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Insurance Law Committee response to the Law Commission consultation on Insurance Contract Law: Post Contract Duties and Other Issues

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The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of Insurance Contract Law: Post Contract Duties and Other Issues has been prepared by the CLLS Insurance Law Committee

DAMAGES FOR LATE PAYMENT

A statutory duty to pay valid claims

1.1 Do consultees agree that legislative reform should provide that:

(1) insurers should be under a contractual obligation to pay valid claims within a reasonable time;

Agree: X Disagree: Other:

Comment: There are two questions here:

(i) The first is whether the essential obligation of the insurer should be (a) to prevent the loss occurring or (b) to indemnify the insured after the loss has occurred.

(ii) The second is whether the insurers obligation to pay should arise immediately on the loss occurring or at some later time – the proposal being that it should arise after a reasonable time for the insurer to investigate and assess the claim has passed.

The present state of the law – that the insurer's obligation is to prevent the loss occurring - has the consequence that the remedy of the insured is always damages for breach of that obligation (to prevent the loss occurring). We agree that such a rule makes the law look silly

because there is nothing the insurer can do to avoid breaching that obligation, and we further agree that steps to make the law look less silly are welcome. As to the argument that the present rule should be retained because there is certainty about when the insured's cause of action arises, we agree that certainty is important but we believe that certainty about the date the cause of action arises can be achieved in another way. See 1.7 to 1.9 below.

We also believe that the obligation to pay within a reasonable time should be a good faith obligation so that if there is bad faith on the part of the insurer non compensatory damages should be available. See 1.3 below.

Changing the essential obligation of the insurer to one of indemnifying the insured for the insured loss suffered does not of itself result in a situation that allows the insured to claim damages for late payment of a claim. Even where there is a primary payment obligation the circumstances in which the courts allow suit for the sum of money itself rather than damages are limited – debt and an action for the price in sale of goods being the primary cases. Further, since the amount of the indemnity will often not be a sum certain – as the price of goods or the amount of a debt are likely to be – even a claim for an indemnity will be for a sum which the court has to assess, and have the feel of damages. **We therefore favour express statutory provisions that both (a) change the law so that the obligation of the insurer is to indemnify after a loss has occurred, not to prevent the loss and (b) state expressly that (without prejudice to the right to claim damages) the insured may sue for the indemnity (not simply damages for breach of the obligation to indemnify).**

(2) an insurer who fails to meet this obligation should be liable to pay damages for any foreseeable losses which result? (5.9)

Agree: Disagree: Other: x

Comment: We agree that an insurer who fails to pay within a reasonable time should be liable for losses that result from his breach of this obligation. However, we favour that the losses recoverable should be those fairly and reasonably considered as arising naturally, as well as those that are foreseeable. We see no benefit in permitting the damages recoverable for failure to pay to be recoverable under only one head of Hadley v Baxendale. If ever the common law or statute provides a general remedy of damages for late payment, it is, we think, likely to be rooted in a simple breach of contract proposition.

We foresee a practical problem and we do not see an easy solution to it. If an insurer decides to pay a claim after a considerable period of investigation we think it very likely that when the insurer pays the claim he will insist on receiving a full release of all claims the insured may have, including in relation to any damages for late payment. Such a request may be made in a without prejudice offer, so that it is kept from a court. It will be a brave insured who refuses full payment of the claim on those terms simply so that he is free to sue for damages for late payment. Any rule that sought to prevent the insurer asking for this blanket release – for example one that said that an insurer may not impose conditions on payment if he pays a full indemnity – would probably work against the interest of the insured. The insurer could offer a fraction less than a full indemnity in order to be able to tack on full release safeguards.

The definition of a reasonable time

1.2 Do consultees agree that:

(1) Provided the insurer has acted reasonably in asking the insured for information to enable it to investigate the claim, the time to investigate should only begin once the insured has provided the insurer with all the material information requested?

Agree: Disagree: Other. x

Comment: In our view, no matter what guidelines one seeks to provide, the court will be left with the question of whether a particular payment has been made within a reasonable time and that will depend on the facts in each case. The questions are whether the request of the insurer for information was reasonable and was made reasonably promptly and whether the provision of information by insured (assuming it was not everything requested by the insured) was reasonable and whether the insurer acted reasonably on receiving that information. We think all these questions fall within the court's decision making process and the court does not need guidance on the points. We do not think guidelines will prevent, or limit, litigation on the question of reasonableness and we expect that a body of case-law will emerge from the judges which will produce principles based on experience.

