

Insurance Contract Law Review – Update on Current Position

27 June 2012

LATEST DEVELOPMENTS

The **Law Commissions** published their third and final joint consultation paper on insurance contract law yesterday: [Consultation Paper on Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties](#). The proposals are aimed at all business insurance, including micro-businesses and cover marine insurance and reinsurance.

This briefing highlights the main issues for clients to consider.

BUSINESS INSURED'S DUTY OF DISCLOSURE

CURRENT POSITION

1. As the law currently stands a business policyholder has a duty to disclose "**every material circumstance**" it **knows (or ought to know)** "in the ordinary course of business" about the risk to be covered (section 18 of the Marine Insurance Act 1906 (the "Act")).
2. If the insured fails in this **duty to disclose**, the insurer may **'avoid'** the policy, decline all claims and treat the policy as if it never existed.
3. According to the Law Commissions, this duty can be unclear and avoidance is seen as too harsh a remedy.

PROPOSALS

4. The Consultation Paper proposes that:
 - (a) the insured must provide a **fair presentation of the risk** including:
 - (i) any **unusual or special** circumstances which increase the risk;
 - (ii) any **particular concerns** about the risk which led to the insurance being placed; and
 - (iii) **standard information** which market participants generally understand should be disclosed i.e. established protocols;
 - (b) the **onus** should then be on the **insurer to ask further questions** if the presentation of the risk suggests potential problems; and
 - (c) the **inducement test** be codified and the definition of **knowledge** clarified.
5. **New remedies** proposed are as follows:
 - For **dishonest** conduct: the insurer should be entitled to **avoid** the contract, refuse all claims and keep any premium paid.

- For conduct which is **not dishonest**: the law should aim to **put the insurer into the position it would have been in** had full and accurate information been provided, so that if the insurer would have:

- (a) declined the risk, the policy should be avoided, the claim refused and premiums returned;
- (b) accepted the risk but included another contract term, the contract should be treated as if it included that term; or
- (c) charged a greater premium, the claim should be reduced proportionately.

WARRANTIES

CURRENT POSITION

1. Under section 33(3) of the Act, a warranty "**must be exactly complied with, whether it be material to the risk or not**", meaning the insurer can refuse a claim for a minor mistake which does not relate to the risk.
2. Once the warranty is breached, a defence that it has since been remedied cannot be used (section 34(2) of the Act) and the insurer is **discharged from all liability** under the policy.

PROPOSALS

3. **Abolish 'basis of contract' clauses**, for example to prevent all answers on a proposal form being converted to warranties.
4. Treat warranties as **suspensive conditions** i.e. a breach would suspend, not discharge an insurer's liability. Where such breach is remedied before the loss, the insurer must pay the claim.
5. Introduce **special rules** to deal with any term designed to **reduce a particular risk** e.g. breach of a warranty to install a burglar alarm would suspend liability for loss caused by an intruder, but not a flood loss.

IMPLICATIONS FOR CLIENTS

- For business insurance, parties will be entitled to **contract out** of the new proportionate remedies regime i.e. preserving their 'freedom to contract', but only if it is written in **clear unambiguous language** and brought to the attention of the other party.
- The **'duty of utmost good faith'** in section 17 of the Act is to be retained as an **interpretative principle** but will not give a policyholder or insurer a cause of action.

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NEXT STEPS

SEPTEMBER 2012: Consultation Paper on Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties (responses due by 26 September 2012)

For a summary of the consultation paper click [here](#).

MARCH 2013: Consumer Insurance (Disclosure & Representations) Act 2012 due to come into force

COMMENT

The proposed reforms are designed to take an evolutionary approach and to build on current best practice. However, will for example, the new special rules for certain warranties introduce a causal connection test by the back door?

FURTHER INFORMATION, TRAINING & RESPONSES

For more information, to enquire about training or to request assistance in responding to the Law Commissions Consultation Paper please contact the person with whom you usually deal or Helen Chapman / Clare Douglas

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