DRAFT REPORT OF THE CMI STANDING COMMITTEE ON MARINE INSURANCE

ON

THE IMPACT OF THE UK INSURANCE ACT 2015 ON ENGLISH MARINE INSURANCE LAW AS CONTAINED IN THE MARINE INSURANCE ACT 1906 AND COMMON LAW, AND ITS POTENTIAL INFLUENCE ON OTHER COMMON LAW JURISDICTIONS.

**INTRODUCTION**

The UK Insurance Act 2015 is the most significant reform yet of the codification by the Marine Insurance Act 1906.It applies more widely than to marine insurance alone, embracing all business and commercial insurances apart from consumer insurance. It is also not a comprehensive measure, applying only to a few problematic and sometimes controversial areas of insurance law.

The Act derives from an extensive period of reconsideration by the Law Commissions for England and Wales, and for Scotland. It makes amendments to the law relating to good faith, pre-contract duties of insureds, promissory warranties and certain other contractual terms. It clarifies the law relating to fraudulent claims and introduces a new implied contractual term relating to the payment of claims.

The 2015 Act applies to non-consumer contracts of insurance, including reinsurance contracts and P&I insurance: and also to contractual variations of such contracts.

With two exceptions, the 2015 Act sets out a code of default rules. The exceptions relate to “basis of contract” agreements and the implied obligation to settle claims within a reasonable time (both are examined later). Otherwise its provisions may be excluded or amended by the express agreement of parties. The eight UK member Clubs of the International Group of P & I Clubs have exercised this power widely and new standard clauses have become available in the London insurance market to facilitate both the adoption, with or without amendments, and contracting out of the new statutory provisions. These developments are commented upon later in this Report.

The extant law of English commercial and marine insurance is now to be found principally in the Marine Insurance Act 1906, the Insurance Act 2015 and the common law.

There are occasions when the Consumer Insurance (Disclosure and Representations) Act 2012, which as its title indicates applies to consumer insurance as defined in the Act, may be relevant. This will be the case where the assured is a natural person and the vessel is used wholly or mainly for leisure. Such may be the factual situation relating to the insurance of a luxury yacht.

The focus of this report is to examine the impact of the 2015 Act on marine insurance in the UK and on certain foreign jurisdictions. It is not proposed to subject the Act to a full and detailed technical analysis. No reference is made to case-law or secondary materials and legal and market jargon is also avoided, as also are footnotes.

**GENERAL PRINCIPLE OF GOOD FAITH**

The principle of good faith is codified in section 17 of the Marine Insurance Act 1906 in declaratory terms. Under the reforms of the 2015 Act the section survives save to the extent that the words underlined below are omitted –

A contract of marine insurance is a contract based upon the utmost good faith. and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party

The principal impact of this reform is to uncouple the remedy of avoidance from the breach of the duty of good faith.

Under the preceding law the only remedy available was that set out in the original section 17, namely avoidance, which resulted in the contract of insurance being expunged and the parties returned to the status quo ante. This, over the years, was the source of much judicial concern and had a less than beneficial impact on the development and application of the principle of good faith.

This position is radically changed by the 2015 Act reform. Beyond the bare statement of principle, the amended section 17 no longer specifies any remedy for breach. The effect is (a) to prepare the way for the new law relating to the pre-contract duty of insureds (discussed later) and, more widely (b) it is likely to have a material influence on the future judicial development of the concept of post-contract good faith (a topic not dealt with by the 2015 Act).

Apart from the question of remedies, the definition of the principle of good faith remains unchanged. There continues to be no legislative definition or guidance as to its meaning. It remains an evolving concept developed incrementally by the judiciary.

Also, it is clear that the duty of good faith is owed by both parties to the contract of insurance, the insurer and insured, notwithstanding that this is not now made expressly clear by the reformulated section 17.

**PRE—CONTRACT DUTY OF INSUREDS**

Introduction

This aspect of good faith has been refashioned by the 2015 Act and is now described as “The Duty of Fair Presentation,” the various elements of which are set out in substantial detail in Part 2 and Schedule 1 of the 2015 Act.

Section 3(1) provides-

Before a contract of insurance is entered into, the insured must make to the insurer a fair presentation of the risk.

This provision makes it clear that the duty is owed by the insured only and arises pre-contract during the placement of the risk. The duty, therefore, terminates once the contract of insurance is entered into. On the London market, where the slip procedure is adopted, the contract is entered into once the underwriter scratches the slip. In the context of other procedures, there may exist uncertainty as to when precisely the contract of insurance is entered into. It will primarily, in all instances, be a question of fact.

The substance of the duty of fair presentation is very much in line with the former law, but it is set out in different language and in a different format, and in some regards in much greater detail. There are, however, some differences of detail and emphasis.

The most significant difference relates to what is “known by an insured” which has the effect of extending the duty of disclosure. The consequences of breach of the duty are made more flexible and proportionate. There has also been a significant change to the legal position of the placing broker, though this is considered not to have changed the duties and responsibilities of brokers.

