BIG CHANGES FOR ENGLISH INSURANCE AND REINSURANCE LAW IN 2016

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Three new statutes will come into force in England in 2016 and 2017 that will substantially change English Insurance and Reinsurance law. The key dates are **1 and 12 August 2016** and **4 May 2017**.

INSURANCE ACT

The first and most important of these is the Insurance Act 2015 ("the new Act") which is the most significant reform of English insurance contract law since the Marine Insurance Act 1906 (the 1906 Act) which became law the same year as the San Francisco earthquake when Cuthbert Heath, the Lloyd's underwriter, famously declared "Pay all policyholders in full, regardless of Policy terms". The new Act, in force from 12 August 2016, applies to all new contracts of insurance, reinsurance and retrocession, as well as variations to existing contracts made after that date. Contracting out is possible except for "basis clauses". The new Act is intended materially to change the way in which the business of insurance and reinsurance governed by English law is conducted.

I set out below some of the more important changes. When I refer to insured and insurer, my comments apply equally to reinsured and reinsurer.

DUTY OF FAIR PRESENTATION

Under the new Act, although insurance contracts remain contracts of utmost good faith, the pre-contractual duty of disclosure is now known as the "Duty of Fair Presentation".
Under the 1906 Act, the pre-contractual duty of utmost good faith involves (i) the duty not to make misrepresentations to the insurer; and (ii) the duty to disclose all material matters to the insurer. The new Act does not materially change the following:

- The truth of any material representation of fact made by the insured must be "*substantially correct*".
- The test for what amounts to a material matter for disclosure is codified in section 7(3) as anything which *"would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms*". This mirrors the existing law.

The second limb of the duty of disclosure

However, under the new Act, in an important change from the past, the insured may positively satisfy its duty of disclosure in one of two ways. Under the first limb, as in the current law, the insured discloses every material circumstance which it knows or ought to know. If the insured fails to fulfil the first limb, the new Act introduces a fall-back position whereby the insured will satisfy the duty of disclosure if it 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*". The introduction of the second limb means that an insured may positively satisfy the duty by doing something that falls short of actually disclosing every material circumstance. If it says enough to put a prudent insurer on notice that it needs to ask further questions, the duty has been fulfilled.

The requirement for disclosure that is "*reasonably clear and accessible*" is intended to discourage the practice of "data-dumping", where an insured provides vast quantities of undigested information to the insurer in an attempt to safeguard itself.

KNOWLEDGE OF THE INSURED AND THE INSURER

In the corporate insured context there are also important changes in this area.

A corporate insured is taken to know that which is actually known to any individual who is part of the "*senior management*" of the insured, and that which is actually known to the individuals who are responsible for the insured's insurance (e.g. the insured's risk manager, or its broker).

What ought an insured to know? Constructive knowledge

This area amounts to one of the most significant changes embodied in the new Act, and potentially one which will increase the insured's burden of disclosure quite substantially. For the purposes of what it must disclose under the duty of fair presentation, an insured "*ought to know what should reasonably have been revealed by a reasonable search of information available to the insured*", including information which is "*held within the insured's organisation or by any other person (such as the insured's agent or a person for whom cover is provided by the contract of insurance)*". The Information can be revealed by "*making enquiries*", or by "*any other means*".

Under the old law, the insured's constructive knowledge is qualified as being that which it ought to know "*in the ordinary course of business*". Under the new Act, this is entirely replaced by a "*reasonable search*" of a potentially broad range of sources. The "*reasonable search*" will, therefore, assume a position of importance. It seems probable that in many cases, this alteration of the law could materially increase the insured's burden of disclosure.

The new Act was intended to be more insured friendly so it would be an unintended consequence if the new Act caused the burden of disclosure to increase. The London market has therefore developed standard form clauses which seek to limit this duty and the senior management to which it applies.

What does the insurer know under the new Act?

The insured is not obliged to disclose matters which the insurer knows, ought to know, or is presumed to know.

- **Actual knowledge**
  - The insurer actually knows whatever is known to any individual who participates in the underwriting decision on the specific risk in question, including the insurer's agent (such as a cover holder).
- **Constructive knowledge**
  - One change is that the new Act appears to envisage that insurers should also undertake a search of information that is readily available to them. For example, where an insurer has written cover for an insured over a number of years, information about it, and its claims history, is likely to qualify as "readily available". Information on the internet will not qualify, since it is not "held by" the insurer.
- **Presumed knowledge**
  - The insurer is presumed to know things which are common knowledge. It is also presumed to know the "things which an insurer offering insurance of the class in question to insureds in the field of activity in question would reasonably be expected to know in the ordinary course of business". These provisions do not materially alter the current law.

