court in Hong Kong in *Leung Yuet Ping v. Manulife (International) Limited* (HCA 2380 of 2006) recently upheld that a breach of warranty would entitle an insurer to avoid liability under a policy and reinforced the need for strict compliance with warranties (whether they be material to the risk or not) in insurance contracts.

The Facts

The deceased applied for a life insurance policy for HK$1 million on 18 June 2004 with Manulife. He was later diagnosed with colon cancer in June 2006 from which he died on 9 November 2006. The deceased's widow, the Plaintiff, applied to Manulife for payment of the benefits under the policy to her as the beneficiary.

Manulife discovered that the deceased had made a visit to his doctor following experience of an episode of shortness of breath and palpitations on 7 June 2006, merely 11 days before applying to Manulife for the relevant life insurance cover. The deceased was then advised by his doctor to consult a cardiologist but he did not follow that advice. There was no evidence of any recurrence of the episode and he was declared "healthy" after examination by Manulife's doctor.

The medical cause of death was given as colon cancer, though the death certificate did note evidence of coronary heart disease.

Manulife refused to pay out on the policy relying on the fact that the deceased had failed to inform them in the proposal (application) form and the medical examination form of the visit on 7 June 2006 to his doctor. In the proposal form, the deceased had answered "No" to a question asking whether within the 60 days prior to the application the applicant had consulted a doctor and been advised to have a diagnostic test or surgery that had not yet been performed. The deceased also answered "No" to a question in the medical examination form about whether to his knowledge he had or had been treated for or had been told that he had any disease or disturbance of *inter alia* palpitation or shortness of breath.

The Plaintiff argued that the episode of shortness of breath and palpitations was an isolated matter and a once-only incident, which could not be reasonably required to be disclosed and reported in the proposal form, and that in any event, the deceased was examined by Manulife's own doctor who confirmed, as a matter of policy and procedure, that he was healthy.

The Court held that the information provided by the deceased in the proposal form was a condition precedent to attachment of the risk, or to the liability of Manulife under the policy, and was therefore a warranty. Under Hong Kong insurance law, Manulife would have a defence to any claim that arose after the warranty had been broken, even if there was no causal connection between the loss and the breach of warranty. In addition, where an insurance warranty is breached, the insurer was not required to consider the test of materiality. The Court found the answers given by the deceased in the proposal form and the medical form to be inaccurate and misleading. As the deceased had breached the warranties, Manulife was therefore entitled to repudiate the insurance contract.

The Court also considered that the nature of an insurance contract was based on the duty of utmost good faith and therefore the insured was under a duty to make full and frank disclosure in applying for an insurance policy and was required to give accurate information in respect of all material facts when completing the proposal form and the medical form. In determining what facts would be considered material, Manulife was required to show that a prudent insurer would have taken the information regarding the visit by the deceased to his doctor on 7 June 2006 into account in coming to its decision as to whether to underwrite the risk and at what premium. In this regard, the Court held that the episode experienced by the deceased constituted material information which Manulife as a prudent insurer would have taken into account in deciding whether to issue a policy on the life of the deceased.

Once there is evidence of non-disclosure of a material fact or that a misrepresentation has been made, the insurer must show that it was induced by the non-disclosure or the misrepresentation to enter into the contract on terms that it would not have agreed if all the material facts had been known to it. The Court held that an insurer was not required to show that the non-disclosure was deliberate. The test relates to the conduct of the reasonable prudent insurer and not that of the reasonable assured. The Court held that Manulife was only required to show that the non-disclosure or misrepresentation was an effective inducement and that it need not have been the sole inducement to issue the policy.

Comment

This decision demonstrates the Hong Kong court's insistence on strict compliance with warranties in insurance contracts. Despite the harsh effect, the Court upheld the stringent requirement that a warranty must be complied with exactly, whether it be material to the risk or not. Any inaccurate information given by an applicant in an insurance proposal form may amount to a breach of warranty which will discharge the insurer from its liability. This may work injustice to the assured as he is compelled to assume responsibility for the accuracy of all material facts and information given to the insurer, even if he does not understand or is unaware of the importance of that information to the insurer. Though this decision represents present Hong Kong insurance law, it may not reflect recent developments in the insurance industry.

The insurance industry is one of the few industries in Hong Kong that enjoys a high degree of self-regulation. The Hong Kong Federation of Insurers (the HKFI), a self-regulating body of insurers, was established on 8 August 1988 to advance and promote the development of the insurance industry in Hong Kong and in May 1999, the HKFI adopted the Code of Conduct for Insurers (the Code) in order to promote good insurance practices amongst insurance companies and to strengthen public awareness of the expected standards of insurance services offered. Paragraph 24 of the Code stipulates that "an insurer should not refuse a claim by a policyholder:

- on the grounds of non-disclosure of a material fact which the policyholder could not reasonably have been expected to disclose, or if the insurance was issued without the policyholder being requested to submit a proposal;
- on the grounds of misrepresentation unless this is a deliberate or negligent misrepresentation of a material fact, provided that this does not apply to marine or aviation policies; or
- in the absence of fraud by the policyholder, on the grounds of a breach of warranty or condition if the loss is unrelated to the breach."

Though the Code does not have the force of law and does not directly contradict the judgment in *Leung Yuet Ping v. Manulife ((International) Limited*, nevertheless the Code clearly suggests a move away from termination of a policy for

breach of an unrelated warranty (in the absence of fraud) and from the prudent insurer test to a test of an innocent reasonable assured. Such a move and reform of the present Hong Kong insurance law may be appropriate as there are clearly circumstances where an injustice may occur and the reasonable expectations of an insured may be defeated.