Duty of fair presentation of the risk

*The duty defined*

The duty of fair presentation of the risk obliges the insured to –

1. disclose every material circumstance which the insured knows or ought to know or, alternatively, which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquires for the purpose of revealing those material circumstances, and
2. make that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer, and
3. ensure that every material representation as to a matter of fact is substantially correct, and every material representation as to a matter of expectation or belief is made in good faith.

The duty as stated is identifiable with the preceding law, but there are differences. The duty of disclosure in paras (a) and (b) is set out in much greater detail than in the former law and also gives clear recognition to aspects of the common law that were in the process of evolving. To this extent the new formulation introduces momentum and certainty to the law. The duty of disclosure is also probably wider because of the way the knowledge of insureds is defined (considered later).

Para (c) addresses the duty with regard to representations made by an insured.

*Observations on the duty of disclosure*

With regard to disclosure the duty is discharged even if there has been a failure to disclose all material circumstances as required under the first part of para (a), provided sufficient material circumstances have been disclosed to put a prudent insurer on notice that by making further enquires such further material circumstances may be revealed. This is the effect of the second part of para (a) and hints at “waiver”. An insurer who fails to make the further enquiries impliedly waives the necessity to communicate to it the further material circumstances that would have been revealed had those enquires been made.

The qualification in the second part of para (a) also makes it clear that an insurer during the pre-contract stage bears a degree of personal responsibility to take steps to ascertain material circumstances. The obligation is no longer entirely on the shoulders of the insured, with the insurer entitled to sit back and remain uninvolved. In appropriate circumstances the insurer is required to take the initiative, seek out material information, with failure to do so prejudicial to his interests.

The duty of disclosure also incorporates a procedural obligation which is set out in para (b). The disclosure must be made in a manner which is reasonable clear and accessible to a prudent insurer. It follows that an insured or broker who buries a material circumstance in a large bundle of documents and files presented to an insurer in the hope that it will not be discovered will not be considered to have made a fair presentation of the risk. The insured and his broker have a positive obligation to bring material circumstances to the attention of the insurer. Whether this requirement has been satisfied will in each case be a question of fact.

*Duty not to make misrepresentions*

The substance of the legal duty relating to material representations remains the same as under the preceding law.

The test of materiality

This is a question which has received considerable judicial attention over the years. The test under the 2015 Act remains the same as under the former law –

A circumstance or representation is material if it would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms.

The test is objective, assuming the stance of a prudent insurer, not a prudent insured. The essential criterion is that the circumstance or representation would influence the judgment of a prudent insurer in assessing the risk, in the context of the decision whether or not to accept the risk, and, if acceptance, on what terms and conditions. The test of materiality extends more broadly than circumstances and representations that affect the actual decision of the insurer. Something may be material, therefore, notwithstanding that it does not ultimately weigh directly upon the decision of the prudent insurer, in the sense of being considered as decisive. It is sufficient, in a broad sense, if the prudent insurer would wish to be aware of the circumstance. This has the effect of broadening the reach of the concept of materiality.

The question what is material in any particular circumstance gives rise to a question of fact with the burden of proof on the insurer.

The 2015 Act does not provide a detailed definition of what is material. It does, nevertheless, set out the following guidelines -

1. special or unusual facts relating to the risk,
2. any particular concerns which led the insured to seek insurance cover for the risk, and
3. anything which those concerned with the class of insurance and field of activity in question would generally understand as being something that should be dealt with in a fair presentation of risks of the type in question.

Knowledge of the insured

This is a crucial concept because the duty of fair presentation relates to every material circumstance “which the insured knows or ought to know”. This begs the question what does the insured know and what, beyond that, ought he to know?

The position under the 2015 Act differs according to whether the insured is an individual or other entity, such as a company.

Insured as an individual

Where the insured is an individual, the insured knows what is known to him as an individual, and to the individual(s) who is/are responsible for the insured’s insurance.

Insured as a corporate entity

Where the insured is a company, the insured knows what is known to the individual or individuals who are (a) part of the insured’s senior management, or (b) responsible for the insured’s insurance.

Senior management

An individual is part of the insured’s senior management if the individual plays a significant role in the making of decisions about how the insured’s activities are to be managed or organised.

The concept of “senior management” clearly includes a member of the board of directors. It does, however, have the capacity to extend more widely into higher tiers of management below board level, but the crucial question is how far.

Constituent elements of Knowledge

*What is known by an individual?*

In all circumstances where the knowledge of an individual is in issue the 2015 Act adopts a broad approach. Knowledge includes –

(a) *actual knowledge* – that which the individual actually knows;

(b) *blind-eye knowledge* - matters which the individual suspected did exist but of which he had no actual knowledge because he deliberately refrained from confirming or enquiring about them

and

(c) *knowledge that ought to be known to the insured* - that which should have been revealed by a reasonable research of information available to the insured, by making enquires or by any other means.

In this context “information” includes information held within the insured’s organisation or by other persons, such as the insured’s agent or a person for whom cover is provided by the contract of insurance.

*Knowledge of individual(s) responsible for the insured’s insurance*

The insured also knows what is known to an individual who is responsible for the insured’s insurance.

This alludes to any individual who participates on behalf of the insured in whatever capacity in the process of procuring the insured’s insurance.

This will include but it is not confined to the placing broker.

