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The Insurance Act 2015:  
Rebalancing The Interests of Insurer and Assured

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**THE PATH TO REFORM**

The law of insurance as it stood in 2013 had its origins in the practices first adopted in Edward Lloyd's Coffee House<sup>1</sup> from which policies were first issued in December 1720. The Bubble Act 1720 which sought to prevent the diversion of funds into speculative and often fraudulent schemes encouraged partly by the success of the South Sea Company, outlawed the writing of marine insurance by all companies other than by two recipients of royal charters, London Assurance and Royal Exchange. Unincorporated associations were unaffected, Lloyd's rapidly becoming dominant and establishing in effect a monopoly<sup>2</sup> in the formative period of insurance law – to all intents and purposes, marine insurance law<sup>3</sup> – in the century preceding the repeal of the Bubble Act in 1825. The core principles in Lord Mansfield's seminal judgments in his stewardship of the Court of King's Bench from 1756 to 1788<sup>4</sup>, adopted and indeed extended by his various judicial disciples, and then applied to other forms of insurance and in an era for which they were never designed, held sway. Asymmetry of underwriting information, the driving force behind the development of marine insurance law, had to a significant extent been eroded by the middle of the twentieth century. The most obvious manifestations of eighteenth century influence were the law relating to utmost good faith (imposing a pre-contractual duty of disclosure on applicants for insurance, in addition to the generally applicable obligation not to make false statements) and to warranties (draconian terms whose breach terminated the risk under the policy).

Mitigation for consumers was found only by the voluntary adoption by parts of the insurance industry of Statements of Practice in 1977 and 1986, promising fair handling of claims, and of the Insurance Ombudsman Bureau in 1981, charged with the duty of resolving disputes by reference to "good insurance practice" rather than legal principle. Fair claims handling principles now have statutory force under the Financial Services and Markets Act 2000, which authorised the making by the regulator (now the Financial Conduct Authority) of the Insurance Conduct of Business Rules (ICOBS) and which established the Financial Ombudsman Service with the jurisdiction to give legally binding determinations in consumer cases. But the law itself remained untouched, and indeed the 2000 or so cases decided up to that point had been codified by Chalmers in the Marine Insurance Act 1906, thereby all but inhibiting significant developments in the law to match changing times and markets.

Insurance law reform has been on the agenda in the UK for over 50 years. The Law Reform Committee, the forerunner of the Law Commission, reporting in 1957,<sup>5</sup> made limited suggestions for reform, but those elicited no

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<sup>1</sup> See also: H.H. Lay, *History of Marine Insurance* (London: Post Magazine, 1925); C. Wright and C.E. Fayle, *A History of Lloyd's* (London: Macmillan, 1928); D.E.W. Gibb, *Lloyd's of London: A Study in Individualism* (London: Macmillan, 1956).

<sup>2</sup> The House of Commons Select Committee on Marine Insurance, reporting in April 1810, noted that less than 4% of the value of risks written were attributable to the chartered companies. Other than insurance offered by illegal associations, Lloyd's accounted for the rest.

<sup>3</sup> Policies on lives and fire policies on wooden buildings, were also a part of the market, but gave rise to relatively few disputes.

<sup>4</sup> *Carter v Boehm* (1766) 3 Burrow 1905; *London Assurance Company v Sainsbury* (1783) 3 Doug. KB 244; *Bermon v Woodbridge* (1781) 2 Douglas 781; *Bond v Nutt* (1777) 2 Cowper 601; *De Hahn v Hartley* (1786) 1 Term Report 343; *Hamilton v Mendes* (1761) 2 Burrow 1198; *Loraine v Thomlinson* (1781) 2 Douglas 585; *Manning v Newnham* (1782) 3 Douglas 130; *Mason v Sainsbury* (1782) 3 Douglas 61; *Stevenson v Snow* (1761) 3 Burrow 1237; *Tyrie v Fletcher* (1777) 2 Cowper 666; *Vallejo v Wheeler* (1774) 1 Cowper 143.

<sup>5</sup> *Conditions and Exceptions in Insurance Policies*, Cmnd 62.

response. The Law Commission produced further reform proposals in 1979 and 1980,<sup>6</sup> but they were largely developed to forestall a harmonisation programme at the time under consideration by the European Commission: when the risk of the latter dissipated, the incentive to implement the former evaporated. The matter was not revisited until, prompted by the deliberations of Law Reform Committee of the British Insurance Law Association in 2004,<sup>7</sup> the English and Scottish Law Commissions launched a joint reform programme in 2006. That programme in its original conception was one of overall codification, but ambitions narrowed over time and the focus shifted to a small number of key areas. The Law Commissions' programme will terminate in 2015, but the main work has been done.<sup>8</sup> This has consisted of a series of Issues Papers, Consultation Papers<sup>9</sup> and Reports, and has generated two significant Acts of Parliament, the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015.

The Insurance Act 2015 is based upon the Law Commissions' Report, *Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment*,<sup>10</sup> published in July 2014. The major recommendations were: recasting the duty of utmost good faith; adopting modern principles for pre-contract presentation by a business assured; restriction on the use of warranties and of policy terms, in each case where the loss was unrelated to the assured's breach; clarification of the law of fraudulent claims; and an implied contractual duty on insurers to pay claims within a reasonable time. Government responded to the Report almost immediately by publishing an Insurance Bill in much the same terms as the Law Commissions' draft bill appended to the Report, but with two significant omissions: late payment; and policy terms. There was to be no recanting on the former, but the latter has in modified form found its way into law.

The Bill was referred to a Special Public Bills Committee of the House of Lords, chaired by Lord Woolf using the procedure reserved for uncontroversial bills. It passed in December 2014 with minor amendments after four days of evidence from a variety of judicial, market, practitioner and academic witnesses, and one day of debate. The Bill then completed its House of Commons' stages unscathed and virtually undiscussed. Royal assent was received on 16 February 2015 and the operative date for the measure is 12 August 2016. The transcripts of the oral evidence to, and all of the written evidence received by, the Committee, are published online.<sup>11</sup> That, coupled with the voluminous documentation available on the Law Commissions' websites and an Explanatory Note accompanying the Bill,<sup>12</sup> provides almost unprecedented background material for the interpretation of, and research into the Act. In this article it is possible only to scratch the surface by identifying the most important changes and the policy considerations behind the decisions taken to change or to leave alone.<sup>13</sup> We also hope that our survey of the Insurance Act 2015 will, for the benefit of contract scholars with limited exposure to recalcitrant insurance principles, highlight the most important variations between insurance and the general law.

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<sup>6</sup> Law Commission, Working Paper no.70, 1979; Law Commission Report no.104, 1980.

<sup>7</sup> A body whose membership is drawn from all stakeholders in the insurance industry, providers, users, advisers and commentators alike.

<sup>8</sup> The outstanding issues are Insurable interest and the form of marine policies. The former was addressed in a Consultation Document published on 27 March 2015, rejecting sweeping changes to the law. Issues paper 10, Insurable Interest- updated proposals can be found at <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm> (last accessed 18 May 2015)

<sup>9</sup> The Law Commissions' Consultation Papers and reform proposals were extensively discussed in the literature. See eg M. Clarke, 'Insurance warranties: the absolute end?' [2007] LMCLQ 474; R. Merkin and J. Lowry, 'Reconstructing Insurance Law: The Law Commissions' Consultation Paper' (2008) 71(1) MLR 95; J. Lowry and P. Rawlings, ' "That wicked rule, that evil doctrine . . .": Reforming the Law on Disclosure in Insurance Contracts' (2012) 75(6) MLR 1099; G. Blackwood, 'The Pre-contractual Duty of (Utmost) Good Faith: The Past and The Future' [2013] LMCLQ 311; C. Blanchard, 'Reform of The Pre-contractual Duty of Disclosure of the Agent to Insure: Evolution or Revolution' [2013] LMCLQ 325; S. Rainey 'The Law Commission's Proposals for the Reform of an Insurer's Remedies for Fraudulent Claims Made under Business Insurance Contracts' [2013] LMCLQ 357; B. Soyer, 'Beginning of a New Era for Insurance Warranties' [2013] LMCLQ 384; J. Davey, 'Remedying the remedies: the shifting shape of insurance contract law' [2013] LMCLQ 476; For late payment see P. MacDonald Eggers, 'Late Payment of Insurance Claims' [2013] LMCLQ 341; J. Lowry and P. Rawlings, 'Insurers, Claims and the Boundaries of Good Faith' (2005) 68(1) MLR 82.

