

## NEWSSTAND

UK Insurance Contract Law Reform: Reflections and the Road Ahead

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Since we last reported to you in our December 2008 issue, there have been some important developments in the Law Commission's project for insurance contract law reform. As the year draws to a close, a key phase in the reform of consumer insurance law will be completed, with the publication of a final report and draft bill in December. In this article, we look back on the reasons for reform, key milestones in the project to date and what we can expect in the coming year. We also look briefly at a parallel project underway in Europe designed to enable insurance companies to provide their services throughout the European Union based on uniform rules, establishing a high standard of policyholder protection.

### **Background**

UK insurance contract law has been widely criticised as being needlessly complex, out of step with modern industry practice and unduly harsh on policyholders. What has been needed, for the UK to remain competitive in the European market, is a wide ranging review of the law applicable to consumer and business insurance contracts. This began in 2006 and the proposals that have emerged so far will undoubtedly bring UK insurance law much closer to the latest continental models.

### **Distinction Between Consumers and Businesses**

A key aspect of the proposals has been the decision to deal with consumers and businesses separately. Consumers invariably contract on standard terms which they lack the bargaining power to alter, they are unlikely to have the level of expert advice available to larger businesses and they are typically less sophisticated and able to understand the technicalities of insurance contract law. The new laws relating to consumer insurance will be mandatory, so the parties will not be free to contract out, unless the relevant terms are more favourable to the insured. However, for business insurance, it is proposed that a new default regime will apply, based on accepted good practice. This means that, with certain formal safeguards, the parties will be free to agree a different set of contractual rules; if they do not, they will be subject to the default rules.

### **Misrepresentation, Non-disclosure and Warranties**

The Law Commission Consultation in 2007 and 2008 on proposed reforms to the law of misrepresentation, non-disclosure and breach of warranty generated an excellent response, with over 100 insurers, brokers, buyers, academics and lawyers setting forth their views. There was overwhelming support for consumer law reform and general agreement on the terms of that reform. This then became the Commission's immediate priority.

There was far less consensus as to the reforms appropriate for the business insurance sector, with divergent views on key issues such as the appropriate remedies for misrepresentation and non-disclosure and the definition of materiality. The Commission recognises that it needs to consult further on this subject and a further Policy Statement on non-disclosure, misrepresentation and warranties in business insurance is expected in 2010.

### **The Consumer Insurance Law Proposals**

Although the final report and draft bill have, at the time of writing, yet to be published, the Law Commissioner, David Hertzell, led a discussion on 16 October 2009 before the British Insurance Law Association, at which he previewed the contents of the Draft 2009 Consumer Bill.

The duty of disclosure for consumers is to be abolished. Insurers will need to ask consumers clear questions about any matter that is material to them. This is in contrast to business insurance, where most consultees agreed that the duty of disclosure had become part of the way the London business (re)insurance market works and should remain. For consumers, while the duty of disclosure has been abolished, insurers may still have a remedy for misrepresentation, matched against the conduct of the policyholder. If the insured has behaved honestly and reasonably, the insurer will have no right to refuse the claim. If the misrepresentation is careless, the Commission introduces a new concept under English law of proportionality, whereby the insurer is placed in the position it would have been in had it known the true facts. Thus, where an insurer would have charged more premium for a risk, the claim should be reduced proportionately to the under-payment of premium. Only where the consumer has effectively acted dishonestly – by making a deliberate or reckless misrepresentation – will the insurer be entitled to treat the policy as if it did not exist and refuse all claims under it.

The test for materiality of information is to be assessed according to the standard of the reasonable insured rather than a prudent insurer, the current test. Finally, the much criticised legal device of “*basis of the contract*” clauses, whereby all answers in a proposal form are given warranty status, will be abolished. Where a consumer makes a statement of past or current fact, it will be treated as a representation rather than a warranty, with the insurer’s remedy depending upon the character of that incorrect representation.

### **Micro Businesses: the Very Smallest Businesses**

The Commission is currently considering whether the very smallest businesses, with up to nine employees, should be treated as consumers when they buy insurance. There are 4.5 million such business enterprises in the UK, at least half of whom buy directly from insurers without a broker and many of whom are no more sophisticated than consumers. In April 2009, the Commission published an Issues Paper on this topic and intends to publish a summary of responses before the end of the year. In a preview, it has indicated that 60% of the consultees agreed that micro businesses should be treated as consumers. One of the key issues has been the appropriate definition for micro-businesses and the Commission is keen to reach a landing on a simple test for establishing whether a business is micro. Two of the definition tests it put forward, based on either number of employees or annual turnover, were both dismissed by consultees as far too simplistic and uncertain in practice. 80% of the consultees, however, agreed that the test should instead be tied to the Financial Ombudsman Service (FOS) jurisdiction, so that if a business is entitled to take a claim to the Ombudsman, it will be defined as a micro-business. The FOS’s

jurisdiction is currently set at fewer than ten employees and a turnover of less than €2m. The Commission recognises that in addition to the basic test, there will need to be sophistication filters to prevent sophisticated businesses, such as Special Purpose Vehicles, from being defined as micro-businesses.