A significant feature of the 2015 Act is that the placing broker has ceased to be independently recognised as was the case under the repealed section 19 of the Marine Insurance act 1906. There is no replication of a distinct duty of disclosure.

The broker is now included in the group of individuals “responsible for the insured’s insurance” and as such the broker’s knowledge as an “individual” is attributed to the insured.

Of course, if the broker fails to disclose to the insured material information known to him and this results in the insured being in breach of the duty of fair presentation, there is also a breach of duty under the brokerage contract, with the insured entitled to compensation for any adverse consequences arising from the breach to make fair presentation. In this regard the position of the placing broker is in reality the same as under the 1906 Act.

If an individual who is responsible for the insured’s insurance perpetrates a fraud on the insured, knowledge of the fraud is not attributable to the insured.

The insured also is not taken to know confidential information about (i) an individual who is the insured’s agent or an employee of the agent, and (ii) that information was obtained by the insured’s agent or an employee of the agent through a business relationship with a person who is not connected with the contract of insurance.

The persons connected with the contract of insurance are (i) the insured and any persons to whom cover is provided by the contract, and (ii) if the contract reinsures risks covered by another contract, the persons who are connected with that other contract.

To this extent the change in the framing of the law relating to pre-contract disclosure has not worked any change to the legal relation between insured and broker.

What need not be disclosed by insureds

As was the case under the former law, the 2015 Act expressly identifies categories of circumstance that need not be disclosed.

In the absence of enquiry the insured need not disclose a circumstance if -

(i) *it diminishes the risk*,

(ii) *the insurer knows it* – an insurer knows what is known by one or more individuals who participate on behalf of the insurer (whether as employee or agent or as employee of an agent or other capacity) in the decision whether to take the risk and, if so, on what terms.

Where an individual identified above perpetrates a fraud on the insurer, that knowledge is not attributed to the insurer.

(iii) *the insurer ought to know it* - an insurer ought to know something if (a) an employee or agent of the insurer knows it and ought reasonably to have passed on the relevant information to an individual mentioned in (ii) above or (b) the relevant information is held by the insurer and is readily available to an individual mentioned in (ii) above;

(iv) *the insurer is presumed to know it* – an insurer is presumed to know (a) things which are common knowledge, and (b) things which an insurer offering insurance of the class in questions to insureds in the field of activity in question would reasonably be expected to know in the ordinary course of business;

(v) *it is something as to which the insurer waives information* – it is open to an insurer to expressly or impliedly waive the obligation to communicate material circumstances.

The recognition in the former law that a circumstance need not be disclosed if it was covered by a warranty is not reproduced. This, probably, is because of the different approach taken to breach of warranty in the 2015 Act (considered later).

The above categories apply only in the absence of an enquiry by the insurer. If the insurer puts specific questions to the insured, the insured is required to provide answers which are in keeping with the duty of fair presentation.

Breach of the duty of fair presentation and the consequences of breach

Requirement of causation

Beyond the establishment of a factual breach of duty, a remedy is not available unless the breach can be shown to have been causal. There must first be established the fact of causation. The 2015 Act makes express reference to this precondition, whereas in the preceding law the requirement arose by implication.

The requirement of causation means that the breach must have had a direct impact on the way the insurer responded to the presentation of the risk. The insurer must show that “but for” the breach he (a) would not have entered into the contract of insurance at all, or (b) would have done so only on different terms, which might relate to policy conditions or premium rating.

The requirement of causation has the consequence that there could be a breach of the duty of fair presentation which has had no impact on the response of the insurer, and therefore leaves the insurer without any remedy. If, had there not been a breach of duty, the insurer would have underwritten the risk on the same terms and premium rating, there is no remedy.

The burden of proof is on the insurer to establish causation.

Qualifying breaches

When a causal breach is established, it is characterised under the 2015 Act as a “qualifying breach”, indicating that the breach is remediable.

A “qualifying breach” may be either (a) deliberate or reckless or (b) neither.

The former characterisation applies if the insured knew that he was in breach of the duty of fair presentation or did not care whether or not he was in breach

The burden of proof is on the insurer to establish intentional or reckless conduct on the part of the insured.

As it will be seen the characterisation of a qualifying breach is relevant to the question of remedies.

Remedies for breach

*Original contract of insurance*

With regard to the original contract of insurance the remedies for breach vary according to the nature of the qualifying breach.

Where the breach is deliberate or reckless the insurer (a) may avoid the contract and refuse all claims, and (b) need not return any of the premiums paid.

Where the breach is otherwise, the remedies open to the insurer depend on the way the insurer would have responded to the presentation of the risk had there not been a qualifying breach, in other words had the insured properly performed the duty of fair presentation of the risk.

If the insurer would not have entered into the contract on any terms, the insurer may avoid the contract and refuse all claims, but must in that event return the premiums paid.

If the Insurer would have entered into the contract but on different terms (other than terms relating to the premium), the contract is to be treated as if entered into on those terms, if the insurer so requires

If the insurer would have entered into the contract, whether on the original or different terms, but would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on the claim.

The reduction is based on the ratio that the premium actually charged bears to the higher premium that would have been charged expressed as a percentage.