<sup>10</sup> Law Commission Report nos 353 (England) and 238 (Scotland): Cm 8898.

<sup>11</sup> <http://services.parliament.uk/bills/2014-15/insurance/stages.html> (last accessed 18 May 2015)

<sup>12</sup> Which had to be corrected as it was shown in one respect not to reflect what the Law Commissions' had intended. See <http://lawcommission.justice.gov.uk/areas/insurance-contract-law.htm> (last accessed 18 May 2015)

<sup>13</sup> The 2015 Act, by correcting a drafting error in the Third Parties (Rights against Insurers) Act 2010, clears the way for the implementation of that measure and the repeal of the flawed Third Parties (Rights against Insurers) Act 1930. That is anticipated to occur in the autumn of 2015. The 2010 Act merits an article in its own right.

## THE PRINCIPLE OF UTMOST GOOD FAITH

The structure of the Marine Insurance Act 1906 is curious. Section 17, which is, with modifications, based on the judgment of Lord Mansfield in *Carter v Boehm*,<sup>14</sup> provides that a contract of marine insurance is one of the utmost good faith<sup>15</sup> and if good faith is not shown by either party then the policy may be avoided.<sup>17</sup> This is followed by sections 18, 19 and 20 which deal respectively with disclosure by the assured, disclosure by the assured's agent to insure and misrepresentation by the assured. While sections 18 to 20 are confined to pre-contractual presentation of the risk, section 17 is in general terms and, as expressed, is capable of operating post-contractually. That interpretation, which arguably was not intended by Chalmers given the absence of pre-1906 authority on the point, has been adopted by the courts,<sup>18</sup> but the post-contractual duty has no obvious content in the light of the now-accepted proposition – codified by the Insurance Act 2015, section 12 – that a fraudulent claim is a breach of contract with a prospective rather than retroactive remedy. Even if some content could be found it is apparent that avoidance for post-contractual conduct is disproportionate and the appropriate remedy is one for breach of a contractual obligation to provide information.<sup>19</sup>

As far as the insurer's pre-contractual disclosure is concerned such authority as exists indicates that it extends to explanation and appropriateness of cover,<sup>20</sup> but the remedy of avoidance is meaningless for an assured whose complaint is of inadequate insurance (unless the problem comes to light before a loss has occurred). Post-contractual conduct by the insurer will typically involve an allegation of deficiencies in claims-handling, and in particular late payment, but the cases are clear – as discussed below – that late payment sounds only in an award of interest<sup>21</sup> and even if it is to be classified as a breach of the duty of utmost good faith then again the sole remedy of avoidance is the last thing that the assured will want.

To attempt to give some effect to the principle of utmost good faith in these three scenarios, section 14 of the Insurance Act 2015 repeals the concluding sentence of section 17 of the 1906 Act, along with any corresponding rule of the common law, to leave the bare statement that a contract of marine insurance is one of the utmost good faith. The outcome is what is described by the Law Commissions as an “interpretative principle”,<sup>22</sup> but nevertheless one without any stated remedy. Assuming that utmost good faith can be defined, possibly in terms of a duty “not to act in bad faith”,<sup>23</sup> at least three possibilities follow. First, section 17 may itself be elevated into the status of an Australian-style implied term,<sup>24</sup> with damages available for its breach. The divorce of the principle of utmost good faith from the assured's pre-contractual duties – in respect of which a remedy in damages was vehemently denied at common law by a trio of House of Lords decisions<sup>25</sup> – leaves the way open for damages to be awarded for a breach of section 17, although it should be added that that cannot easily apply to a pre-contractual failure to disclose by insurers, given that at that stage there is no contract into which a term can be implied. Secondly, section 17 may be used as the basis for

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<sup>14</sup> (1766) 3 Burr 1905

<sup>15</sup> ‘Utmost’ was a later refinement added by Buller J, in *Wolff v Horncastle* (1798) 1 B & P 316.

<sup>16</sup> In Lord Mansfield's formulation, some element of concealment was required, but any suggestion that fraud had to be shown faded away almost immediately.

<sup>17</sup> Lord Mansfield's formulation was ‘void’. *Carter v Boehm* n 4 above

<sup>18</sup> *Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437; *K/S-Merc Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep 563; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep 389.

<sup>19</sup> *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters, The Mercandian Continent* n 19 above.

<sup>20</sup> *La Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1989] 2 All ER 952.

<sup>21</sup> *Sprung v Royal Insurance* [1999] Lloyd's Rep IR 111

<sup>22</sup> Report 353, [30.22].

<sup>23</sup> *Horwood v Land of Leather Ltd* [2010] Lloyd's Rep IR 453; *Drake Insurance plc v Provident Insurance plc* [2003] Lloyd's Rep IR 781

<sup>24</sup> Insurance Contracts Act 1984, s 13. Perhaps surprisingly, there is little relevant authority on that section. Section 14 of the 1984 Act goes on to provide that reliance on a contract term may amount to breach of duty, and amendments introduced into the 1984 Act by the Insurance Contracts Amendment Act 2013 have effectively provided for regulatory support for private enforcement by the Australian Securities and Investment Commission (s 14(2)) and administrative sanctions potentially leading to a withdrawal of authorisation where an insurer persistently acts unfairly in relying on contract terms (s 14A). See, generally, I. Enright and R. Merkin, Sutton's Law of Insurance in Australia, (Australia: Thomson Reuters 4<sup>th</sup> ed, 2014), chapter 4.

<sup>25</sup> *La Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* n 21 above; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501; *Manifest Shipping Co v Uni-Polaris Shipping Co Ltd, The Star Sea* n 19 above.

implying specific terms into a contract of insurance, a step which the courts had begun to take even before the passing of the Insurance Act 2015.<sup>26</sup> Thirdly, the courts might adopt entirely fresh remedies, eg, an estoppel which precludes a party – typically, the insurer – from relying upon a policy term or other right that might otherwise be open to that party.<sup>27</sup>

## FAIR PRESENTATION BY THE ASSURED

### *Non-disclosure and misrepresentation: the existing position*

Sections 18-20 of the Marine Insurance Act 1906, which apply to non-marine as well as marine insurance,<sup>28</sup> set out the pre-contractual<sup>29</sup> duties of the assured and any agent to insure. In outline, an assured must disclose all material facts, being defined as facts which would influence the judgment of a prudent underwriter (section 18), an agent to insure must disclose material facts known to the agent whether or not the assured was aware of them (section 19) and the assured must not misrepresent material facts (section 20). Sections 18 and 20 are effectively mirror-image provisions and require the assured to disclose, or not misrepresent “material” facts, defined as any fact which would affect the underwriting judgment of a prudent insurer. The meaning of this phrase was amplified by the House of Lords, in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*<sup>30</sup>, which held by a 3:2 majority that it suffices that expert evidence from an underwriter in the market at the time demonstrates that the fact would have been of interest even if it would not have affected the final underwriting decision. That light burden was, however, tempered by the unanimous ruling that an additional subjective inducement test is to be read into the legislation whereby the insurer who underwrote the risk is required to prove that a different outcome would actually have resulted had the true position been stated. It suffices to say here that the inducement test became the dominant issue in the vast majority of cases.<sup>31</sup>

A number of important features of the Marine Insurance Act 1906 attracted the attention of the Law Commissions. First, the prudent insurer test appears on its face to require the assured to predict what a prudent insurer might find of interest. Secondly, proof of materiality and inducement justify avoidance of the entire policy, an outcome which is frequently disproportionate to the degree to which the insurer has been misled. Thirdly, the curious provisions of section 19 impose a duty on the agent to insure to disclose facts known to him whether or not they are known to the assured: there is no definition of agent to insure and it is disputed whether the term refers only to a placing broker or extends to intermediate agents; the type of information which falls within section 19 is unclear; and the duty is placed squarely on the agent but the sanction is that of avoidance as against the assured. Fourthly, although the assured is under a duty to disclose what is known or ought to be known in the ordinary course of business, and equally the assured is not under a duty to disclose what is known or ought to be known to the insurer, there is no clear statement of exactly when either party possesses the requisite knowledge.

