

COMING TO A SCREEN NEAR YOU...THE FUTURE OF ENGLISH  
INSURANCE LAW

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# Introduction

## The Law Commission's insurance contract law reforms

- > Joint project to reform the law of insurance contracts
- > Early 2014: final report due to be published
- > 2014? Bill following Commissions recommendations may be introduced.

## Proposals for reform

- > Duty of good faith
- > Warranties
- > Late payment of claims
- > Basis of contract clauses
- > Contracting out of the proposals.

## AIRMIC: Reservation of rights clauses

# Consumer Insurance (Disclosure and Representations) Act 2012

- > Already in force and applies only to “Consumers”
- > Defined as:

*“an individual (i.e. a natural person rather than a legal person) who enters into the contract for purposes wholly or mainly unrelated to their trade, business or profession.”*

# Consumer Insurance (Disclosure and Representations) Act 2012

- > Essentially adopts a similar position to that already followed by the FOS and generally accepted good practice within the industry.
- > The Act is fairly narrow in its scope:
  - > it deals with the issue of what a consumer must disclose to an insurer before entering into an insurance contract; and
  - > abolishes basis of contract clauses.

# Consumer Insurance (Disclosure and Representations) Act 2012

- > Not to be confused with the Law Commission Reforms
- > These apply to Non-Consumers (i.e. small businesses and commercial policyholders)
- > Presently the traditional common law position still applies to all Non-Consumers.

# Duty of Good Faith – Current law

## Section 17 Marine Insurance Act 1906

“a contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party”

The duty of good faith means the assured must:

- > Not misrepresent material facts; and
- > disclose material facts even if no question is asked.

# Duty of Good Faith – Current law

Section 18 (2) Marine Insurance Act 1906:

*"Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk"*

> Post *Pan Atlantic v Pine Top*, 2 part test:

1. a circumstance must be "material" in the sense that it would influence a hypothetical prudent insurer in assessing the risk; and
2. an insurer may only avoid if it was actually induced by the misrepresentation/non-disclosure to enter into the policy on the relevant terms.

# Duty of Good Faith – Current law

## Section 19: Disclosure by agent effecting insurance

- > *Where an insurance is effected for the assured by an agent, the agent must disclose to the insurer:*
  - a. *every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and*
  - b. *every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.*

# Current wording – LMA3112

4. *It is a condition precedent to any liability of the Underwriters that the Insured has:*

4.1 *truthfully declared all Material Facts having made all reasonable inquiries, including of any Insured Person, to establish those facts;*

3.11 *Material Facts means those facts which the Underwriters conclude, in their sole discretion, are necessary for their determination of:*

3.11.1 *the acceptance or otherwise of the risk or any subsequent amendment; or*

3.11.2 *the premium; or*

3.11.3 *the application of any additional Terms, Conditions, Exclusions, Warranties and Limitations.*

# Duty of Good Faith – Problems with current law

Five problems the Law Commission has identified with the current law:

- > Duty of disclosure is poorly understood.
- > Complying with the duty is especially difficult for medium/large enterprises.
- > The law encourages data dumping.
- > The law encourages underwriting at the claims stage.
- > The remedy for failure is too harsh.

Reforms:

- > Some Evolutionary;
- > Some Radical!

# Duty of Good Faith – Proposals for reform

## Law Commissions' Proposals (1)

- > Evolutionary
  - > Place the existing concept of fair presentation at the heart of business disclosure and codify the doctrines of waiver and inducement
  - > Clarify how the concept of 'knowledge' should apply to modern business organisations.

# Duty of Good Faith – Proposals for reform

“Fair presentation” – onus shifts to insurer to ask questions

- > businesses should endeavour to give the insurer an accurate summary of the risk; and
- > the insurer should make further inquiries when prompted by the information received.

What information is material?

- > any unusual or special circumstances which increase the risk;
- > any particular concerns about the risk which led to the insurance being placed; and
- > standard information which market participants generally understand should be disclosed.

# Duty of Good Faith – Proposals for reform

“Knowledge” – will be defined in legislation

- > Actual knowledge
  - > For insureds: *Those with the knowledge of the highest level management of the organisation and the knowledge of persons who arranged the insurance.*
  - > For insurers: *Those in the highest level management and the person(s) who made the underwriting decision.*
  
- > Constructive knowledge
  - > For insureds: information which would have been discoverable by reasonable enquiries.
  - > For insurers: information which ought to have been communicated to the underwriter.

# Duty of Good Faith – Proposals for reform

## Law Commissions' Proposals (2)

- > Radical
  - > Current law: insurers may avoid a policy whether a misrepresentation or non-disclosure is made fraudulently, negligently or innocently
  - > Law Commissions Proposal: Proportionate remedies
    - Fraudulent/dishonest: avoidance
    - Non-fraudulent: remedy to reflect what insurer would have done had it received a fair presentation of the risk

# Duty of Good Faith – Proposals for reform

## Proportionate remedies

- > Inducement test – what would the insurer have done instead?
  - > If the insurer would not have entered into the insurance contract at all, the insurer may avoid the contract as at present; but
  - > if the insurer would have entered into the contract on different terms (excluding premium), the contract is to be treated as if it included those terms from inception; and/or
  - > if the insurer would have charged a higher premium, the insurer may reduce proportionately the amount to be paid.