The burden of proof is on the insurer to show how he would have responded but for the breach of duty by the insured. It will be of interest to observe how this burden of proof will be discharged in practice. Clearly a simple assertion on the part of the insurer will not necessarily be sufficient. The test presumably cannot be wholly subjective. It would appear that there must be some supporting evidence, for example, by reference to the nature of market practice or the evidence of other experienced and reputable underwriters in the same area of insurance or the previous practice of the particular insurer.

*Contract varying the original contract*

Where the breach relates to the variation of a contract of insurance, the possible remedies follow the same general pattern but are adjusted to respond to the changed situation. There are now two contracts in issue, the original contract of insurance and the contract purporting to effect the variation. It is also possible that the variation may be accompanied by an increase or decrease in the premium rating.

The remedial position is set out in Part 2 of Schedule 1 of the 2015 Act.

*Where the breach is deliberate or reckless*, the insurer may by notice to the insured treat the contract of insurance as terminated as from the time the variation was made and is not obliged to return the premiums paid.

*Where the breach is otherwise and the total premium payable has been increased or remains the same*, the remedies available to the insurer will again depend on how he would have responded had there not been a breach of duty on the part of the insured.

If the insurer would not have agreed the variation on any terms, the insurer may treat the contract as if the variation had not been made, but must return any extra premium paid.

If the insurer would have accepted the risk but on different terms (other than a term relating to the premium) the variation is to be treated as if those terms were included, if the insurer so requires.

If, in the same circumstances, the insurer would have increased the premium (in the case of unchanged premium) or increased it by more (in the case of an increased premium), the insurer may reduce proportionately the amount to be paid on a claim arising out of events after the variation. The amount payable is the proportion that the total premium actually charged bears to the total premium that the insurer would have charged expressed as a percentage.

*Where, by contrast, the total premium was reduced as a result of the variation*, the same broad approach is adopted to remedies but with adjustments made for proportional payments.

If the insurer would not have agreed to the variation on any terms, the insurer may treat the contract as if the variation had not been made and may reduce proportionately the amount paid on claims arising out of events occurring after the (purported) variation. The ratio being that which the premium actually charged bears to the original premium.

If the insurer would have agreed to the variation on different terms (other than a term relating to the premium) the variation is to be treated as if those terms were incorporated.

If, though prepared to accept the risk, the insurer would have increased the premium or not have reduced the premium or reduced it by less, the insurer may reduce proportionately the sum payable on claims arising out of events occurring after the variation. The percentage sum payable is determined by the ratio as between the total premium actually charged and the original premium, if the insurer would not have changed it, and the increased or reduced total premium (as the case may be) the insurer would have charged.

*Comment*

The formulation of the possible remedies may appear densely complex but there are explanations for this state of affairs.

As previously explained, in the event of a variation there come into existence two contracts, the original contract of insurance and the subsequent contract to vary the original contract. This, in turn, raises the question as to whether the remedy for breach of the duty of fair presentation in respect to the variation should be restricted to the variation or extend to the original contract of insurance.

When it comes to the assessment of premium rating, the remedy of reducing proportionately the amount to be paid on a claim is straightforward in the case of the original contract because it applies only when the insurer would have charged a higher premium. But when it comes to a variation the total premium payable may have been increased, remained the same or decreased, and, but for the breach of duty, the insurer may have responded in anyone of these possible ways to the rating of the premium. In this regard the legislation attempts to respond to the various possibilities. There is also the question whether any proportional reduction in the payment of claims should apply to all claims arising under the varied contract or only to claims arising from events occurring after the variation is agreed.

**PROMISSORY WARRANTIES AND OTHER TERMS**

Marine Insurance Act 1906

The English law on warranties has long courted controversy primarily because of the consequences of breach. The pre 2015 Act law is set out in the MIA 1906, sections 33- 41, much of which is unaffected by the new law.

A promissory warranty is defined in s. 33(1) as an undertaking of the assured –

“…that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts”.

The nature of the undertaking and consequences of breach were set out in s. 33(3) which may be summarised as follows –

1. a warranty must be exactly complied with;
2. it may be material to the risk or not;
3. if not complied with, subject to policy terms, the insurer is discharged from liability from the date of the breach; but
4. the insurer is responsible for liabilities incurred before the date of breach

The discharge from liability occurs automatically and is not dependent on the exercise of an election and/or giving notice (The Good Luck [1992] 1 A.C. 233).

Further, where there has been a breach, the assured cannot cure the breach by complying with the warranty before loss has occurred (s. 34(2) ).

It is always possible for an insurer to waive a breach of warranty (s. 34(3)).

Apart from express warranties the 1906 Act recognises implied warranties in relation to the seaworthiness of ships (ss.39 and 40(2)) and legality (s.41).

Reforms introduced by the 2015 Act

The 2015 Act repeals ss. 33 (3) and 34 of the MIA 1906. Otherwise the provisions of the MIA 1906 remain in force, including the definition of a promissory warranty and the recognition of implied warranties.

The new provisions in the 2015 Act are set out in sections 10 and 11 and their effect may be presented as follows –

1. Continuing warranties

These are warranties where the undertaking of the assured extends continuously over the period of the policy or a shorter period specified in the policy.