### **The Status of Intermediaries**

Earlier this year, the Law Commission published a Policy Statement explaining the principles that should apply to the question of for whom an intermediary acts in transmitting pre-contract information from consumer to insurer. The Commission has confirmed its intention to include these principles within the Draft 2009 Consumer Bill. The new statutory code will be based largely on the existing law and will have a direct effect in cases concerning faults in the transmission of pre-contractual information in consumer insurance. The Commission has concluded that it is not possible to have a single test; rather who an intermediary acts for must depend on a range of factors. Some factors will be *decisive*: for example an intermediary will be considered to act for the insurer if the intermediary has authority to bind the insurer to cover or the intermediary is the appointed representative of the insurer.

There will also be *persuasive* factors which will not be binding but may help the courts in deciding for whom an intermediary acts. Generally, the intermediary will act for the consumer unless there is a close relationship between the intermediary and the insurer, so as to indicate that the insurer has granted the intermediary implied or apparent authority to act on the insurer's behalf. Persuasive factors suggesting such a close relationship would include where the intermediary only places insurance with a limited number of available insurers or permits the intermediary to brand its services with the insurer's name. Persuasive factors indicating that an intermediary acts for the consumer would include where the consumer pays the intermediary a fee and where the intermediary undertakes to act in the consumer's interest by, for example, giving him impartial advice or providing a fair analysis of the market.

### **Damages for Late Payment**

Failure by insurers to provide a prompt indemnity, for example, following a fire at commercial premises, can lead to disastrous consequences, which can include a total loss of the business. Under English law, there is no recompense, save for the discretionary award of interest which will often not reflect the policyholder's true loss. In American jurisdictions of course, the position is very different since in most States, the claimant is permitted to seek damages for late or non-payment of insurance money.

The problem arises because in English law, a claim under an insurance policy is a claim for damages and there is no right to damages for late payment of damages, as the Court of Appeal reluctantly found in the key case of *Sprung v Royal Insurance (UK) Limited* [1997] CLC 70. The Court of Appeal urged there to be early consideration to the reform of the law in similar cases.

The Commission proposes to publish an Issues Paper on this topic in the first half of 2010 but has already indicated that one option would be legislation to amend section 17 of the Marine Insurance Act 1906 which provides that insurance contracts are contracts of mutual good faith. While the duty is mutual, at present the only remedy available to an insured for a breach of good faith on the part of the insurer is avoidance, which is of little use to the insured in the case of an

insurer who is dilatory in settling claims. The Commission suggests that the insurer could be made liable for breach of good faith obligations to the insured where there was dishonesty, malicious conduct or maladministration on the insurer's part, albeit only for losses which were foreseeable when the contract was made. We will look again at these proposals, once more detail becomes available next year.

### **Principles of European Insurance Contract Law**

The European Commission is concerned about the lack of cross-border insurance products and services, believing that the matrix of laws and regulations in each of the 27 member states act as a barrier. In response, the Project Group for the Restatement of European Insurance Contract Law has for the last ten years been working on a set of Principles of European Insurance Contract Law (PEICL) which were launched publicly in September 2009. It is proposed that the Principles operate as an "*optional instrument*", allowing insurers and policyholders to apply the principles to their contracts instead of the relevant national insurance contract law. As is the case for UK consumers under the Law Commission's proposals, the Principles limit the insured's duty of disclosure to responding to clear and precise questions put by the insurer. Also mirroring the Law Commission's proposals, the Principles introduce a proportionate approach to remedies. An EU regulation will be required in order for the Principles to become binding and the Project Group still has some drafting work to do. There are however good political indications that the European Commission is firmly behind the Project and that in future, legislation will be introduced to allow the Principles to operate.

### **Conclusion**

The Law Commission has made great strides with respect to the reform of consumer insurance law. Just as in Europe, reforms have been proposed which are intended to give policyholders confidence in insurance by ensuring that it meets their reasonable expectations, while protecting the legitimate interests of insurers. For those in the business insurance community, the wait will continue well into 2010 to see how a better consensus can be achieved amongst the different sectors of the market on the most appropriate way forward for reform. We will continue to closely monitor the project both on [InsureReinsure.com](http://InsureReinsure.com) and through this publication.