Examining New Changes to English Insurance Law

by Peter A. Halprin

English insurance law is changing. On August 1, 2016, the new insurance law, the Insurance Act of 2015, came into force. The 2015 Act addresses pre-contractual disclosure, misrepresentation and insurance companies' remedies for breach of pre-contractual duties with respect to non-consumer insurance contracts and warranties and fraudulent claims with respect to all insurance contracts.

Many U.S. businesses large and small purchase insurance in the London market, and many policies governed by English law are part of U.S. companies' insurance portfolios. Therefore, risk managers on this side of the Atlantic should take careful note of the changes.

Before it came into force in August, the 2015 Act was amended with additional provisions introduced by another piece of legislation, the Enterprise Act 2016, to permit, for the first time in English law, damages for late payment of insurance claims. These new provisions regarding damages for late payment come into force in May 2017.

BACKGROUND REGARDING THE ACT

Many insurance policies, particularly those sold by London or Bermudan insurance companies, contain English choice of law clauses. (For ease of reference, we use the phrase English law as shorthand for the law of England and Wales. We also use this phrase even though the changes described in this article in fact apply to the whole of the United Kingdom with only minor exceptions.) The jurisdiction has developed a reputation for being challenging when it comes to the payment of claims and treatment of policyholders. American policyholders will be aware of the harsh application of the existing law whereby, in response to a wholly innocent failure by an insured to disclose a material circumstance pre-contractually, the insurance company is entitled to void the policy ab initio (from the beginning) and refuse to pay an otherwise valid claim to which the non-disclosure bears no relation.

English insurance law was developed during the 18th and 19th centuries. Marine insurance law was partially codified in the Marine Insurance Act of 1906. Codification had its detractors even then, and the 1906 Act took some 12 years to become law. Although only ever intended to regulate certain aspects of marine insurance, the 1906 Act became the touchstone for insurance law more generally as regards disclosure, misrepresentation and warranties. In a 2014 Law Commission report, which annexed an initial draft of what would eventually become to the 2015 Act, the 1906 Act is described as being "insurer-friendly." More specifically, the report notes that "where a policyholder is in breach of an obligation, the law gives wide-ranging opportunities for the insurer to avoid the contract and refuse all claims, or to treat its liability as discharged, even where the remedy seems out of proportion to the wrong done by the policyholder." Those descriptions held sway, and similar themes found their way into the explanatory notes which accompanied the original draft of the Insurance Bill when it was introduced into the House of Lords. The provisions of the 1906 Act dealing with disclosure, misrepresentation and warranties were there described as being "significantly out of line with best practice in the modern insurance market" and it was asserted that "the law has also failed to keep pace with developments in other areas of commercial contract and consumer law, and with insurance law in other jurisdictions." Such was the view of things that resulted in the 2015 Act.

CHANGES UNDER THE 2015 ACT

Disclosure and Misrepresentation

Duty of Fair Presentation

Sections 18 to 20 of the 1906 Act deal with the pre-contractual stage and address disclosure by the insured, disclosure by the agent effecting the insurance and representations, respectively. The 2015 Act replaces those sections of the 1906 Act with the compendiously described duty of fair presentation of the risk, an expression borrowed from the landmark case of CTI v. Oceanus.

A fair presentation of the risk is one which:

- makes disclosure of every material circumstances that the insured knows or ought to know or gives sufficient dis-

closure to put the insurer on notice that it needs to make further enquiries to reveal material circumstances; and
- makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurance company; and
- in which every material representation as to a matter of fact is substantially correct, and every material misrepresentation as to a matter of expectation or belief is made in good faith.

Regarding what a policyholder actually knows, the 2015 Act provides that a policyholder who is not an individual is deemed to know only what is known to one or more of the individuals who are 1) part of the policyholder's senior management or 2) responsible for the policyholder's insurance. With respect to what a policyholder ought to know, the 2015 Act provides that a policyholder "ought to know what should reasonably have been revealed by a reasonable search of information available to [it], whether the search is conducted by making enquires or by any other means."