(2) The insurer should have sufficient time to carry out a full investigation, including time to seek information from third parties where necessary?

Agree: Disagree: Other: x

Comment: See 1.2(1) above. The questions of whether it is reasonable for the insurer to carry out an investigation, and whether the depth of that investigation is reasonable, and whether it is reasonable to approach third parties, again fall within the court's decision making process. We consider that these questions are for the court and that the court would not be aided by guidelines on what it should consider.

(3) Once it has investigated, the insurer should assess the claim and arrive at and communicate its decision promptly?

(4) Overall, the insurer should have a reasonable time to investigate and assess the claim, taking into account market practice, the type of the insurance, and the size, location and complexity of the claim? (5.14)

Agree: Disagree: Other: x

Comment: This is a double question. We agree that the cause of action against the insurer should not arise immediately on the loss occurring. We agree that the cause of action should arise after the insurer has had a reasonable time to assess a claim. We do not agree that the cause of action should not arise until after the insurer "has had a reasonable time to investigate and assess the claim, *taking into account market practice, the type of the insurance, and the size, location and complexity of the claim".* That is, we do not agree the additional words in italic. The decision of what is a reasonable time should be left to the court, and not restricted by further words which necessarily will not be able to cater for each different set of facts.

Business insurance: an excludable duty

1.3 Do consultees agree that in business insurance:

(1) Insurers should be able to limit or exclude their liability to pay damages for late payment through a term of the contract; and

Agree: Disagree: Other: x

Comment: We see no advantage to considering any part of the question of whether the insurer should be able/unable to exclude liability in respect of business insurance policies [absent bad faith - see 1.5 below] piecemeal. The obligations of insured and insurer in business insurance, and any question of restrictions on the insurer's attempts to not pay need to be looked at as a whole. We are concerned that a rigid distinction between consumers and small businesses may be inappropriate. The consideration of the appropriate degree of protection of the policyholder should focus on the bargaining power of the insured and the bargaining power of a small business is likely to be little greater than that of an individual consumer.

(2) The term should only apply if the insurer has acted in good faith? (5.19)

Agree: Disagree: Other: x

Comment: We state in our understanding of what "the term" is in this context, so that our meaning is clear. We understand "the term" to be a term of the insurance policy that attempts to exclude the insurer's liability for damages for late payment of an indemnity/damages under an insurance policy.

In our view, the insurer should have a duty of good faith in assessing a claim and non compensatory damages should be available for breaches of that duty. We do not think that good faith should be introduced as a concept only by way of depriving the insurer of the ability to rely on an exclusion clause. We think it should be an overriding duty that cannot be excluded.

If an insurer deliberately delays paying a claim or puts up specious defences, damages would be recoverable in principle (the insured has to prove loss etc) because the insurer would clearly not have paid the claim within a reasonable time (provided of course the law was changed). Deliberate delay and specious defences are also bad faith and we favour additional non compensatory damages for such bad faith.

Consumer insurance: a non-excludable duty

1.4 Do consultees agree that in consumer insurance, insurers should not be able to limit or exclude their liability to pay damages for late payment? (5 25)

Agree: x Disagree: Other:

Comment: The consumer is defenceless if such duties can be written out in policies. We do not think it sufficient that the insured may be able to call on UCTA.

A "shield" of good faith in business insurance

1.5 Do consultees agree that an insurer should not be entitled to rely on an exclusion clause to limit liability for a delayed payment or a rejected claim where it has not acted in good faith? (5.32)

Agree: x Disagree: Other:

Comment: Where an insurer has not acted in good faith, he has acted in bad faith. The court should offer no assistance to a party who has acted in bad faith.