As a result of the Consumer Insurance (Disclosure and Representations) Act 2012, which came in to force on 6 April 2013, those duties no longer apply to consumers. They were instead replaced by a single duty to take reasonable care to avoid misrepresentation, thereby abolishing any disclosure requirement and leaving the onus squarely on the insurers to ask questions. The Insurance Act 2015 addresses the position as regards commercial insurance. Both the 2012 and 2015 Acts apply in full to renewals and variations, in the latter case on the basis that the duty is to be applied purely to the variation and not retrospectively to the contract prior to its variation.

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<sup>26</sup> *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2)* [2001] Lloyd’s Rep IR 667.

<sup>27</sup> Cf: *Drake Insurance Co v Provident Insurance Co* n 24 above; *Sherdley v Nordea Life & Pension SA* [2012] EWCA Civ 88.

<sup>28</sup> See *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* n 26 above, 447, Lord Mustill; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd, The Star Sea* n 19 above, at [47]; Lord Hobhouse; *Assicurazioni Generali SpA v Arab Insurance Group* [2003] Lloyd’s Rep IR 131, at [55]; *Brotherton v Aseguradora Colseguros SA (No.2)* [2003] Lloyd’s Rep IR 746, at [12]; *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd’s Rep 61 at [42], Lord Hoffmann; *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd’s Rep 109, 114.

<sup>29</sup> The 2015 Act does not change the position; the duty of fair presentation of the risk is a pre-contractual duty. This is confirmed by s 7(6) which states the assured may withdraw or amend a representation before the contract of insurance is concluded.

<sup>30</sup> [1994] 2 Lloyd’s Rep 427

<sup>31</sup> *Sea Glory Maritime Co, Swedish Management Co SA v AL Sagr National Insurance Co* [2013] EWHC 2116 (Comm); *Lewis v Norwich Union Healthcare Ltd* [2010] Lloyd’s Rep IR 198; *Drake Insurance plc v Provident Insurance plc* n 24 above

The Insurance Act 2015, section 21(2), repeals sections 18-20 of the MIA 1906, dispenses with utmost good faith in the context of the assured's pre-contractual duties and replaces it with the concept of "fair presentation" (section 3), a phrase found in pre 1906 authority and regarded by the Law Commissions as a more appropriate formulation of the duty.<sup>32</sup> Much of the old law is re-enacted, but with significant change. Unlike the position now applicable to consumer insurance, the duty of disclosure has been retained for business policies, reflecting the established market reliance on disclosure, so that a business assured remains under the dual obligations to disclose, and not to misrepresent, material circumstances. In each case the objective materiality test has been retained by section 7(3) of the 2015 Act, despite widespread criticism of it in the consultation process: the view taken by the Law Commissions was that the overwhelming majority of commercial risks are placed by brokers who are equally cognisant with insurers as to what facts are material, so that the test is unlikely to be damaging in practice. It should be added that section 8(1) of the 2015 Act codifies the subjective inducement requirement – in practice the real protection for the assured – by removing the right of the insurer to any remedy for breach of duty unless the insurer can prove that, but for the breach, the insurer either would not have entered into the contract of insurance at all or would have done so only on different terms.<sup>33</sup> This will doubtless be construed in the same way as the previous law, so that it is necessary for the insurers to show that, had there been compliance with the duty of fair presentation there would have been a different underwriting outcome.<sup>34</sup> As a result of conflicting dicta in *Pan Atlantic* the common law flirted briefly with the idea that proof of objective materiality led to a presumption of inducement, but that was rapidly abandoned<sup>35</sup> and has not re-emerged in the Act.

The law of misrepresentation set out in section 3 is more or less untouched. Every material representation as to a matter of fact must be substantially correct, the Act repeating in section 7(5) the earlier principle that a material representation is substantially correct if a prudent insurer would not consider the difference between what is represented and what is actually correct to be material.<sup>36</sup> Every material representation as to a matter of expectation or belief must be made in good faith. The most important changes are made to the duty of disclosure.

First, although there is much complex authority on the classes of fact that are likely to be material, the Act for the first time provides illustrations, namely: special or unusual facts relating to the risk; any particular concerns which led the assured to seek insurance cover for the risk; and anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question. It is anticipated by the Law Commissions that the market will put together protocols for specific classes of business, so that the disclosure process can be within settled parameters.

Secondly, under section 3(3)(b) disclosure must be in a manner reasonably clear and accessible to a prudent insurer. This addresses the long-standing problem of "data-dumping", whereby a broker or assured provides a mass of information, often in CD form, which contains deeply buried material information. Although the Act does not require a broker to perform the underwriting function for the insurer, at the very least the broker must not render disclosed material facts opaque or inaccessible.

Thirdly, and somewhat controversially, although section 3(4)(a) preserves the rule that the assured must disclose every material circumstance which the assured knows or ought to know, an entirely new provision – section 3(4)(b) – provides for a lesser form of disclosure which nevertheless complies with the duty of fair presentation, namely that the disclosure "gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances".<sup>37</sup> This probably adds nothing to the waiver principle enshrined in the 1906 Act and re-enacted as section 4(5) of the 2015 Act, which recognises that a failure by insurers to ask follow-up questions is a waiver of the additional information,<sup>38</sup> but section 3(4)(b) is symbolic and is

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<sup>32</sup> *Bates v Hewitt* (1866-67) LR 2 QB 595; *Morrison v The Universal Marine Insurance Company* (1872-73) LR 8 Ex. 197; *Blackburn v Vigors* (1887) 12 App Cas 531; *Harrower v Hutchinson* (1869-70) LR 5 Q.B. 584; *Haywood v Rodgers* (1804) 4 East 590; *Ionides v Pender* (1873-74) LR 9 QB 531; *Sibbald v Hill* (1814) II Dow 263; *Anderson v Pacific Fire & Marine Insurance Co* (1871-72) LR 7 C.P. 65

<sup>33</sup> The notion of requiring proof of inducement as a prerequisite to a remedy, rather than as a part of the test of breach, is borrowed from s 29 of the Australian Insurance Contracts Act 1984.

<sup>34</sup> *Drake Insurance plc v Provident Insurance plc* n 24 above; *Toomey v Banco Vitalicio de Espana SA de Seguros y Reaseguros* [2004] EWCA Civ 685.

<sup>35</sup> *Assicurazioni Generali v Arab Insurance Group* n 29.

<sup>36</sup> *Eagle Star Insurance Co Ltd v Games Video Co (GVC) SA, The Game Boy* [2004] 1 Lloyd's Rep 238.

<sup>37</sup> There is no equivalent provision in the 1906 Act. Assureds have argued in a number of cases that the insurers should have played an active role in making further investigations, but the courts have emphasised that the duty of making a fair presentation was that of the assured. *Marc Rich and Co AG v Portman* [1996] 1 Lloyd's Rep 430; [1997] 1 Lloyd's Rep 225; *WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA* [2004] 2 Lloyd's Rep 483.

<sup>38</sup> *WISE Underwriting Agency Ltd v Grupo Nacional Provincial SA* n 38 above.

designed to send out a message that insurers should wherever possible not rely upon disclosure but should ask the right questions.<sup>39</sup>

#### *Disclosure: knowledge of the parties*

Knowledge plays a key role in the operation of the disclosure provisions, and this feature of the Act is perhaps embodies the most obvious changes from the earlier law. The starting point of the 2015 Act is consistent with the 1906 Act, in that under section 3(4) the assured need to disclose only what is known or ought to be known in the ordinary course of business, and that under section 4(5) there is no duty to disclose what the insurer knows or ought to know. The meaning of knowledge was the subject of as much oral and written evidence to the Committee as any other element of the Act, and necessitated amendment. The Act seeks to define “knowledge” for each of these purposes.

