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A modernised insurance contract law now in sight?

Briefing

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Summary

Insurance contract law is now likely to be reformed by a Bill currently going through Parliament. The Insurance Bill 2014 will amend the law in relation to misrepresentation and non-disclosure, warranties and remedies for fraudulent claims.

Introduction

The Law Commissions of England and Wales and of Scotland have published a second report on the project to reform insurance contract law. The report deals with reform to the law of disclosure in business insurance, warranties, insurers' remedies for fraudulent claims and late payment of claims.

A Bill (the Insurance Bill) has been simultaneously introduced into Parliament in order that the Law Commissions' proposals are implemented, if enacted. The Bill will follow the special Parliamentary procedure used for uncontroversial Law Commission proposals. Importantly however, two aspects of the proposals were thought to be unsuitable to be included under this procedure and have not been included in the Bill:

- the effect of a breach of warranty where the loss is unrelated to the breach
- whether damages should be available to the insured following the late payment of a claim by the insurer.

There is currently insufficient consensus about how best to address these two areas to merit the inclusion into the Bill currently before Parliament. The Law Commissions state that they will continue to seek workable solutions to enable reform in these two areas.

If enacted what will the Bill do?

If the Insurance Bill passes substantially unchanged through Parliament, it will amend the law embodied in the Marine Insurance Act 1906 (MIA) to provide more flexible remedies should the insured misrepresent or fail to disclose a material fact relevant to the risk being insured. MIA provides for the avoidance of the contract where there has been a material non-disclosure or misrepresentation.

The Bill will codify the law to reflect the judicial decisions on the application of MIA in the hundred years since the statute came into force. The Bill gives the courts greater flexibility to review the commercial effect of a non-disclosure or misrepresentation and apply remedies that better reflect the impact of the misrepresentation or non-disclosure on the underwriting.

Fair presentation of the risk

Currently, the Bill replaces the duty set out in MIA to disclose every material circumstance that a prudent underwriter would wish to know with a duty to make a 'fair presentation of the risk'. In other words, the emphasis has changed from disclosure (which can lead to data dumping by the insured or their broker) to making a fair presentation which requires a more active and considered approach to what information is given to the insurer. A fair presentation is one which would be reasonably clear and accessible to a prudent insurer.

The insured should disclose every material circumstance which they know or ought to know (as is currently required by MIA) but in addition requires the insured to disclose sufficient information to put a prudent insurer on notice that it needs to make further enquiries about the risk. This requires the underwriter to play a more active role in the pre-contractual negotiations.

The Bill provides greater clarity on whose knowledge is relevant when a risk is placed with an insurer. Where the insured is an individual, knowledge of material facts will include the knowledge of the individual who will become the insured and knowledge of the person with responsibility for placing the insurance (i.e. an agent). Where the insured is not an individual, knowledge will include facts known to the senior management of the entity and knowledge of those responsible for placing insurance (for example a risk manager or their agent). Importantly, regardless of whether the insured is an individual or a company, they are deemed to have knowledge of those material circumstances that would have been revealed by a reasonable search of information available. This is likely to require risk managers to undertake and evidence that they have done at least some due diligence on the risks for which they are responsible for finding cover.

For insurers, the Bill clarifies that knowledge about a material circumstance will extend only to those individuals who participate on behalf of the insurer in the decision whether to take the risk and on what terms. Clearly, this limits presumed knowledge to those within underwriting teams (but extends to employees or agents acting in this capacity). The implication of this is that underwriters need not necessarily be deemed to have access to knowledge held by those within claims teams.

The main change introduced by the Bill is the system of proportionate remedies available to underwriters where the duty to make a fair presentation has been breached. The single remedy of avoidance of the contract is replaced by remedies that are dependent upon whether a breach was deliberate or reckless or not. The Bill only provides remedies where, but for the breach, the insurer would not have entered into the contract at all or, if they would have still entered into the contract, they would have done so on different terms. Where the terms on which the insurer would have contracted would have been different had they known of the material circumstance (i.e. they would have charged a higher premium or included an exclusion in the terms) the remedy applied by the courts will reflect the position that the insurer would have contracted upon had the fact been known.

Warranties

MIA has the effect that a breach of a warranty discharges the insurer from further liability under the contract. The Bill seeks to reduce the draconian impact of the law as it stands in MIA where the breach of warranty was only temporary – for example where a burglar alarm was not working for a brief period of time. The Bill states that an insurer will have no liability for any loss occurring after a breach of warranty. Once remedied – so long as the risk originally contemplated remains the same – the insurer will be back 'on risk'. Furthermore, the Bill abolishes 'basis of the contract' clauses which have the effect of transforming pre-contractual representations into contractual warranties.

Remedies for fraudulent claims

The Bill clarifies the remedies available to insurers where an insured has made a fraudulent claim. When an insured submits a fraudulent claim the insurer will not be liable to pay that claim and can recover any sums previously paid in relation to the claim. Further, the insurer is able to choose to treat the contract as terminated with effect from the fraudulent act. Importantly, a fraudulent claim does not render illegitimate claims made prior to the fraud.

The duty of good faith

Section 17 of MIA is amended by the Bill with the result that the remedy for a breach of the duty of good faith is no longer that the contract is void. The Bill does not however abolish the duty itself which remains applicable to both insurers and insureds.

Contracting out

The Bill should represent the default regime for both consumer and non-consumer contracts. For consumers, the regime should be mandatory. For non-consumer contracts, a term which would put the insured in a worse position than would be provided for under the Bill will be of no effect unless such a term has been sufficiently drawn to the insured's attention (the transparency requirements). In determining whether the transparency requirements have been met, the nature of the insured and the circumstances of the transaction will be taken into account. Presumably therefore, where an insured has negotiated the contract through a broker there will be little scope to argue that the transparency requirements were not met.

Ongoing questions

The Bill has been introduced into the House of Lords using the special procedure which enables Law Commission Bills to be fast-tracked through Parliament (on the basis that they have been subject to extensive review before entering either House). In order that the Insurance Bill qualified for this procedure, it was decided to remove two areas of reform proposed by the Law Commissions which attracted criticism. These were proposals to limit the ability of an insurer to be discharged from further liability under the contract where a breach of warranty had no connection (in time or nature) to the cause of loss. The other proposal was to provide the insured with remedies for a late payment of a claim by an insurer; currently there is no ability to pay damages for a late claim, regardless of the length or consequences of the delay. The Law Commissions have promised to continue to look at how best to reform the law in these areas.

The Bill has failed to address the difference between a fraudulent claim and a fraudulent device. Clause 11 of the Bill mentions 'fraudulent acts' in a claim but it is not clear whether this would extend to the use of fraudulent devices used in an otherwise legitimate claim. This is a much argued point and would benefit from clarification under the Bill.

Should the Bill become an Act, we can expect a number of years of litigation to determine the new landscape of insurance contract law. Although in many respects harsh, the current law has the benefit of being familiar to those in the market. As both the market and the courts navigate their way through a revised law both insurers and insureds will face greater uncertainty in the short term.

What next?

The Bill had its first reading on July 17. It will now proceed through the various stages in Parliament.

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