1.6 Do consultees agree that where an insurer seeks to rely on an exclusion clause:

(1) the insurer should explain to the insured why the payment was delayed or rejected: and

Agree: Disagree: Other: x

Comment: We favour a duty on the insurer to explain to the insured a) why a claim is rejected (if it is), b) why a claim is agreed only in part (if it is) and c) what he has done in the period

between the claim and the letter of explanation - whether it be accompanied by payment or by rejection or by some of both. We favour a rule that this be done in a "statutory letter" in a mandated format. See 1.7 to 1.9 below. We do not see that a duty to explain why payment was "delayed" will work effectively. The insurer will, we hazard, maintain that there was no delay and the claim was paid/rejected within the reasonable period allowed to him. We can see a benefit in the FSA/ the ABI/ the LIIBA, BIBA agreeing a format of such mandated letter to ensure standardisation at an appropriate level of detail. See 1.9(2) below. Market agreement on such a letter may make statutory intervention on that point unnecessary.

(2) the court should evaluate whether the insurer was acting in good faith, given the circumstances and the information available to it at the time? (5.33)

Agree: x Disagree: Other:

Comment: We can see no alternative. We can see no reason why an alternative should be sought.

The test for good faith

1.7 Do consultees agree that legislation should not include further guidance on good faith in claims handling? (5.37)

Agree: x Disagree: Other:

Comment: There should not be further guidance on good faith in claims handling because an attempt at a definition may result in one understanding of bad faith for insurance and a different understanding for the rest of English law.

Limitation of actions

1.8 Do consultees agree that the limitation period in England and Wales to sue an insurer for a claim should commence only after an insurer has had a reasonable time to investigate and assess the claim? (5.47)

Agree: x Disagree: Other:

Comment: We agree but we think that the insured should not be prejudiced by the period within which he must bring a claim being uncertain and any provision which opened up another opportunity to litigate whether a time limit had expired would be unwelcome. See the answer to 1.9 below.

1.9 Alternatively, should the limitation period in England and Wales commence:

(1) At the time of loss, or

Agree:	Disagree: x	Other

Comment: See 1,1 above. We consider that the law should eschew, where it plainly can, circumstances where it looks silly. It is silly to put an insurer in breach of the policy before he even knows that a loss has occurred and before a claim is made. Thereafter it is silly to put him in breach of his obligation to pay before he has had an opportunity to consider the claim.

(2) at the time the insurer's decision about the claim was communicated to the insured? If so, please comment on when in the claim's process you think this should be. (5.48)

Agree: x	Disagree:	Other:

Comment: See our comment in 1.6(1) above. In order to ensure that the insured is aware of when time starts to run on his insurance claim, we consider that in all circumstances - even where the insurer pays the claim in full because the potential for a cause of action for late payment still exists - the "statutory letter", the letter which states the insurers assessment of the claim, should be clearly headed to the effect "This letter is our final assessment of your claim for the purposes of the limitation act. The 6 years within which you should bring a claim against us in respect of this claim begins on the date you receive, or are deemed to have received this letter. If you are in any doubt you should seek professional advice." If the insurer does not send such a statutory letter the time limit will not start. But we suspect that in reality it will make little difference. With no statistics to go on, we doubt insureds often seek to issue insurance claims forms more than 6 years after a letter from the insurer rejecting the claim. Insurers are familiar with such "statutory" letters because they currently write similar letters in order to trigger the insured's right to apply to the FOS.

Damages for distress and inconvenience in consumer insurance

1.10 Do consultees agree that damages for distress and inconvenience or discomfort should be available for consumer insurance policies? (5.55)

Agree: x Disagree: Other:

Comment: The core proposal of the Law Commissions is that the insured should be able to claim damages for late payment, and that the damages – where the insured suffers loss - should be available if a claim is not paid within a "reasonable time". If there is, additionally, a duty, by statute, to act in good faith in insurance contracts, that would offer a further remedy to the insured. He could claim damages for late payment and/or non compensatory damages for bad faith. Damages for distress and inconvenience, if available, would presumably be sought where the claim was paid late, the insurer was not in bad faith but the lateness had caused distress and inconvenience. We think it is appropriate that such damages be available in this situation.

1.11 Should this be achieved through statutory reform? (5.6)

Agree: x □ Disagree: □ Other: □

Comment: We see no other constitutional way, unless, as with Contract Certainty, the FSA persuades the insurance industry to adopt these practices universally by holding over it the threat of statutory reform otherwise. It is not appropriate to make views known to the judiciary and hope they will adopt them.