From the assured’s point of view, “knowledge” is defined by section 4. Where the assured is an individual, that individual’s knowledge, must be disclosed, and consists of actual knowledge and “blind eye” knowledge, the latter meaning matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining from confirming them or enquiring about them (sections 4(1)(a) and 6(1)). Where the assured is not an individual, then information known to those individuals who are part of the assured’s senior management must be disclosed (sections 4(3)(a)), senior management meaning “those individuals who play significant roles in the making of decisions about how the insured’s activities are to be managed or organised” (sections 4(8)(c)). It is plain from the Parliamentary debates that there may be such individuals who are not members of the board of directors, and the outcome is probably little different from the common law imputation principle which focuses on individuals with a duty to know as opposed to junior employees.<sup>40</sup>

At this point, two important changes are made to the duty of the assured – whether or not an individual – as it stood under the 1906 Act. In the first place, by section 4(6) of the 2015 Act, the assured must disclose circumstances that should reasonably have been revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means). The scope of what is effectively a novel<sup>41</sup> duty to make a “reasonable search” is almost certain to be a live issue before the courts, and is only partly assisted by the statement in section 4(7) that “information” includes “information held within the insured’s organisation or by any other person (such as the insured’s agent or a person for whom cover is provided by the contract of insurance)”. This may cause little difficulty where the assured is a small business with limited interests, but the issues will be far more significant for a multinational corporation which insuring not just itself but also on behalf of its subsidiaries, associates and directors and officers. The second change to the assured’s duties is that the curious<sup>42</sup> concept of an “agent to insure” owing separate duties to the insurers has been scrapped and replaced by section 4(3)(b) by which the assured is under a duty to disclose what is known to one or more of the individuals who are responsible for the assured’s insurance, whether as employee of the assured or independent agent such as a broker (section 4(8)(b)). One important clarification is here made, in that under the pre-existing law it was uncertain whether the broker had to disclose information obtained by the broker in dealings with third parties.<sup>43</sup> The effect of section 4(4)-(5) is that an assured is not taken to know confidential information known to an individual who is an employee of the assured’s agent and the information was acquired by the agent (or an employee) through a business relationship with a person not connected with the insurance.

Turning the coin, information is, by section 5(3), known to an insurer and thus not disclosable where there is: (a) actual knowledge on the part of “one or more of the individuals who participate on behalf of the insurer in the decision whether to take the risk, and if so on what terms” in whatever capacity, including (section 6(1)) “blind eye” knowledge (as defined for the purposes of the assured); (b) presumed knowledge, consisting of common knowledge and things which an insurer offering business of the class in question would reasonably be expected to know; and (c) imputed knowledge, in the possession of an employee or agent who ought reasonably to have passed it on, as long as the relevant information “is held by the insurer and is readily available”. There are two stand-out points here: whether information available on the internet can be regarded as in the possession of the insurer, at least where it is free and where the assured has not made a statement which the insurer fails to check;<sup>44</sup> and whether information held by, for

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<sup>39</sup> See Insurance Bill Explanatory note, [14]

<sup>40</sup> *Australia and New Zealand Bank Ltd v Eagle and Colonial Wharves Ltd* [1960] 2 Lloyd’s Rep. 241; *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500

<sup>41</sup> LC Report 353, [8.83] *et seq.*

<sup>42</sup> In that the 1906 Act imposes a duty on the “agent to insure” but provides for a remedy against the assured rather than the agent.

<sup>43</sup> *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685; *Societe Anonyme d’Intermediaires Luxembourgeois v Farex Gie* [1995] LRLR 116.

<sup>44</sup> The fact that information is available on the internet does not necessarily make it of common knowledge. Cases under the 1906 Act have not recognised any duty on insurers to search the internet to check information provided by the assured (see *Hua Tyan Development Ltd v Zurich Insurance Co Ltd* [2013] HKCA 14, affirmed without reference

example, the claims department, is “readily available” to the underwriting team, current law giving that answer a resounding but controversial negative answer.<sup>45</sup> It would seem that the very least that an insurer should do in the latter respect is to run a check on its own online records.<sup>46</sup>

One of the great mysteries of English law in general, and in its application to insurance law in particular, is the decision in *Re Hampshire Land*.<sup>47</sup> The case has been taken to mean that knowledge of the fraud of an agent as against the principal is not imputed to the principal because the agent is by definition not going to reveal his own wrongdoing. Despite doubts as to whether the case decides that at all, in recent years there are dicta extending it to a refusal to impute fraudulent acts to the principal<sup>48</sup> and to disclosure of fraud against a third party.<sup>49</sup> The Act stokes up the problem in section 6(2), which preserves the common law – whatever it may be – on the matter. Thus, if an assured makes a “reasonable search” of its records, but fails to discover the material fraud of an agent<sup>50</sup> because it has been withheld in response to the request, the Law Commission’s view<sup>51</sup> that the assured bears the risk of such fraud is at the very least open to question.

### *Remedies for breach*

The sole remedy for non-disclosure or misrepresentation under the 1906 Act is avoidance of the insurance contract *ab initio*, subject to repayment of the premium in the absence of fraud.<sup>52</sup> In principle that means the return of sums paid for previous losses, although there is some uncertainty as to whether settlement contracts can be overturned for mistake in those circumstances.<sup>53</sup> Both the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015 have rejected all or nothing for slightly different more nuanced approaches. These are based on, but not identical to,<sup>54</sup> the Australian approach in section 29 of the Insurance Contracts Act 1984.<sup>55</sup>

As regards consumers, the 2012 Act provides that there is no remedy at all if the consumer has acted with reasonable care. If there has been a lack of reasonable care (a “qualifying breach”), the insurer has to pass the initial inducement threshold of demonstrating that, but for the breach of duty, it would not have entered into the contract at all, or would have done so only on different terms. If that test is satisfied, then schedule 1 applies. A distinction is drawn between deliberate or reckless breach of duty, which justifies avoidance and retention of the premium to the extent that such retention would not be unfair to the consumer, and careless breach of duty. In the latter case the insurer is to be put back into the position that it can prove would have prevailed but for a breach of duty: (a) if the outcome would have been the same, there is no remedy; (b) if the risk would not have been written on any terms, the policy can be avoided; (c) if the risk would have been written with additional contractual safeguards, the insurer is entitled to have the policy rewritten to that effect; and (d) in addition to (c), if the insurer would have charged a higher premium, the assured can recover only that proportion of the loss represented by the proportion of the full premium actually paid.

A similar but not identical system of remedies is adopted by the Insurance Act 2015 for business insurance. Under section 8 and schedule 1, if the breach is a “qualifying breach” and the inducement test is satisfied, then avoidance remains possible where the insurers can prove that the qualifying breach was deliberate or reckless (in which case premiums may be retained by the insurers) or the qualifying breach was neither deliberate nor reckless but, in the

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to this point, [2014] HKCFA 72) particularly where the information is contained in a subscription-only website (*Sea Glory Maritime Co v Al Sagr National Insurance Co, The Nancy* n 32 above).

<sup>45</sup> *Mahli v Abbey Life Assurance Co Ltd* [1996] LRLR 237.

<sup>46</sup> LC Report 353, at [10.26] and [10.50] *et seq*.

<sup>47</sup> [1896] 2 Ch 743.

<sup>48</sup> *Moore Stephens v Stone & Rolls Ltd* [2009] UKHL 39. But see *Jetivia SA v Bilta (UK) Ltd* [2015] UKSC 23, casting doubt on other aspects of this decision and suggesting that its overall precedent value is low.

<sup>49</sup> *Arab Bank v Zurich Insurance Co* [1999] 1 Lloyd’s Rep 262.

<sup>50</sup> A particular issue for professional indemnity insurance.

<sup>51</sup> Report 353, at [8.67] *et seq*.

<sup>52</sup> Marine Insurance Act 1906 s 84(1). In practice insurers do not seek to establish fraud and simply send a cheque for the premium along with an avoidance letter.

<sup>53</sup> *Magee v Pennine Insurance Co Ltd* [1969] 2 QB 507 so indicates, but the equitable jurisdiction justifying that outcome was held not to exist in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd, The Great Peace* [2004] 4 All ER 689.

<sup>54</sup> The Australian legislation draws distinctions between life and non-life, and reduces remedies in the former. Further, under s 31 of the 1984 Act, the court may deny avoidance for fraud if the effect would be disproportionate. The Law Commissions steadfastly refused to follow that precedent, consistently with their position on fraudulent claims, discussed below.

<sup>55</sup> See *Sutton*, n 25, chapter 5. The position in New Zealand is messy, in that the Contractual Remedies Act 1979 replaces avoidance with cancellation. Despite a number of cases on the point, the relationship between that Act and the common law as regards insurance contracts remains unclear. See R. Merkin and C. Nicoll, *Colinvaus’s Law of Insurance in New Zealand* (New Zealand: Thomson Reuters, 2014) chapter 6.



absence of such breach, the insurer would not have entered into the contract on any terms (in which case the premiums must be returned). Where the qualifying breach was neither deliberate nor reckless, then the position follows the consumer model. Where insurer can show that it would have entered into the contract but on different terms, other than relation to the premium, the contract is to be treated as if it had been entered into on those different terms. Additionally, if the insurer would have charged a higher premium, the sum payable may be reduced proportionately.