Disclosure is not required of a circumstance if 1) it diminishes the risk, 2) the insurance company actually, ought to or is presumed to know it or 3) the insurance company waives information. The actual knowledge of an insurance company is that held by the individuals who participate in the decision to write the policy and if so, on what terms. An insurance company ought to know something if an employee or agent knows it and ought reasonably to have passed it onto the individual(s) who are the repository of the insurance company's actual knowledge or where the information is reasonably available to such individual(s). The third category of knowledge, presumed knowledge, is 1) common knowledge and 2) that which an insurance company offering insurance in the class in question could reasonably be expected to know in the ordinary course of business.

Willful blindness or "blind eye" knowledge—i.e., where the policyholder or insurance company deliberately refrains from obtaining knowledge—is be deemed to be knowledge.

Those familiar with the existing English law of insurance will recognize much of the new law as drawing heavily on the former, at any rate as regards its essential concepts. Much has changed, however. In particular, the Law Commissions set out to reform the law as regards the knowledge of the insured and insurance company, an area of the common law which, coupled with the salient provisions in the 1906 Act, they regarded as being particularly unsatisfactory. In the process, multiple new tests, or new wordings for existing tests, for knowledge have been introduced.

In addition, having wrapped up misrepresentation with disclosure, there is uncertainty as to whether the Misrepresentation Act 1967 will continue to apply to contracts of insurance or whether insurance contracts are now a unique class, incapable of being rescinded for misrepresentation. It seems that was intended.

Breach of the Duty of Fair Representation and Remedies

Under the existing law, the sole remedy for non-disclosure had been voidance of the insurance policy. That rule being enshrined in an Act of Parliament, the common law had been powerless to dilute it. The rule was abolished, as a sole and standalone remedy, for consumer insurance contracts in 2012 and non-consumer insurance contracts have now followed suit. Now, in the case of a non-consumer insurance contract, the insurance company has a remedy only for a qualifying breach. A qualifying breach is one which, but for the same, the insurance company can show that it would not have entered into the contract at all or would have done so only on different terms. Those versed in this area will recognize that as the existing (common law) actual inducement test. The prudent underwriter test has also been retained.

A qualifying breach is either 1) deliberate or reckless or 2) neither deliberate or reckless, with deliberate or reckless in this sense meaning that the insured either knew it was in breach of the duty of fair presentation or did not care whether or not that was so. The insurance company has the burden of proof of showing that the breach was deliberate or reckless.

Where the breach was deliberate or reckless, the insurance company may void the contract, refuse all claims and need not return the premium. In other words, the existing law is essentially retained.

If the breach was neither deliberate nor reckless, the 2015 Act sets forth a scheme of remedies dependent upon the nature of the neither deliberate nor reckless breach. If the insurance company would not have sold the insurance policy on any terms, the insurance company can void the policy and refuse all claims, but it must return the premium. Again, that reflects the existing law.

If the insurance company would have sold the policy on different terms (other than those relating to the premium), the policy is to be treated as if it had been entered into on those different terms if the insurance company so requires it. If the insurance company would have sold the policy but would have charged a higher premium, the insurance company may reduce proportionally the amount to be paid on a claim. Both are completely new concepts in the field of non-consumer insurance law. It is anticipated that they will be particularly fertile ground for disputes.

WARRANTIES AND REPRESENTATIONS

Under the existing law, breach of a warranty automatically discharges the insurance cover from the date of breach. The common law has counter-balanced that rule with a strict approach both to the question of whether a term is in truth a warranty, properly so called, and to the construction of terms which do merit that title. The 2015 Act introduces significant change in this area.

With regard to non-consumer insurance contracts, the 2015 Act provides that a representation made by a policyholder in connection with such contract is not capable of being converted into a warranty by means of a provision in the contract of insurance or any other contract. The purpose of this change was to prevent insurance companies from engaging in the wholesale conversion of pre-contractual statements into warranties. In other words, the use of "basis" clauses has been prohibited. That change was uncontroversial; the use of basis clauses had long been regarded as unacceptable.