The consequence of breach of this category of warranty is that the liability of the insurer is suspended for the period of the breach. If the breach is remedied, from that moment the liability of the insurer is restored.

In the result the insurer is liable under the policy until the occurrence of a breach of warranty and thereafter liability is suspended until the breach is cured. Once cured the insurer is again on risk. Should the breach not be cured the liability of the insurer is suspended for the remainder of the policy period.

There is in this regard a technicality to be noted. With regard to the suspension of liability it is stated that the insurer is not liable for-

“…any loss occurring, or attributable to something happening, after the warranty (express or implied) in the contract has been breached but before the breach has been remedied”. (s.10(2)).

This provision makes it clear that when the source of loss occurs during the period an insured is in breach of warranty but the actual loss is suffered after the breach of warranty has been remedied, the insurer is not liable.

There is less clarity about the position when the source of the loss occurs before the breach of warranty but the actual loss is suffered after the breach. Under section 10(4) the insurer appears to be liable, because the loss is attributable to something happening before the breach of warranty. Nonetheless, by section 10(2) the insurer appears not to be liable for any loss occurring after the breach of warranty and before there has been a remedy.

1. One-off warranties

The rule of suspension of liability operates most comfortably with regard to continuing warranties. There is however a class of warranties where the undertaking of the assured is of a one-off nature, relating, for example, to something specific in point of time. They are, therefore, not continuing warranties and are defined in 2015 Act as warranties which require –

“… that by an ascertainable time something is to be done (or not done), or a condition is to be fulfilled, or something is (or is not) to be the case”.

It is clear that the breach of such a warranty cannot logically be cured in the traditional manner and in response to this difficulty the 2015 Act formulates a specific concept of cure. The breach is deemed to be cured “if the risk to which the warranty relates becomes essentially the same as that originally contemplated by the parties”.

This provision is probably best explained by examining an unexceptional example. An insurance policy on a ship contains a warranty “that a specified safety certificate of compliance will be presented to insurers within 14 days of the date of the insurance”. The insurance is dated 1st January 2018. The insured fails to present the certificate within 14 days and consequently there is a breach of warranty with cover suspended. Nonetheless the insured presents the safety certificate on 1st February 2018. Logically the breach of the express warranty cannot be cured: there is no way the insured can correct the failure to present the certificate by the due date. Nonetheless, applying the concept in the 2015 Act the breach is cured on 1st February 2018, on which date the liability of the insurer is revived.

The essential nature of the risk that the insurers were accepting was the insurance of the particular ship in respect to which the specified safety certificate had been issued. When the insureds failed to produce the certificate within 14 days this ceased to be the case and the liability of the insurers was suspended. But on 1st February 2018 when the safety certificate was presented the risk became precisely that which the insurers had accepted when agreeing to provide the insurance. The Act deems this to amount to curing the breach.

1. Warranties/terms protecting against the occurrence of specific risks

This provision applies to what for convenience may be characterised as specific risk terms. It also applies to promissory warranties which fall within the characterisation.

A specific risk term may be express or implied. It is a term compliance with which would tend to reduce the risk of one or more of the following – (a) loss of a particular kind, (b) loss at a particular location, and (c) loss at a particular time.

In the event of loss the insurer cannot rely on the breach of a specific risk term/warranty to exclude, limit or discharge its liability if the insured shows that the “non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred”.

The burden of proof is borne by the insured to show that the breach is not material in the above sense. That it has not even in the loosest sense increased the risk of loss that has actually occurred. If it is appropriate to view the relationship between the term broken and the loss suffered in terms of causation, it is probably a very weak causal test.

If the burden of proof is not discharged the insurer can rely on the breach to avoid liability.

It may again be best to illustrate how the new law will operate by the use of a simple example. An insurance of a ship includes the following term/warranty –

“The vessel shall at all time carry on board the most up-to-date navigational charts”.

During the period of the insurance a serious fire breaks out on board the vessel which causes extensive damage. The insurance covered the risk of fire.

It is also discovered that the insured owners were in breach of the term/warranty because the ship did not have on board the most up-to-date navigational charts.

Under the new law the insurers cannot rely on the breach of the term/warranty relating to navigational charts if the insured can show that the breach did not increase the risk of fire. The term/warranty relating to navigational charts was incorporated in the insurance to ensure safe navigation of the vessel. It had no connection to the risk of fire. Subject to the insureds being able to discharge the burden of proof, the insurers would be precluded from relying on the breach of the navigational obligation as a defence..

This statutory provision draws a distinction between a specific risk term/warranty and “a term defining the risk as a whole”. The latter alludes to the definition of the cover provided by an insurance contract, to be distinguished from a term/warranty aimed at managing a risk which falls within the cover provided by the contract of insurance.

**BASIS OF CONTRACT AGREEMENTS**

Introduction

A basis of agreement contract is an agreement by the parties that statements made when negotiating the insurance shall form part of the contract of insurance.

The agreement may be in the slip or proposal form, or in the contract or policy, and may be incorporated from another document.

In English law these agreements were valid and construed as invariably establishing warranties. In other words the effect of these clauses was to convert pre-contract representations into promissory warranties. It followed that if any false or incorrect statements made in the placement process, it would also amount to a breach of warranty with serious consequences for the insured.