The differences between the consumer and non-consumer models are that only fraud or recklessness justifies avoidance for a consumer, and that reasonable behaviour provides no remedy at all, whereas for a business the insurer is entitled to a remedy for any breach, and potentially the remedy of avoidance even in the absence of fraud or recklessness.

#### *Assessment*

The removal of the “all or nothing” approach to remedies for breach of the duty of fair presentation is perhaps the most significant step taken by the Insurance Act 2015 in terms of mitigating the perceived unfairness of the duties as set out in the 1906 Act. That generosity is coupled with a recognition – in the form of an alternative right of limited disclosure – that insurers should be asking the questions. The anticipated development of protocols for disclosure in specific areas of cover will be of major assistance to both sides. The trade-offs for insurers are the retention of the prudent underwriter test and the assured’s new duty to undertake a reasonable search in order to prepare for disclosure. The evidence to the Committee was unanimous in supporting the changes, with only gentle queries being raised by some users on the scope of “reasonable search” and by some insurers on the level within the assured’s organisation that information has to be held to be disclosable.

## **TERMS: WARRANTIES AND CONDITIONS**

#### *Common law classifications*

The classification of terms of insurance policies in insurance law is somewhat different from the usual common law analysis. In essence, insurance law recognises the following categories: (1) conditions precedent to the validity of the contract (2) conditions precedent to the attachment of the risk, eg, obligations to undertake surveys or to pay the premium which if not adhered to, preclude any coverage; (3) conditions precedent to liability for a claim, most importantly, conduct obligations relating to the risk run by the insurers, and claims provisions – any breach prevents a claim for the loss in question but does not affect the policy<sup>56</sup>; (4) ordinary conditions (at one time referred to as conditions subsequent), consisting of conditions of the types in (2) and (3) but not rendered conditions precedent – breach gives rise to damages<sup>57</sup> but does not prevent a claim<sup>58</sup>; (5) present warranties, consisting of statements of fact made by the assured at the outset which, if untrue, prevent the risk from attaching; and (6) continuing warranties<sup>59</sup>, consisting of promises by the assured that something will or will not be done during the currency of the policy, any breach giving rise to an irremediable termination of the risk.

The Insurance Act 2015 has patchy effect. It is not concerned with (1) and (2) at all, and applies to conditions under (3) and (4) only insofar as they relate to the risk. There are however, major changes as regards (5) and (6). It might be thought that this approach was somewhat timid, because the Act – despite its undoubted benefits – clings to outcomes based on the formality of a term’s classification rather than the effect of a breach of an obligation on the insurers. By contrast, equivalent Australian and New Zealand legislation focuses on substance, with the consequence that warranties have (marine insurance aside, where the regimes are unchanged) disappeared in those jurisdictions.<sup>60</sup>

#### *Present warranties*

Warranties unarguably constitute the most draconian class of term recognised by insurance law. A present warranty in its eighteenth century conception was the means by which the risk to be run by the insurers was defined. If the description provided by the assured did not match the actual facts, then the risk would simply not attach. It came to be established that the result did not require any analysis of the materiality of the false statement to the risk, with the effect that requiring the assured to warrant a statement removed the restrictions of the law of misrepresentation and simply

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<sup>56</sup> *Kosmar Villa Holidays plc v Trustees of Syndicate 1243* [2008] Lloyd’s Rep IR 489

<sup>57</sup> *Milton Keynes BC v Nulty* [2013] Lloyd’s Rep IR 243.

<sup>58</sup> *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp* [2005] 2 Lloyd’s Rep 517.

<sup>59</sup> *Agapitos v Agnew (The Aegeon) (No.2)* [2003] Lloyd’s Rep IR 54; *Eagle Star Insurance Co Ltd v Games Video Co (GVC) SA (The Game Boy)* n 37 above.

<sup>60</sup> See, respectively, s 11 of the Insurance Law Reform Act 1977 (NZ) and s 54 of the Insurance Contracts Act 1984 (Cth). Both are discussed below.

allowed the insurer to walk away. Insurers at the end of the nineteenth century took matters a step further by inserting “basis of the contract” clauses into application forms, and it rapidly became established that a basis clause converted every single statement in the application – material, inducing or otherwise – into a warranty. In *Dawsons v Bonnin*<sup>61</sup> the House of Lords explained that when answers are declared to be the basis of the contract this can only mean that their truth is made a condition, exact fulfilment of which is rendered by stipulation as essential to its enforceability. Basis meant “the foundation of a thing; that on which a thing stands or lies”<sup>62</sup> so that if any statement of fact was untrue the risk does not attach. Basis clauses became standard fare in consumer policies.

Present warranties are addressed in identical terms by section 6 of the 2012 Act for consumers, and section 9 of the 2015 Act for the business community. The object of the provision is to require the effect of a misrepresentation to be determined by the rules applicable to misrepresentation in the respective regimes. Section 9(1) applies to any representation made by the assured in connection with an insurance contract, and section 9(2) then states that:

Such a representation is not capable of being converted into a warranty by means of any provision of the ... insurance contract ... or of any other contract (and whether by declaring the representation to form the basis of the contract or otherwise).

The primary target is basis clauses, which are deprived of effect. However, it would seem that any pre-contractual statement cannot be treated as a warranty. This is the only provision of the 2015 Act which, under section 16, cannot be modified by agreement in business insurance. That does not mean that the insurer cannot require the assured to warrant a particular statement, but that must be done by a policy term<sup>63</sup> and it is then subject to the remedial provisions in sections 10 and 11, discussed below. An anachronistic and unjustified rule has thereby been removed from English jurisprudence.

### *Continuing warranties*

Continuing warranties developed in eighteenth century conditions because an insurer might wish to exclude liability for a particular event, but – given the absence of reliable and timely communications, particularly with vessels or cargo located in other jurisdictions – be unable to prove how the loss was actually caused. The use of warranties sidestepped the need to prove that a loss was caused by an excluded event. It should also be borne in mind that it was not until the early part of the twentieth century that it became established that the relevant proximate cause was the effective cause and not necessarily the last cause,<sup>64</sup> and the warranty was a useful means of ensuring that there was no liability even though its breach was not the last event in the causal chain.

The principles were codified in sections 33 and 34 of the Marine Insurance Act 1906. The effects of those sections are: a warranty has to be exactly complied with; in the event of non-compliance the insurer is automatically discharged from liability as of the date of the breach of warranty;<sup>65</sup> the automatic discharge principle means that there cannot be waiver by affirmation, but only waiver by estoppel<sup>66</sup>, a principle which is grimly inevitable but seemingly contrary to the express wording of section 33(3);<sup>67</sup> there is no need for any causal connection between loss and breach; and, perhaps most damagingly, a breach cannot be remedied<sup>68</sup> so that a failure to comply removes any possibility of future claims by the assured even if the assured is in full compliance by the date of the loss. The application of these sections in modern conditions gave rise to consequences which were widely criticised by judges, law reform bodies and academics alike, although judges could do little other than insist upon a pedantically narrow construction of warranty wording.<sup>69</sup> Warranties came to be extended to matters which were not relevant to the risk, eg, timely payment of

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<sup>61</sup> [1922] 2 AC 413, 425 Viscount Haldane.

<sup>62</sup> [1922] 2 AC 413, 432 Viscount Cave.

<sup>63</sup> LC Report 353, [15.3] and [16.11].

<sup>64</sup> *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350.

<sup>65</sup> Confirmed in *Bank of Nova Scotia v Hellenic Mutual War Risk Association (Bermuda) Ltd, The Good Luck* [1991] 2 Lloyd’s Rep 191.

<sup>66</sup> *Kirkaldy & Sons Ltd v Walker* [1999] Lloyd’s Rep IR 410, 422; *Argo Systems FZE v Liberty Insurance Pte Ltd* [2012] 1 Lloyd’s Rep 129 Aikens LJ, at [38]; *Weir v Aberdeen* (1819) 2 B & Ald 320; *Samuel v Dumas* [1924] AC 431

<sup>67</sup> *HIH Casualty and General Insurance v Axa* [2003] Lloyd’s Rep IR 1.