Significantly, the 2015 Act provides that breach of a warranty in an insurance policy does not result in the discharge of an insurance company's liability. This, again, was aimed at preventing insurance companies from denying liability on account of a breach of warranty. The 2015 Act, however, does now provide that a breach of warranty by a policyholder suspends the insurance company's liability under the policy from the time of the breach until such time as the breach is remedied. Although some breaches cannot be cured and thus liability will not attach, the 2015 Act contemplates that some warranties, even if they require something to be done by an ascertainable time, can be complied with, even if late.

Under section 11 of the 2015 Act, any warranty or term that relates to a loss of a particular kind, at a particular location, or at a particular time may not be used, in the event of a loss and non-compliance with the term, to limit liability if the policyholder can show that the non-compliance would not have increased the risk of loss which occurred in the circumstances in which it occurred. The explanatory notes provide the following example:

> Where a property has been damaged by flooding, it is expected that [the policyholder] should show that a failure to use the required type of lock on a window could not have increased the risk of that loss. In this case, the [insurance company] should pay out on the flood claim.

Beyond this kind of simple example, how the new statutory provisions dealing with breach of warranty, in general and as it regards section 11 in particular, will apply in practice is decidedly uncertain. Certainly, the new law was controversial; the insurance company fixes the premium on the basis that the warranty will be complied with (i.e., it rates the risk as warranted), not on the basis that the warranty will not be complied with (i.e., not as unwarranted). To meet that concern, section 11 does not apply to a term defining "the risk as a whole", an expression which will no doubt be tested in the courts.

REMEDIES FOR FRAUDULENT CLAIMS

The 2015 Act does not define what is meant by a fraudulent claim; that remains a common law question. Instead, the 2015 Act set out to codify what the common law had arrived at in terms of remedies for fraudulent claims and to clarify areas that the common law had not yet addressed. Specifically, the common law rule, that the making of a fraudulent claim does not entitle the insurance company to void the policy ab initio and thus reclaim sums paid for valid claims made before the fraud, has been retained. And the question of the status of the policy post-fraudulent claim has been clarified; it can be terminated in the election of the insurance company.

DAMAGES FOR LATE PAYMENT

As a matter of English common law, where an insurance company fails to pay a claim within a reasonable time, the insured has no remedy in damages.

When change in this area was first promoted, the Lloyd's Market Association, and others, worried that such reform would "open the floodgates to speculative claims, and in particular to standalone bad faith actions which in the United States have resulted in substantial punitive damages being awarded against [insurance companies]." The fear of bad faith actions may have been unwarranted; English law does not permit claims for punitive damages for breach of contract. Nevertheless, the Law Commissions made recommendations which were intended to balance the interests of insurance companies and policyholders, and to provide policyholders with a remedy while protecting insurance companies.

The law as now enacted implies into every contract of insurance a term that the insurance company must pay any sum due within a reasonable time. The usual rules for remedies for breach of contract apply to the term, including damages. What is reasonable depends on all the circumstances, including the type of insurance, the size and complexity of the claim and so on. Where the insurance company shows that there are reasonable grounds for disputing the claim, the implied term is not breached by the insurance company failing to pay whilst the dispute continues, but the insurance company's conduct in handling the claim may be relevant to the question of whether the term has been breached.

CONTRACTING OUT

The 2015 Act makes provision for contracting out of the new regime in non-consumer insurance contracts, under certain circumstances.

MOVING TOWARD EQUITABLE TREATMENT

The Law Commissions set out with a stated intention of rebalancing the law away from an insurance company bias and toward more equitable treatment of policyholders. While policyholders have cause to applaud the changes, the effects of the new legislation are far from clear in many respects. A major change in law inevitably raises the prospect of legal disputes, and the contracting out provisions may be utilized by insurance companies to avoid the changes. Policyholders seeking to benefit from the changes should consider the consequences associated with an agreement to opt out of the 2015 Act, and should maintain a cooperative and open approach to disclosure to avoid the application of harsh remedies under English law. ■

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