REMEDIES

- **What happens if the insured breaches the Duty**
  - Perhaps the most significant change under the new Act relates to the remedies available if an insured breaches the duty of disclosure/duty of fair presentation. Under the old law, the only remedy for breach of the duty of utmost good faith by the insured is avoidance of the policy ab initio, regardless of the severity of the breach. This has been widely criticised as overly harsh, and something of a blunt instrument.
  - Under the new Act, whilst the duty of utmost good faith survives, the sole remedy of avoidance for its breach is abolished, and is replaced with a new range of proportionate remedies which depend on whether the insured's breach of the duty was deliberate or reckless, or not, and what the insurer would have done if the Duty had been fulfilled.

- **Deliberate or reckless breach**
  - Unlike the old law, which essentially treats all breaches of the duty of utmost good faith in the same way, the new Act distinguishes between breaches of the duty depending on their severity. If a breach is deliberate or reckless, then the insurer may avoid the policy, and need not return the premium. A breach will be deliberate if the insured knows that he is in breach of the duty. It will be reckless if the insured does not care whether he is in breach of the duty.
  - There may be a practical difficulty about an insurer pleading a deliberate or reckless breach of the Duty. The potential difficulty arises because the insurer has the burden of proving that the insured's breach was either deliberate or reckless.

- **Breach not deliberate or reckless**
  - If the breach is neither deliberate nor reckless, the position is entirely different, and a range of proportionate remedies is potentially available (quite unlike the current law). Which of these remedies is available depends on what the actual underwriter who wrote the risk in question would have done if there had been a fair presentation of the risk – i.e. the question of inducement.

- **Avoidance**
  - If the underwriter in question would not have written the risk at all, then the insurer may avoid the policy, but must return the premium. Avoidance is, therefore, still available where breach of the duty is neither deliberate nor reckless. It will only be permitted if the insurer demonstrates (on the balance of probabilities) that, if the insured had made a fair presentation of the risk, the participating underwriter would not have been willing to write it at all.

- **Varying the term of the contract**
  - If the insurer would have written the risk, but on different terms, the contract will be treated as if it had been written on those terms. That does not include terms relating to the premium. Effectively, this means that the courts will rewrite the contract – on the basis of what the underwriter would have written if he/she had received a fair presentation of the risk.

- **Proportionate reduction of the claim**
  - If the insurer would have written the risk, but for a higher premium, then the insurer may proportionately reduce the claim. The reduction will be in the same proportion that the

actual premium bears to the premium that would have been charged if a fair presentation had been made. This proportionate reduction may work alongside the "rewriting" of the contract described above, or may stand alone as a sole remedy.

- **Practical effects of the new range of remedies on the business of insurers**
  - The central change brought about by the introduction of proportionate remedies is an increase in the importance and complexity of inducement. The actual underwriter will, in certain cases, have to prove that he was induced to a much finer degree – including specific terms he might have imposed, or premiums charged.

WARRANTIES

Abolition of basis clauses

The new Act abolishes "basis clauses" in Business Insurance Contracts. This means that any representation made by the insured in connection with a "proposed" Business Insurance Contract is no longer capable of being converted into a warranty by means of any term in either the policy, or the proposal. For example, a term which says that the facts stated in the proposal form the basis of the contract, will no longer be of any effect. The parties may not contract out of this provision.

Warranties become suspensory conditions

Under the old law, a breach of warranty in an insurance policy permanently discharges the insurer's liability from the moment of breach, even if the breach of warranty is later remedied by the insured.

Insurance warranties are now treated as suspensory conditions. The insurer will not be liable for losses while the insured is in breach of warranty. If, however, the insured/reinsured remedies its breach of warranty, the insurer will be liable for subsequent losses, unless they were "attributable to something happening" before the breach was remedied. The insurer will also be liable for loss occurring or attributable to something happening before the breach of warranty.