The following is a simple illustration of such a term -

*“…*this proposal and the statements made therein shall form the basis of the contract between me/us and the insurer”.

There had long existed disquiet about the fairness of these agreements, which concern was shared by the judiciary.

Reform

By section 9 of the 2015 Act these clauses are rendered void, as also is any agreement which purports to circumvent the prohibition.

The principal policy reason for this repeal is based on considerations of fairness. The clauses are considered to give insurers an unconscionable advantage.

When the statutory wording is considered closely it is noticeable that the prohibition is that the “representation is not capable of being converted into a warranty by means of any provision of the…insurance contract…or any other contract…whether by declaring the representation to form the basis of the contract or otherwise”.

This suggests that the objection based on considerations of policy relates to the conversion of representations into warranties and not to the principle of a basis of contract agreement. Such an agreement may exist and it may succeed in incorporating terms into the insurance contract provided they are not promissory warranties.

Also, it remains possible for a representation made in the course of the placement of risk to be made the subject of a warranty, but this can only be achieved by an express warranty in the insurance contract.

Relevance to marine insurance

These clauses appear to be more relevant to P&I insurance than to other types of marine insurance. For example -

North P&I Rules 2017-18 -Rule 7(2) - ‘Accuracy of information’

All particulars and information given in the course of applying for insurance shall, if the entry of the relevant ship is accepted, be deemed to form part of the contract of insurance between the Member and the Association and it shall be a condition precedent of such insurance that all such particulars and information were true so far as within the Member’s knowledge or could with reasonable diligence have been ascertained.

It is arguable that where the 2015 Act applies this clause is void. The words underlined (for the purpose of emphasis) would probably be construed in English law as indicating an intention that the particulars and information provided are to be regarded as promissory warranties.

**FRAUDULENT CLAIMS**

Common law

The definition of fraudulent claim and the associated law has developed under the English common law. For reasons influenced by considerations of policy rather than logic, a fraudulent claim is not viewed as a breach of the principle of good faith: it is analysed as beach of a distinct common law rule.

A claim is fraudulent if it is made in whole or part dishonestly or with reckless indifference whether it is true or false. A claim which is substantively honest but the indemnity claimed is exaggerated (but not *de minimis*) is a fraudulent claim.

A claim which is true but is advanced by dishonest means may also be a fraudulent claim. This category is generally described as “fraudulent devices” or “collateral lies”. Recently the Supreme Court has recognised a limitation to this approach in *The DC Merwestone* [2016] UKSC 45. Where the lie or dishonest act is irrelevant to the existence or amount of the insurer’s liability the fraudulent device is not to be considered as rendering the claim fraudulent.

There was continuing uncertainty in the common law as to the effect of making a fraudulent claim on the contract of insurance. Beyond striking down the fraudulent claim in its entirety, or recovering a payment already made, there was debate if it also amounted to a breach of the insurance contract, and if so, the contractual remedies that followed. In particular, did the making of a fraudulent claim justify the insurer accepting it as a repudiatory breach and terminate the contract of insurance. In other words, in addition to rejecting the claim in its entirety could the insurer also terminate the cover.

Reform

The Insurance Act 2015, section 12, follows the common law definition of fraudulent claim and focuses wholly on the remedies available to insurers. In this way it usefully introduces clarity and certainty into the law.

The 2015 Act sets out the following remedies –

1. the insurer is not liable to pay the claim,
2. the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim, and
3. in addition, the insurer may by notice to the insured treat the contract as having been terminated with effect from the time of the fraudulent act, and need not return any premium paid under the contract.

It is to be noted that under para (c) the contract of insurance is terminated from the time of the “fraudulent act” and not the time notice to terminate is communicated to the insured. The former may be at a much earlier point in time than the latter and it may not always be straightforward to pinpoint.

Para (c) is of importance because it establishes an additional statutory legal right to terminate the contract. This has the effect that the insurer (a) may refuse all liability under the insurance in respect of a relevant event occurring after the time of the fraudulent act and (b) is not under any obligation to return any of the premiums paid under the contract.

The liability of the insurer is unaffected with regard to a relevant event occurring before the time of the fraudulent act.

A “relevant event” refers to whatever gives rise to the liability of the insurer under the insurance contract. This is essentially a question of contract e.g. the occurrence of loss, the making of a claim, or notice of a potential claim.

The Act also deals with fraudulent claims in the context of group insurance which relates to insurance provided for a person(s) who is not a party to the contract of insurance, identified as the covered person. In the event of a fraudulent claim by the covered person the insurer may exercise the rights under the 2015 Act as against that person as if there is a contract between the covered person and the insurer. But this does not affect the insurance cover provided to any other person.

**DAMAGES FOR LATE PAYMENT OF CLAIMS**

Introduction

Section 13A of the 2015 Act, incorporated in the legislation by the Enterprise Act 2016, for the first time introduces into English law an implied term relating to the settlement of claims. It provides in sub-section (1) --

It is an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time.

Concept of a reasonable time

This is a question of fact to be determined having regard to the all the facts and circumstances of individual cases.

The section sets out the following framework.

A reasonable time includes a reasonable time to investigate and assess the claim.