<sup>68</sup> *De Hahn v Hartley* n 4 above; *Quebec Marine Insurance Company v The Commercial Bank of Canada* (1869–71) LR 3 PC 234

<sup>69</sup> *Hide v Bruce* (1783) 3 Doug KB 213; *Brownsville Holdings Ltd v Adamjee Insurance Co Ltd (The Milasan)* [2000] 2 Lloyd’s Rep 458; *GE Frankona Reinsurance Limited v CMM Trust No.1400, The ‘Newfoundland Explorer’* [2006] Lloyd’s Rep IR 704; *Pratt v Aigaion Insurance Co SA (The Resolute)* [2009] 1 Lloyd’s Rep 225; *Agapitos v Agnew (The Aegeon) (No.2)* n 60 above; *Eagle Star Insurance Co Ltd v Games Video Co (GVC) SA (The Game Boy)* n 37 above; *Sea Glory Maritime Co, Swedish Management Co SA v AL Sagr National Insurance Co* n 32 above.

premiums.<sup>70</sup>

The Law Commissions were not prepared to accept the abolition of continuing warranties. Instead, after lengthy deliberation, it was determined that the worst feature of a warranty would be removed, namely, the automatic termination principle. Accordingly, section 10(1) of the Act abolishes any rule of that breach of a warranty in a contract of insurance results in the discharge of the insurer's liability under the contract, and replaces it under section 10(2) with a suspensory principle. An insurer remains able (subject to section 11, discussed below) to deny liability for a loss occurring after a warranty has been breached but before the breach has been remedied (section 10(2)). However, once the breach has been remedied, the risk reattaches. The suspensory solution was one that had appealed to the courts, particularly in motor cases, and had led to a series of cases where terms described as "warranties" were construed as suspensory only, although the basis of such a construction was not clear and the cases were incapable of reconciliation<sup>71</sup>. Counter-intuitively, in some cases insurers had sought to argue their express warranties were suspensory only, although that was done where the assured was in breach at the time of loss so that there would be no recovery in any event, and insurers were hoping to persuade the courts to adopt less rigorous rules of construction to such lesser terms.<sup>72</sup>

The suspensory solution is a neat one, and certainly negatives many of the most criticised decisions. However, it is important to stress that section 10 does not impose a causation test, requiring the breach to be causative of the loss. It merely provides that the insurer cannot rely upon a breach of warranty after it has been cured, and says nothing about a loss which occurs in the period of breach. That is the province of section 11 of the 2015 Act. Finally, it should be noted that section 10 applies to the warranties implied into marine policies by sections 39(1) and 41, respectively the warranty of the seaworthiness of a vessel in a voyage policy, and the warranty of legality. Market practice and judicial rulings have rendered these warranties of little modern significance, but where they remain effective the ability of an insurer to rely upon a breach is restricted by the 2015 Act.

#### *Terms unrelated to the risk*

The reform of the law of continuing warranties, while long overdue, on its own does not deal with the use of conditions precedent in respect of claims, and other non-risk obligations in the policy. The Insurance Act 2015 leaves those untouched. That is a pity, because conditions precedent can defeat a perfectly good claim in circumstances where the transgression is trivial by its nature and inconsequential so far as the insurers are concerned. The Law Commissions did not at any point seriously consider amending the law in this respect, despite important precedents in section 9 of the Insurance Law Reform Act 1977 (New Zealand) and section 54(1) of the Insurance Contracts Act 1984 (Australia). Each of those provisions takes the sting out of claims (and in the Australian case, other non-risk) provisions by requiring proof by the insurers of prejudice to them, and such prejudice can be shown where, for example, the assured's delay or non-co-operation has made it impossible to assess the validity of the claim or the cause of loss, or where it has become all but impossible for insurers to exercise subrogation rights. The objection to reform, that quantifying prejudice for the purposes of determining the amount to be deducted from the sums payable under the policy is frequently arbitrary, is certainly true, but this is no more than a function of any claim for loss of opportunity and has in any event to be done under the existing law where the clause is not a condition precedent and the insurers are seeking offsetting damages for breach.<sup>73</sup> It might be thought that an equivalent statutory provision would at least have deterred the worst examples of reliance on such terms. That said, ICOBS has in consumer cases brought an end to the problem, and the Consumer Rights Act 2015, sections 62-69, by amending and extending the Unfair Terms in Consumer Contracts Regulations, provides a further layer of protection for consumers.<sup>74</sup>

#### *Terms unrelated to the loss*

As noted above, the warranty reforms taken alone fall short where there is a loss at a time when a warranty has been broken, because section 10 then cannot ride to the rescue. Further, section 10 has no application to risk-related terms that are not warranties. As noted above, the Law Commissions in the July 2014 Report proposed a measure that would have required a causal link between loss and breach, whether the term was a warranty or a condition. The reaction of sections of the insurance market to a causation test was adverse, and the provision was accordingly not included in the

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<sup>70</sup> *JA Chapman & Co Ltd v Kadirga Denizcilik Ve Ticaret* [1998] Lloyd's Rep IR 377.

<sup>71</sup> See the discussion of the authorities in *CTN Cash and Carry Ltd v General Accident Fire and Life Assurance Corp* [1989] 1 Lloyd's Rep. 299

<sup>72</sup> *Pratt v Aigaion Insurance Co SA (The Resolute)* [2004] Lloyd's Rep. I.R. 149; *AC Ward & Sons Ltd v Catlin (Five) Ltd* [2010] Lloyd's Rep IR 30.

<sup>73</sup> *Nulty v Milton Keynes Borough Council* [2013] EWCA Civ 13

<sup>74</sup> *Bankers Insurance Co v South* [2003] EWHC 380 (QB), although see *Parker v National Farmers Union Mutual Insurance Society Ltd* [2012] EHC 2156 (Comm), where ICOBS, part 8, was thought to be sufficient protection in its own right.

Bill as first presented to Parliament. However, the Law Commissions persisted in their work on the point, and a revised clause was put to the Committee in December 2014 shortly before the hearings commenced. The clause was received enthusiastically by the Committee, their Lordships being unable to understand why an insurer who insisted upon a working burglar alarm in a building should have the right to refuse to pay a claim where the building was destroyed by an aircraft falling out of the sky. The compromise measure, which bears a strong resemblance in intent if not in form to section 11 of the Insurance Law Reform Act 1977 (New Zealand) and section 54(2) of the Insurance Contracts Act 1984 (Australia), was graciously accepted by the Government, in the absence of any objection from the insurance industry, and passed almost without debate or comment. The result is section 11 of the Insurance Act 2015. This is worth reproducing in full:

- (1) This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following—
  - (a) loss of a particular kind,
  - (b) loss at a particular location,
  - (c) loss at a particular time.
- (2) If a loss occurs, and the term has not been complied with, the insurer may not rely on the non-compliance to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3).
- (3) The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.
- (4) This section may apply in addition to section 10.

As will be seen from subsection (4), section 11 applies to any risk term but, in the case of a warranty, picks up where section 10 leaves off, and focuses on the period where the assured is in breach. It is a safe bet that section 11 will prove to be the most controversial of all of the provisions in the 2015 Act. That is not to say that matters should have been left as they were, because the existing law was unacceptable for the reason given above. The real point about section 11, and indeed all provisions with a similar aim, is that it encounters two difficulties which are, in our view, incapable of solution other than on a case by case basis: identifying the terms caught by the provision; and applying the relevant test for a link between the term and the loss.