# Duty of Good Faith – Proposals for reform

A change of approach:

- > Underwriters can no longer sit back and “await” information
- > Underwriters will need to be far more pro-active
- > Far greater focus on proposal forms
  - Clarity of questions
  - Ensuring answers/queries are followed up and not ignored
- > Will need a renewed focus on the standard wordings!
  - Contracting out
  - Remedies

# Warranties

I will explore:

- > The present legal position and its criticisms
- > The Law Commission's proposals to change the law on warranties
- > Application of old vs. new against some examples

# Warranties

## Criticisms of the current law

- > *"The current law on warranties brings English Law into **disrepute** and puts the English market at a **competitive disadvantage** against other jurisdictions in which a more balanced approach to the effect of such terms has been adopted."*
- > *"The current law on warranties has been called **archaic, blunt** and **unfair**. It is out of date..." (David Hertzell, Law Commissioner)*

# Warranties

## Why the criticism?

- > The consequences of breach of a warranty are considered as being draconian and disproportionately severe.
- > It permits an insurer to escape liability for technical breaches that:
  - a. Have nothing to do with the loss in question; and
  - b. Which may have been remedied prior to the loss.

# Warranties

## The current law (1)

- > Section 33(3) of the Marine Insurance Act 1906 states that:
  - > A warranty must be exactly complied with, whether material to the risk or not;
  - > If not complied with, the insurer is discharged from liability altogether from the date of the breach of warranty;
  - > So, if breached, the policyholder cannot use the defence that the breach was remedied before the loss.

# Warranties

## The current law (2)

- > The position was reaffirmed more recently in case law by Lord Goff in *The Good Luck* [1992]:
  - > *"If a promissory warranty is not complied with, the insurer is discharged from liability as from the date of breach of warranty, for the simple reason that fulfilment of warranty is a condition precedent to the liability of the insurer. This moreover reflects the fact that the insurer only accepts the risk provided that the warranty is fulfilled."*

# Warranties

## The current law (3)

- > Why not make every clause a warranty?
  - > Due to the draconian consequences, the Courts will scrutinise each clause closely to see whether it amounts to a “True Warranty” and are careful to construe it as such.
  - > Courts will take the following factors into account (see *HIH Casualty v New Hampshire Insurance* [2001]):
    - does the term go to the root of the contract;
    - is the term descriptive of the risk or does it bear materially on the risk; and
    - would damages be an inadequate remedy.
  - > However, this approach still leaves an insured too often at the mercy of the Court and/or goodwill of insurers.

# Warranties

## The Law Commission's proposals (1)

- > The Law Commission identified 3 key problems with the law on warranties:
  - > An insurer may refuse a claim for a **trivial mistake** which has no bearing on the risk.
  - > The insured cannot rely on the defence that he has subsequently **remedied** the breach.
  - > A breach of warranty discharges the insurer from **all liability**, not just liability for the type of loss in question.

# Warranties

## The Law Commission's proposals (2)

- > Warranties should become '**suspensive conditions**'
  - > an insurer would not be liable for a loss under the policy whilst the insured is still in breach of the warranty.
  - > But, the insurer's liability would be restored if the breach of warranty is remedied before the loss.

# Warranties

## The Law Commission's proposals (3)

- > Where a term is designed to reduce a particular type of risk, then if the insured is in breach of that term the insurer should only be able to refuse claims for losses falling within the **same type** of risk.
  - > For example, if the insured is in breach of a sprinkler warranty then the insurer could not decline a claim for burglary
  - > But it could decline a fire claim
  - > However, provided that it falls within the same type of risk, the breach still does not need to be causative to the loss.

# Warranties

## Example 1

- > Premium Payment Warranty
  - > Requires payment by 1 June
  - > Insured fails to pay premium until 15 June
  - > Claim occurs on 1 July

# Warranties

## Example 1

- > Current position?
  - > Discharged from liability
  - > Liability is not restored if insurer later accepts payment
  
- > Under Law Commission Proposals?
  - > Liable to pay the claim
  - > Payment on 15 June remedies the breach

# Warranties continued...

## Example 2

- > It is warranted that the stage is covered by a roof and all three sides and that all electrics are waterproofed.
  - > An Artist is due to perform on an outdoor stage on a sunny evening.
  - > The stage was not covered by a roof.
  - > The Artist suffers a sudden and unexpected heart attack shortly before performing and the concert is cancelled.

# Warranties continued...

## Example 2

- > Current position?
  - > **Discharged from liability**
  - > It does not matter that the breach of the roof warranty has no connection with the cancellation of the event due to the death of the artist.
  
- > Under Law Commission Proposals?
  - > **Liable to pay the claim**
  - > Since Death and cancellation due to weather are separate perils, the losses arguably would not be deemed to fall under the same type of risk even though technically the insured is in breach of the warranty.