The relevant circumstances to be taken into account include –

(a) the type of insurance

(b) the size and complexity of the claim

(c) the obligation to comply with any relevant statutory or regulatory rules or guidance, and

(d) any factors outside the control of the insurer

If the insurer is justified in disputing the claim on the question of liability or quantum, the insurer does not act unreasonable merely by failing to pay the claim while the dispute is continuing.

But the conduct of the insurer in handling the claim may be relevant in determining whether or not the insurer has acted reasonably.

Remedies for breach

This question is not directly addressed by the section save that it is incidentally recognised that the possible remedies include damages.

Damages will doubtlessly be the standard remedy but questions may arise as to whether in appropriate circumstances other contractual remedies may be available, such as repudiation. This will depend, at least in part, on the way the implied term is characterised as a matter of contract law.

The contractual remedy for breach is in addition to any right to enforce payment of the sum due and any right to interest.

The existence of the implied term does not preclude the parties from agreeing that the settlement of claims shall be governed by the terms of an express agreement.

Comment

Although on the face of it this appears to be a straightforward provision, in its practical application it is likely to be troublesome and of limited assistance. It is highly fact based and operates within a protective framework that may be considered to assist insurers.

On the London market the desirability of prompt settlement of claims is also governed by market practice and regulation, and this may prove to be a more effective source of protection for insureds.

**CONTRACTING OUT OF THE 2015 ACT**

A significant aspect of the 2015 Act is that subject to two exceptions its provisions may be excluded or amended by agreement of the parties, thereby placing an insured in a disadvantageous position compared with the position that would have been occupied had the provisions of the 2015 Act applied. To this extent the legislative provisions may be regarded as default provisions.

The first mandatory provision relates to “basis of contract agreements”, which are rendered void by the Act and any agreement of the parties to the contrary is void (considered previously).

The second relates to any attempt to avoid liability for deliberate or reckless breaches of the implied obligation to pay a claim within a reasonable period of time. Such an agreement is again void (considered previously).

An exclusion agreement is one that places the insured in a worse position in respects of any relevant provisions in the 2015 Act. Although the principle of contracting out is accepted there are certain transparency provisions which have to be satisfied for the agreement to be valid.

To achieve exclusion by what are referred to generally as “disadvantageous terms” the parties must satisfy the following procedural pre-conditions -

1. the insurer must have taken sufficient steps to draw the disadvantageous term to the insured’s attention before the contract is entered into or the variation agreed

This requirement does not apply if the insured or his agent had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.

1. the disadvantageous term must be clear and unambiguous as to its effect.

It is to be noted that the emphasis is on the “effect” of the agreement and in this regard the term must be “clear and unambiguous”. The precise demands of this requirement are uncertain and will probably be clarified over time by judicial pronouncements. Nonetheless, it is clear that the insured must to some extent be given knowledge of the consequences of agreeing to the exclusion, but the question is how much.

In determining whether the requirements in (a) and (b) have been met the characteristics of the insured as a group to which the insured belongs, and the circumstances of the transaction, are to be taken into account.

*CONTRACTING OUT BY UK P & I CLUBS*

The eight UK member Clubs of the IGP&IC, the Rules of which are governed by English Law, have contracted out of the provisions indicted below. The sub-titles indicate the rules excluded, described succinctly, and the brief commentary that follows explains the consequences of the exclusion:

1. Abolition of legal remedy of avoidance for breach of good faith in contract of insurance

Consequently, the contract of insurance between Club and owner is one of good faith and in the event of a breach of the duty the Club is entitled to avoid the contract. The original position under section 17 of the MIA 1906 is retained.

1. Remedy for breach of the duty of fair presentation to be proportionate.

Consequently, in the event of any breach of the duty to make fair representation of the risk the Club retains the right to avoid the policy regardless of whether the breach is innocent, deliberate or reckless. Avoidance is retained as the sole remedy.

1. Remedy for breach of warranty to be suspensory.

Consequently, the Clubs continue to require all warranties to be strictly complied with and in the event of breach the Club is automatically discharged from liability from the date of the breach regardless of whether the breach is subsequently remedied.

1. Remedy for breach of a specific risk term or warranty and causal requirement.

Consequently, the Clubs require all contractual terms, including warranties, relating to the management of specific risks, to be strictly complied with. In the event of breach the Club’s liability may be excluded, limited or discharged in accordance with Club Rules, notwithstanding that the breach of the term or warranty did not cause or increase the risk of the actual loss suffered.

1. Remedy for fraudulent claims in group insurance

Consequently, in the event of a fraudulent claim by or on behalf of the Owner and/or any Group Affiliate the Club shall be entitled to terminate the contract in respect of the Owner and all insureds.

The Clubs have adopted the remaining provisions relating to fraudulent claims, including the right to terminate the contract of insurance by giving notice.

1. Implied term relating to payment of claims

Consequently, there does not exist an implied term that the Club will pay any sums due in respect of a claim within a reasonable period of time except where the breach is deliberate or reckless.

*RESPONSE OF THE LONDON INSURANCE MARKET*

The Lloyd’s Market Association (LMA) and the International Underwriters Association (IUA) have cooperated in formulating a general response to the 2015 Act. In particular they have formulated two suites of standard terms for use in insurance and reinsurance contracts, the first of a general character and the second relating to damages for late payment of claims.