The first of these matters is exemplified by section 11(1), which applies to terms designed to reduce the risk of loss, but then draws a distinction between specific risk terms and “a term defining the risk as a whole” to which section 11 does not apply. The Law Commissions have asserted that any such term “will have a general limiting effect ... not linked to a specific risk sector.”<sup>75</sup> As far as a wording draftsman is concerned, this is a distinction without a difference. A policy on a building may contain an exclusion for loss suffered while a burglar alarm is not working. That is plainly a term within section 11(1)(a) and thus requires the inquiry to proceed to section 11(2)-(3). But could the same be said if the policy stated, on the front page under “risk definition”, that “This policy applies only to a building with a working burglar alarm”? The risk is thereby defined, and section 11 cannot apply to it. The obvious response is that this is merely a drafting device designed to sidestep section 11, and that is certainly true. But the questions for the courts are: is effect to be given to substance over form; and when can it be said that a risk definition is in reality an exclusion? Doubtless the answer to the first question is resoundingly in the positive, but the second can only be one of impression. The same problem is faced under the Consumer Rights Act 2015 in its distinction, for the purposes of the unfair terms controls, between core and ancillary terms, and a brief perusal of Australian and New Zealand authorities demonstrates the problem. The reader may wish to attempt the following:

- (1) A policy on a building excludes liability for “fault, defect, error or omission in design”. A wall collapses in bad weather and is found to have been defective. Does the policy cover a wall, but excluding the risk of its collapse due to a defect, or does it cover only wall free of defects?<sup>76</sup>
- (2) A policy on a motor vehicle provides cover only where the vehicle has not been modified. Does that exclude a claim in respect of a modified vehicle or does it remove cover entirely?<sup>77</sup>
- (3) A travel policy covers the assured only while travelling abroad and not working. Is there an exclusion for injury while working, or is there no cover for workers but only travellers?<sup>78</sup>
- (4) A vehicle is insured only where its driver has obtained a test profile score of at least 36 in a specified programme. Exclusion or risk definition?<sup>79</sup>

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<sup>75</sup> Report No 353, at [18.35].

<sup>76</sup> *Barnaby v South British Insurance Co Ltd* (1980) 1 ANZ Insurance Cases 60-401:

<sup>77</sup> *Price v New Zealand Insurance Ltd* [2003] DCR 700: issue ducked.

<sup>78</sup> *Sun Alliance v Travel the Earth* [1997] DCR 31: exclusion.

<sup>79</sup> *Maxwell v Highway Hauliers Pty Ltd* [2014] HCA 33: risk definition.

(5) An aeroplane has to be piloted by a pilot with up to date qualifications. Exclusion of cover whilst in the hands of an unqualified pilot, or no cover at all?<sup>80</sup>

The second issue is that of causation. The question is whether section 11 has successfully eliminated the causation test. The Law Commissions, in illustrating how causation is irrelevant because the test is purely objective, gave a series of examples. Suppose a building is damaged by fire at a time when the assured had failed to comply with the obligation to maintain a burglar alarm.<sup>81</sup> An inoperative burglar alarm could not have increased the risk of a fire, so insurers would have to pay. Again, suppose that the policy requires the insured factory to install five-lever mortise locks on all doors. The assured does not comply with this requirement, because door A only has three levers. If thieves break in through door A, then it can be said that the lock might have made a difference, and there is no recovery. On the other hand, if thieves break in through a window, or compliant door B, the default as regards door A would not have made any difference to the outcome and the insurers must pay.

But, despite the Law Commissions' protestations, this is pure causation.<sup>82</sup> The section is asking whether the objective risk of the loss which actually occurred and the way that it occurred was actually increased by non-compliance. Take the example of a vehicle with a defective light where the vehicle is warranted to be roadworthy and is involved in a collision in broad daylight. The insurers will presumably have to pay, because the absence of a light could not have affected the collision that actually took place and the manner in which it took place. Unless the courts choose to focus on the general nature of the loss (the risk of collision), causation remains in place. The section requires the court to consider the actual loss (the collision that took place). It is difficult to escape from the conclusion that this is the very outcome to which the market objected.

Pulling all of this together, what is one to make of *New Zealand Insurance v Harris*,<sup>83</sup> where a policy on a tractor was stated to be inapplicable while the tractor was let out on hire to a third party. The tractor was destroyed by fire while under hire, but the fire had nothing to do with the hiring. Is the clause one which excludes liability for fire in given circumstances or describes the risk? If the former, can it be said that the assured's hiring out of the tractor could not have increased the risk of the fire that actually occurred? The New Zealand Court of Appeal found for the assured on the ground that under the causation test imposed by s 11 of the Insurance Law Reform Act 1977, cover should not be lost by reason of a hiring which merely set the scene for a loss by fire but could not be regarded as the proximate cause of the loss. Would the reasoning be any different under the Insurance Act 2015?

## Fraudulent claims

### *The common law position*

Fraud has been defined as seeking to obtain an advantage, usually monetary, or to put someone else at a disadvantage, by lies and deceit.<sup>84</sup> Fraud for this purposes was defined by Lord Herschell in *Derry v Peek*<sup>21</sup> as arising "when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false." Dishonesty requires knowledge by the defendant that his statement would be regarded as dishonest by honest people.<sup>85</sup> In order for the fraudulent claims rule to apply, where a claim for a loss known to be non-existent or exaggerated, the part of the claim which is non-existent or exaggerated should not itself be immaterial or insubstantial.

The common law recognises five types of fraud in the concept of insurance: (1) loss deliberately caused by the assured;<sup>86</sup> (2) deliberate or reckless claim where there is no loss or where the amount of the claim is exaggerated;<sup>87</sup> (3) a claim which is honestly believed when initially presented, but the assured subsequently realises that it is exaggerated and continues to maintain it; (4) a genuine loss has occurred, but the assured seeks to improve or embellish the facts

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<sup>80</sup> *Johnson v Triple C Furniture & Electrical Pty Ltd* [2010] QCA 282: risk definition, but disapproved in *Maxwell* n 80 above.

<sup>81</sup> LC Report No 353, at [18.61].

<sup>82</sup> The Explanatory Notes state "In the event of non-compliance with such a term, it is intended that the insurer should not be able to rely on that non-compliance to escape liability unless the non-compliance could potentially have had some bearing on the risk of the loss which actually occurred." It is curious to see if not causation, what this statement refers to.

<sup>83</sup> [1990] 1 NZLR 10.

<sup>84</sup> Roche J while directing the jury in *Wisenthal v World Auxiliary Insurance Corp Ltd* (1930) 38 Ll L Rep 54, 62. See also s 1 of the Fraud Act 2006.

<sup>85</sup> *Twinsectra Ltd v Yardley* [2002] 2 AC 164, at [36]

<sup>86</sup> *Samuel v Dumas* n 67 above.

<sup>87</sup> *Agapitos v Agnew (The Aegeon) (No.1)* [2002] Lloyd's Rep IR 573, at [30].

surrounding the claim, by some lie, ie, the use of “fraudulent means and devices”;<sup>88</sup> and (5) deliberate suppression of a known defence.

The consequence of a fraudulent claim has long been a matter of contention. By reason of the notion that a contract of insurance is one of utmost good faith, the common law flirted with the possibility that the appropriate remedy was avoidance *ab initio*,<sup>89</sup> but that received its quietus in the House of Lords in *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd, The Star Sea*.<sup>90</sup> The duty not to make a fraudulent claim is either an implied contract term, or possibly a special rule of law,<sup>91</sup> but the effect is that any fraud is prospective only.<sup>92</sup>

### *Insurance Act 2015*

Section 12 of the 2015 Act deals with one aspect only of fraudulent claims, and that is the remedy. If the assured makes a fraudulent insurance claim the insurer is not liable to pay the claim (section 12(1)(a)) and the insurer may recover from the assured any sums paid in respect of the claim (section 12(1)(b)). It is also stated that the insurer may terminate the insurance contract with effect from the time of the fraudulent act (section 12(1)(c)), a proposition which was assumed to represent the common law but which had never been tested. Termination has prospective effect only, and does not affect accrued rights in respect of other claims (section 12(2)-(3)), and it is apparent from the wording that an insurer who fails to give notice of termination effectively waives the right to do so and must pay future claims. Section 13 deals with the specific issue of group insurance, typically a policy taken out by an employer for the benefit of employees, and states that each employee is to be treated as a separate assured for present purposes. Thus, a fraudulent claim by an employee does not affect the policy itself or the cover extended to other employees, but merely strips the fraudster of any rights under the policy.