# Warranties continued...

## Example 3

- > Assured warrants it has ensured that all necessary contractual arrangements have been made and confirmed in writing and authorisations obtained.
  - > Visa obtained by artist to perform at a concert in another country.
  - > However no attempt has been made to obtain a licence to perform at the venue.
  - > Concert is subsequently cancelled due to revocation of the Visa.

# Warranties continued...

## Example 3

- > Current position?
  - > **Discharged from liability**
  - > It does not matter that the failure to obtain a licence has any causal connection to the cancellation due to revocation of a Visa.
  
- > Under Law Commission Proposals?
  - > **Discharged from liability**
  - > Arguably the failure to obtain a licence is still relevant even though it is not causative to the loss.
  - > This is because it would fall under the same loss type as the cancellation due to the revocation of the Visa (i.e. failure to obtain all necessary permits).

# Warranties

## Summary

- > Provided the breach has been remedied before the loss and if the breach is not of the same type of loss, then insurers would no longer be discharged from all liability in the event of a breach of warranty.
- > Shifts the balance of the law to being more insured friendly.
- > Considered as being more fair and in line with continental approach.
- > Possible battle lines still to be drawn as to what considered to be same type of loss and to what extent something has been remedied (i.e. if only partly).
- > However, how much difference would the proposals make in practice. Would insurers necessarily enforce a non-causative breach of warranty which was remedied prior to the loss taking a commercial point of view?

# Late Payment of Claims (1)

## Current law:

- > An insurance payment is characterised in law as a payment for damages for breach of contract
- > There can be no award of damages for non-payment of damages, and as a result losses consequent on failure to pay a valid claim under an insurance contract are unrecoverable.

## Commissions' proposals:

- > The insurer should be under a contractual obligation to pay claims within a reasonable time.
- > Failure to meet this obligation should result in liability to pay damages for any foreseeable loss which results.
- > 'Reasonable time': assessed by reference to all the circumstances, including the size and complexity of the claim, and any reliance on third parties for information.

# Late Payment of Claims (2)

Do insurers have any defence?

- > Yes
  - > Only a defence to a claim for damages (not for the substantive claim).
  - > Insurers will have to show that they acted reasonably.

# Basis of Contract Clauses (1)

What is it?

- > Basis of contract clauses seek to convert even minor misrepresentations during placement into warranties.
- > This takes the form of a declaration on a proposal form or policy stating that the insured warrants the accuracy of the answers or that the answers given form the basis of the contract.

# Basis of Contract Clauses (2)

Their effect?

- > They absolve insurers from liability if a representation is untrue since it would amount to a breach of warranty however minor.
- > Therefore, there is no requirement to show that this information is either material or induced the underwriter to enter into the contract.
- > This gets around the common law test for avoidance.
- > Very insurer friendly.
- > Blanket basis of contract clauses have received much criticism and Courts have sometimes shown a reluctance to enforce them. Nevertheless, it is still good law as a basis of contract clause was upheld by the Court of Appeal recently.

# Basis of Contract Clauses (3)

## Law Commission's proposal

- > To abolish Basis of Contract Clauses.
- > However, it may still be possible to make representations on specific issues or subjects into warranties, although this would need to be expressly agreed between the parties.

# Contracting out (1)

- > Whilst the Law Commission's proposals are mandatory for consumer insurance, they are only intended as a default regime for business insurance.
- > Commercial parties are likely to be free to contract out of the reforms and substitute their own agreed regimes.
- > This seeks to strike a fair balance between the interests of policyholders and insurers, especially in more sophisticated markets where buyers are more likely to be better advised and more commercially aware.

## Contracting out (2)

- > It should be possible for commercial parties to contract out of the proposed changes provided that the following requirements are met:
  - > The terms are clear and unambiguous; and
  - > Sufficiently brought to the attention of the policyholder.

# Reservation Of Rights

## Current law

- > Reservation of rights used too frequently?

## Proposals:

- > 2008: AIRMIC proposed a Statement of Principles, that an agreement between the insured and insurers proposing that a 90 day period should be allowed for discussion during which the insurer would not initiate any formal dispute resolution proceedings or issue any reservation of rights
- > 2012: AIRMIC unveiled a clause for use in commercial insurance contracts to reduce the use of reservation of rights by insurers.
- > Once inserted into a contract, this would be legally binding.
  - > 90 day automatic moratorium
  - > Can be extended by agreement
  - > On expiry of 90 days, insurer has to give detailed reasons if a reservation of rights is issues

# Overview

- > Remedies for avoidance will need to be proportionate to the action which underwriters would have taken and will depend on the knowledge of the insured.
- > Insurers will be required to pay claims within a 'reasonable' amount of time.
- > Warranties can no longer be enforced if the breach is remedied before the loss and/or if there is a technical breach relating to a separate peril which is not causative.
- > Blanket Basis of Contract clauses will be abolished.
- > It should be possible for commercial parties to contract out of the reforms if the terms are clear and unambiguous and sufficiently brought to the insured's attention.

Thank you!

Questions?