On the whole the response is not as cohesive and clearly directed as that of the UK P & I Clubs .They provide a choice whether to follow or depart from the terms of the 2015 Act, or to adopt the terms together with selected amplification of their provisions. It appears that no market position has been adopted, the choice is left to individual underwriters and the standard clauses formulated are sufficiently diverse to facilitate the choice made.

The standard clauses relating to damages for late payment of claims variously provide for damages being limited to breaches which are deliberate or reckless; a general limitation, variously designed, on damages payable; what a reasonable time to investigate a claim may involve by way of action; and the obtaining of legal advice not to be a waiver of privilege.

As for reinsurance clauses they may variously provide for the reinsurer not to be liable for liabilities for late payment under the primary insurance, or to be liable only when the breach is deliberate or reckless. Provision may also be made for the reinsurer to be liable only when the breach by the reinsured was caused by the power of the reinsurer to control the settlement of claims under the primary insurance.

A FINAL COMMENT ON THE UK APPLICATION OF THE 2015 ACT

The 2015 Act is clearly a significant development in the evolution of English marine insurance law but it may not be of momentous importance. This is particularly the case if the focus is directed to the practical effect of the Act rather than its underlying theoretical policies analysed in the abstract.

Apart from the two mandatory provisions which have been noted, and which are of limited practical significance, the Act provides a code of default rules which apply in the absence of any specific agreement by the parties. They may consequently be excluded or varied by party agreement. It follows that on the matters covered by the 2015 Act the parties can establish their own contractual regime and thereby may even elect to continue to be governed by the relevant provisions in the 1906 Act.

This has been the policy of the eight UK members of the International Group of P & I Clubs. They have effectively contracted out of the significant provisions of the 2015 Act relating to the consequence of breach of the duty of good faith, the duty to make fair presentation, warranties and specific risk terms, retaining the default regime set out in the 1906 Act. They have also excluded the implied duty to settle claims within a reasonable period of time, save to the extent the implied term is mandatory.

The London Market has not developed a coordinated response with matters left to be determined by individual underwriters. The standard clauses which have been prepared and published by market organisations in response to the 2015 Act facilitate whatever may be the choice of individual underwriters or the agreement of the parties.

**WIDER IMPACT OF THE 2015 ACT**

Although this is potentially an enquiry without limitations, for practical reasons it has been restricted to jurisdictions within the common law tradition which have, to differing degrees, shown an inclination to follow or be influenced by legislative developments in English law[[1]](#footnote-1). These include -

Australia

A sub-committee of the Maritime Law Association of Australia and New Zealand (MLAANZ) has noted and considered the provisions in the UK Insurance Act 2015 and proposed that the Australian Marine Insurance Act 1909 be amended, suggesting several supporting reasons, including “maintaining legal harmony with the UK marine insurance law”.

The sub-committee prepared a draft Bill proposing the enactment of a Marine Insurance Amendment Act 2016, the effect of which would have been to make amendments to the Marine Insurance Act 1909.

This proposal has not to-date been acted on and the indications are that there is no enthusiasm currently on the part of government for new legislation. The insurance industry also appears to be disinterested.

New Zealand

The UK Insurance Act 2015 and developments in Australian law have resulted in renewed consideration of the state of insurance law in New Zealand.

The Ministry of Business, Innovation and Employment has instigated a process to review a range of insurance topics including those covered by the UK legislation. This process closed on the 13 July 2018 but no report has yet been published.

Singapore

In Singapore marine insurance is governed by the Marine Insurance Act 1999 which is in harmony with the UK Marine Insurance Act 1906.

The Singapore Academy of Law has recently convened the Law Reform Sub-Committee on Review of Insurance Law to evaluate the deficiencies of Singapore law in the light of the UK insurance law reforms. It has yet to report.

Malaysia

The Malaysian Financial Services Act 2013, Schedule 9, makes provisions relating to insurance which amend the Malaysian Insurance Act 1996.

These provisions are adapted from the UK Consumer Insurance (Disclosure and Representations) Act 2012 and what was then the prospective Insurance Act 2015.The new law does not follow UK law in strict detail, but are adaptations taking into account national policy and circumstances. However, some of the amendments take a fundamental different course – for example, the adoption of the “reasonable proposer” test in the context of the assured’s pre-contract duty and do not adopt the approach of proportional remedies for breach of this duty.

It has to be observed that some of the amendments may have been introduced before the UK reforms had become familiar or fully digested.

Hong Kong

It does not appear that the UK reforms have elicited any response.

Canada

Canadian marine insurance law follows the MIA 1906 very closely and to date there is nothing to suggest that the UK reforms have stimulated any reassessment or call for reform.

1. I am grateful to the following who generously and very helpfully responded to enquires about the position in their respective jurisdictions, namely The Hon Justice S C Derrington (Australian Law Reform Commission), Pauline Davies, Partner, Fee Langstone, Auckland, New Zealand, Associate Professor Yeo Hwee Ying, National University of Singapore and Marc D Isaacs, Isaacs & Co, Toronto, Canada. [↑](#footnote-ref-1)