On July 17, 2014 the Government introduced the Insurance Bill (the Bill) into Parliament which proposes amendments to the insurer’s duty of disclosure in business insurance, the law of warranties and insurers’ remedies for fraudulent claims. It addresses several areas where the existing legislation (primarily the Marine Insurance Act 1906) is widely regarded as being unduly weighted in favour of the insurers. Unlike the vast majority of commercial insurance buyers, the landlord operates at arms length from the day-to-day operations of the property. This makes property owners particularly vulnerable to accusations that they have failed to declare all the facts relevant to the individual locations that insurers will deem ‘material’. If passed the Bill would become law 18 months from the day it was enacted.

It is important to note that (with one or two exceptions) the Bill sets a default regime, and allows insurers to contract out of important elements of the Bill as long as it is done in a “transparent” manner.

In this bulletin we provide an overview of the key changes, outline Willis’ broad support and provide guidance on how they may affect your business – including points for you to consider.

DUTY OF DISCLOSURE

THE CURRENT SITUATION

Currently, the law requires policyholders to disclose “every material circumstance” known or which ought to be known “in the ordinary course of the business”. In the event of breach of that obligation, the insurer is entitled to avoid the policy and refuse all claims under it.

The risks faced by property owners who employ managing agents to look after properties on their behalf are particularly onerous. Legal precedent [Ajou v Dollar Land Holdings, 1994] dictates that the knowledge of such managing agents shall be imputed to the property owner. In other words, if an agent is aware of circumstances that breach policy conditions, the fact that the property owner was unaware is no defence. Commonly used ‘non-invalidation’ clauses are designed to protect the property owner from the consequences of their tenant’s actions and consequently do not cater for this scenario.

THE BILL PROPOSAL

Under the proposed new law there would be greater clarity around what information a purchaser of insurance has to provide to the insurer, which of their staff is responsible for doing so and to whom they have to provide it. Before a contract is entered into or before making an amendment to the contract, the insurer would have to make “a fair presentation of the risk”, i.e. disclose every material circumstance which the insured knows or ought to know, or failing that, make a disclosure which 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. Every material representation as to a matter of fact must be substantially correct, and every material representation as to a matter of expectation or belief must be made in good faith.

REMEDIES FOR BREACH OF DUTY OF DISCLOSURE

THE CURRENT SITUATION

Currently an insurer only has one draconian remedy – to avoid the policy and walk away from all claims, even in circumstances where the non-disclosure was inadvertent and the insurer would have agreed to the contract, perhaps on revised terms.

More advanced policy wordings attempt to mitigate this risk by stipulating that the policy will only be voidable in the event of deliberate non-disclosure. However, even this positive adaptation leaves the policyholder with a fight on their hands to prove that their omission was inadvertent.

THE BILL PROPOSAL

The proposals establish a more proportionate range of remedies should the policyholder fail to provide accurate information. One remedy of particular interest is the proposed “proportional reduction” in claims settlement where the insurer can show that he would have written the risk but at a higher premium (in which case a form of average may be applied to any claim). This remedy is preferable by far to the current position, but falls short of an alternative remedy that some insurers will agree to incorporate into a policy, whereby the insured merely has to pay the higher premium for full cover to then apply.

BASIS OF CONTRACT CLAUSES

THE CURRENT SITUATION

Basis of contract clauses are regularly included in either the policy, proposal forms or both. They essentially convert all statements made by the insured to the insurers into warranties. So if the information given proves inaccurate or incomplete, the insured may not only face an allegation of material non-disclosure or misrepresentation, but also an allegation of breach of warranty. Under current law the remedy for a breach of warranty is draconian (explained below).

THE BILL PROPOSAL

The Bill would effectively abolish basis of contract clauses, and the insurer would not be able to contract out of this amendment.

WARRANTIES (OTHER THAN BASIS OF CONTRACT CLAUSES)

THE CURRENT SITUATION

A breach of warranty discharges the insurer from its obligations from the date the warranty is breached, irrespective of whether the insurer has been prejudiced in any way by the breach. Cover is not reinstated even where the breach is remedied.
THE BILL PROPOSAL

The Bill proposes cover is reinstated where the insured remedies the breach.

THE CURRENT SITUATION

Under the current law, unless there is an express term in the insurance contract dealing with fraud, the general law will apply. The law itself is unclear but in the worst case, an insurer could avoid the policy and recover from the policyholder any sums already paid out on genuine claims. Because of uncertainty around the question of an insurer’s remedy, clarification of the law is to be welcomed.

The Bill, if enacted, would provide a new framework for business insurance contracts but it will be for the Courts to interpret the new law. It does appear that the Bill goes some way to redressing the imbalance under the current law between the interests of the insured and insurers. We will continue to monitor developments.

THE BILL PROPOSAL

The proposals provide clear guidelines for what action should be taken, particularly relating to the rights and obligations of parties to the contract in relation to an event occurring before the time of the fraudulent act. Under the Bill, if the insured makes a fraudulent claim under a contract of insurance: the insurer is not liable to pay the claim; he may recover from the insured any sums he paid to the insured in respect of the claim; and he may, by notice to the insured, treat the contract as having been terminated with effect from the time of the fraudulent act.

If the insurer does treat the contract as having been terminated: the insurer may refuse all liability to the insured under the contract in respect of a “relevant event” occurring after the time of the fraudulent act, and he does not need to return any of the premiums paid under the contract. The Bill also makes clear that treating a contract as having been terminated does not affect any rights and obligations of the parties to the contract with respect to a “relevant event”, e.g. the occurrence of a loss, the making of a claim, or the notification of a potential claim, occurring before the time of the fraudulent act.

KEY CHANGES FROM THE ORIGINAL PROPOSALS

Sadly two important provisions that were contained in the Law Commissions’ original draft proposals have been removed from the proposed Bill:

Clause 11 – which provided that a breach of a term (condition precedent or warranty) applied to a particular type or location of loss will not affect a loss of a different type or at a different location. The removal means that insurers will still be able to refuse claims (and cancel cover) for breach of warranty, even if the loss in question is in no way related to the warranty breach. The Bill does, however, propose that cover is reinstated where the insured remedies the breach.

Clause 14 – which relates to late payment of claims. The removal of this clause is especially disappointing as Mactavish, an insurance governance consultancy, estimates that 45% of “significant” commercial claims are disputed by insurers, with such cases taking an average of 35 months to settle. (Source: Post Magazine, July 24, 2014). As any Director knows, any delays in payment can have a devastating effect on a business; as the loss will likely impair its ability to trade, may impact on reputation and can result in negative press.

SUMMARY

The Bill, if enacted, would provide a new framework for business insurance contracts but it will be for the Courts to interpret the new law. It does appear that the Bill goes some way to redressing the imbalance under the current law between the interests of the insured and insurers. We will continue to monitor developments.