Section 12 is deliberately silent<sup>93</sup> on the thorny problem of fraud in the form of the use of fraudulent means and devices. As mentioned above, this type of fraud is exceptional when compared to the others, because it strips the assured of a valid claim by reason of post-loss conduct which is unrelated to liability but is merely designed to secure payment of a sum to which the assured is otherwise entitled. The evidence to the Committee showed little enthusiasm for a reversal of the rule despite some recognition of its draconian nature, the ABI commenting in oral evidence in response to an express question that it did not wish to be “fraud-light”. However, the issue is not yet dead. Five Commercial Court judges gave evidence to the Law Commissions deprecating the rule and, by one of fate’s strange workings, a case on point, *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG, The DC Merwestone*<sup>94</sup> came before one of those judges, Popplewell J, in the course of the Law Commissions’ deliberations. Popplewell J felt constrained by prior authority to deny the assured a remedy even though the fraud – a claim by a ship’s manager that he had been told that an alarm was sounding during the course of the casualty – was unrelated to the actual head of cover (perils of the seas) ultimately made. The Law Commissions’ original clause would have preserved the fraudulent means and devices principle, but it was ultimately thought to be preferable to remove that wording and to leave the resolution of the matter to the courts. In October 2014, shortly before the Parliamentary hearings, the Court of Appeal upheld the decision in *Versloot*<sup>95</sup> but did so enthusiastically, and in particular the Court of Appeal rejected the suggestion that the removal of an accrued claim is inconsistent with the Human Rights Act 1998. Permission has been granted for an appeal to the Supreme Court.

One other matter considered and rejected by the Law Commissions was a model based on the Australian Insurance Contracts Act 1984, section 56, which is similar in fixing the remedy for fraudulent claims as prospective only but which goes on to give the court a discretion to disregard trivial fraud.<sup>96</sup> As with the remedy for fraudulent breach of the duty of fair presentation, it was thought that judicial discretion in this sphere was inappropriate.

### **Contracting out**

Contracting out, in the sense that a contract term would put the assured in a worse position than under the Act, is not

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<sup>88</sup> *Agapitos v Agnew (The Aegeon) (No.1)* n 88 above, at [30].

<sup>89</sup> The root decision being *Black King Shipping v Massie, The Litsion Pride* n 19 above

<sup>90</sup> [2001] 1 Lloyd’s Rep 389

<sup>91</sup> This was the view of Lord Hobhouse in *The Star Sea* n 19 above.

<sup>92</sup> *Axa Insurance Ltd v Gottlieb* [2005] Lloyd’s Rep IR 369.

<sup>93</sup> The provision was amended by the Law Commissions in the consultation process to remove wording which appeared to codify the principle.

<sup>94</sup> [2013] EWHC 1666 (Comm).

<sup>95</sup> [2014] EWCA Civ 1349

<sup>96</sup> A discretion which has been exercised in respect of exaggerated loss and – rather less obviously, given the wording of the section – fraudulent means and devices. The Australian provision in one respect goes further than its UK counterpart, and allows the insurers to cancel all insurance contracts with the assured and not simply the tainted policy.

permitted for consumer policies (section 15), and is also not permitted with respect to present warranties in business policies (section 16(1)). However, the remainder of the Act can under section 16(2) be excluded in business policies, subject to important transparency safeguards as set out in section 17. A disadvantageous term may be enforced if it is clear and unambiguous as to its effect and the insurer takes sufficient steps to draw the disadvantageous term to the assured's attention before the contract is entered into. In determining the application of the transparency test, the characteristics of the assured of the kind in question, and the circumstances of the transaction, are to be taken into account. In case the insurer fails to meet the requirements of section 17 the term may still be enforced if the assured had actual knowledge of the disadvantageous term when the contract was made.

To what extent exclusion or limitation clauses will be employed is as yet uncertain. All will depend upon the extent to which brokers can exercise influence over underwriters in the preparation of wordings, but it is far from obvious that the provisions of the Act will be ousted in practice.

## Late payment

Brief mention may be made of this matter, because it does not appear in the Insurance Act 2015. The common law denies the assured any claim for damages for non-payment of policy moneys in a timely fashion, and confines the assured to simple interest. This emerges from *Sprung v Royal Insurance*,<sup>97</sup> which classifies a claim under an insurance policy as one for unliquidated damages payable on the occurrence of the insured peril, so that any claim for damages amounts to one seeking damages for non-payment of damages. In the outcome, the assured in *Sprung* was unable to recover anything over and above the policy moneys even though it was alleged that the delay in payment had caused the loss of the assured's business. Evidence to the Law Commissions was broadly favourable to a change in the law, despite the arguments that damages might be disproportionate to the amount of the claim, that insurance against business losses can be purchased separately if required, that FOS does not apply *Sprung* in consumer cases so that damages for distress are in practice awarded, and that insurers are in any event under strong competitive pressure to pay claims timeously.

The Law Commissions chose to recommend a remedy for late payment, in the form of damages to be assessed on ordinary remoteness principles. The Law Commissions were of the view that it was far from obvious that the *Sprung* ruling was consistent with legal principle, and that there was no reason to give insurers immunity from damages where they caused foreseeable losses. To that it may be added that the Insurance Act 2015 happily preserves the rules on fraudulent claims, but very often the reason for a fraudulent claim – certainly in the form of the use of fraudulent means and devices – is a failure by insurers to pay when they should. The Government nevertheless rejected the proposal and excluded late payment from the Bill. This proved to be a matter of some contention in the Committee. The evidence was virtually all one way, even from insurers, that this was a worthwhile reform. However, powerful submissions were received from the Lloyd's Market Association and the International Underwriting Association, as well as from Lord Mance, that this was a bad idea for the reasons given above. The Government resisted formal tabled amendments to the Bill from members of the Committee of all political persuasions, including a compromise proposal from Lord Woolf that would have given the courts the power to award compound interest where that sanction was merited. A formal vote was taken but the attempt to reinsert the provision was defeated. The Government's indication that it would revisit the matter in a separate Bill in the next Parliament was not taken seriously, although it remains on the record of the proceedings.

One matter of wider interest arises from all of this. The special procedure reserved for Law Commission bills operates only where the measures proposed are not controversial: if an amendment regarded as controversial is carried the entire bill is threatened. That point was made by the Government in its opposition to the proposals to resurrect the late payment clause in the Law Commissions' Bill, and was countered with a fascinating but inconclusive discussion as to whether a matter could be controversial if it was opposed – however vehemently – only by a tiny minority of witnesses.

## Concluding remarks

The Insurance Act 2015 is a balanced package, offering something to insurers and assureds alike on every matter that it addresses. It could, and perhaps should, have gone further, not the least in respect of late payment. That said, it is pleasantly surprising that the Government was prepared to adopt a measure in which there are no votes, and at a time of heightened political uncertainty in the run up to the 2015 election. There are nevertheless two significant consequences of these changes, one inevitable and one unintended.

The inevitable consequence is short-term dislocation and uncertainty. The meaning of new concepts, such as the assured's "reasonable search", and the "risk-defining" term, must await judicial determination, and there will be

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<sup>97</sup> [1999] Lloyd's Rep. I.R. 111, followed in *Pride Valley Foods Ltd v Independent Insurance Co Ltd* [1999] Lloyd's Rep IR 120.

several false starts before, ultimately,<sup>98</sup> seminal decisions are handed down. The majority view in the debates on the Bill was that reform was necessary and that temporary uncertainty was a price worth paying. One particular issue will be the extent to which the courts will have regard to the common law or whether they will follow their Australian counterparts in insisting that the starting point is the legislation.<sup>99</sup>

The unintended consequence is the implication for the Commonwealth jurisdictions whose law is similarly based on the Marine Insurance Act 1906. Singapore and Hong Kong retain the measure as the basis for all of their insurance law. New Zealand has by the Insurance Law Reform Acts 1977 and 1985 altered non-marine insurance, including modifying marine legislation in certain respects, but otherwise the 1906<sup>100</sup> Act predominates. Even Australia, which, by the Insurance Contracts Act 1984, swept away the common law, did so only with respect to most forms of non-marine covers: marine insurance<sup>101</sup> and reinsurance in particular are outside the reformed scheme, the former expressly on the basis that there was no point in moving ahead of the UK given that most contracts were governed by English law. But even where Australian and New Zealand non-marine legislation does differ from the marine regime, there are respects in which the Insurance Act 2015 is worthy model. It would be unsurprising if other common law jurisdictions watch the fireworks and then make a decision as to whether or not to light their own blue touch-papers. What is also for sure is that, given how many major insurance policies are insured or reinsured in London or under contracts governed by English law, the Insurance Act 2015 will be keenly observed worldwide.

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<sup>98</sup> As seen above, the latter issue took the Australian courts 30 years to resolve, and debate – albeit now more muted – remains extant.

<sup>99</sup> *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* [2003] HCA 25.

<sup>100</sup> Marine Insurance Act 1908.

<sup>101</sup> Marine Insurance Act 1909.