Terms not relevant to the actual loss

The new Act materially changes the law and now prevents an insurer from relying on breach of a term by the insured if that breach is entirely unconnected with the actual loss which the insured has suffered (which was allowed under the old law). A classic example is the insurer's reliance on breach of a burglar alarm warranty where the loss has been caused by fire – since the breach of such a warranty may have had nothing at all to do with the new actual loss suffered.

Although the new Act converts Warranties into suspensory conditions, it has not altered the law on conditions precedent. Therefore, failure to comply with a condition precedent under English law, causes cover to cease even though the insurer cannot prove any damages suffered by the breach.

CONTRACTING OUT

In Consumer Contracts, any attempt to contract out of any part of the new Act will be of no effect. In Business Contracts, the parties are free to contract out of any of the provisions in the new Act, apart from those relating to basis clauses.

If the insurer contracts out, it "*must take sufficient steps to draw the disadvantageous term to the insured's attention*" before the contract (or variation) is concluded.

The disadvantageous term must also be "*clear and unambiguous as to its effect*". Therefore it is the *effect* of the term that must be clear and unambiguous.

DAMAGES FOR LATE PAYMENT OF INSURANCE / REINSURANCE CLAIMS

The Enterprise Act 2016 introduces into the Insurance Act the concept of late payment damages. From 4 May 2017 these provisions (applying to insurance and reinsurance contracts made after that date):

- Introduce into every insurance contract a requirement that the underwriter pay sums due within a reasonable time;
- Provide a non-exhaustive list of matters which may be taken into account when determining what is a "*reasonable time"* for payment in the particular circumstances of a case, and state that a reasonable time will always include time to investigate and assess the claim. The insurer will have a defence to a claim for breach of the implied term where it had reasonable grounds for disputing the validity or value of a claim; and
- Allow contracting out for non-consumer insurance contracts, provided that the insurer satisfies the transparency requirements set out in the Insurance Act 2015.

In terms of defining "*reasonable time*", the Enterprise Act provides that it will depend on the specific circumstances and provides a non-exhaustive list of factors that will be taken into account.

- The type of insurance
- The size and complexity of the claim
- Compliance with any relevant statutory or regulatory rules or guidance
- Factors outside the insurer's control

Under the old law, an insured can only recover what it is owed under the policy plus interest. However, the Enterprise Act provides that damages will be payable by an insurer where a policyholder suffers additional loss because of the insurer's unreasonable delay in payment.

It is important to note that these provisions do not seek to impose on insurers bad faith or punitive damages. They imply into every insurance/reinsurance contract the obligation on the underwriter to pay promptly. However, failure to do so does not result in an automatic obligation to pay damages. The insured has to prove actual loss suffered by the delay.

THIRD PARTIES RIGHTS AGAINST INSURERS

On 1 August 2016 the Third Parties (Rights against Insurers) Act 2010 came into force.

This Act will have significant implications where the insured is insolvent.

Under the old 1933 Act, if a third party wishes to bring a claim against an insolvent insured (e.g. a contractor) in order to obtain compensation under the insured's insurance policy (a relatively common situation in professional indemnity claims), the third party must go through a cumbersome (and costly) procedure to first establish the liability of the insured. For example, this has until now required the third party to apply to Court to have the insured restored to the register of companies if the company has been struck off.

Under this new Act, restoration to the register will no longer be required. Instead, the third party will be permitted to issue proceedings directly against the insurer without involving the insolvent insured at all. As would be expected however, the third party will still have to

establish the liability of the insured for the claim before any judgment can be enforced against the insurer.

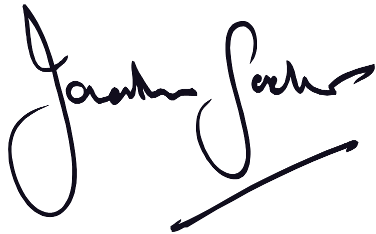
In addition, certain defences previously available to insurers (e.g. late notification by the insured) will be removed under this new Act. Instead, the third party itself will be able to notify the relevant insurers of its claim against them.

The Act also obliges the liquidator or person in possession of the property of the insolvent to disclose relevant insurance policies to the third party

CONCLUSION

So for those of us used to practising under the 100+ year old English insurance and reinsurance law, the next few years will be very interesting as the English courts seek to interpret these new laws.

If you have any queries regarding this document, please do not hesitate to contact me or your usual BLP contact.



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