ASSESSING THE IMPACT OF REFORM

Damages for late payment

1.12 What are the likely benefits if prompt payment prevents businesses from ceasing to trade? We invite comments on the view that such benefits may exceed £5 million. (21.13)

We are not in a position to comment

1.13 How many claims for damages for late payment are likely to be paid each year? And what would be the average size of each claim? (21.22)

1.14 We invite comments on the view that total payments for damages for late payment may be in the region of £500,000 to £1.2 million. (21.23)

We are not in a position to comment

1 . 1 5 What, if any. additional legal costs would be generated by the proposals? (21.26)

We are not in a position to comment

Transitional costs

1.16 What are the likely transitional costs of our proposals on damages for late payment, in terms of training and familiarisation?

We are not in a position to comment

1.17 The transitional costs of the recent Consumer Insurance (Disclosure and Representations) Bill were estimated at between £1 million and £1 5 million. Do consultees think that the transitional costs of all our proposals in this Consultation Paper would be of a similar order of magnitude? (21.54)

Agree: Disagree: Other: x Comment: We are not in a position to comment

INSURERS' REMEDIES FOR FRAUDULENT CLAIMS

Insurers' remedies for fraud

1.1 Do consultees agree that a policyholder who commits a fraud should:

(1) forfeit the whole claim to which the fraud relates

Agree: X Disagree: Other:

Comment: We agree that as a matter of principle and for deterrent effect, as a general rule an insured who makes a fraudulent claim should forfeit the whole of the claim to which the fraud relates.

That said, we recognise that an insured may stoop to doing something fraudulent to assist his claim which is fairly minor and which may have no significant effect on his claim (e.g. writing a false receipt for an item he has genuinely lost). Such behaviour may in part be prompted (although not excused) by failure on the part of the insurer to deal with claims promptly and fairly, in breach of the requirements under ICOBS 8. Some members of the CLLS Insurance Law Committee feel that in such circumstances, it may be unfair that the insured should lose the whole of his claim. They would (recognising that the dividing line may be difficult to draw and that guidance may have to be set out in primary legislation) draw a distinction between this type of conduct and cases where the claimant never had a genuine claim or has made a materially exaggerated claim; in the latter cases they would favour the whole claim being forfeit. Where, however, there has been a genuine loss in connection with which an insured has engaged in some fraudulent conduct to substantiate his claim to a minor degree, a minority of the Committee's membership would favour giving the courts some discretion to award him an appropriate amount of his claim but to penalise him (e.g. in costs) in recognition that such conduct was reprehensible. The factors to be taken into account by the courts in exercising its discretion would include the circumstances of the insured and the conduct of the insurer in dealing with the claim.

The consensus of the majority of the Committee, however, is that deterrence of fraud should be the paramount objective and that no legislative provision should be made for discretionary relief from forfeiture.

(2) Also forfeit any claim where the loss arises after the date of the fraud

Agree:	Disagree:	Other: X

Comment: We do not favour automatic forfeiture of all claims made subsequent to a fraud, but when there has been a fraudulent claim, insurers should have the right to terminate the contract with effect from the date of the fraud. In the nature of things (i.e. because there is likely to be a time lag between the commission of a fraud and its discovery), this may involve retrospective cancellation, but insureds who are prepared to commit fraud must expect that insurers will not want to have any dealings with them after discovery of the fraud. Insurers should not be liable to pay any claim arising after such termination, but if they are prepared to defer termination (or waive their right to terminate) and to indemnify an insured in respect of a valid claim arising between the fraudulent conduct and the termination, we do not see why any such valid claim should automatically be forfeited. We recognise, of course, that insurers are highly unlikely to be prepared to grant any indulgence to the insured in this regard, but termination for what amounts to a repudiatory breach of the insurance policy seems more in accordance with established principles of contract than automatic forfeiture. See also our answer to question 1.3 (3) below.

(3) Be entitled to be paid for any previous valid claim which arose before the fraud took place? (8.17)

Agree: X	Disagree:	Other:

Comment: Provided that such claim has been made in good faith, it is difficult to see why the insured should be denied indemnification retrospectively because of subsequent events.

1.2 Do consultees agree that the definition of "the whole claim" should be left to the courts? (8.18)

Agree: X	Disagree:	Other:

Comment: We assume that the underlying concept is all claims arising from or connected with the same occurrence of an insured peril, but we agree that attempts to define it may generate more problems than solutions, and the answer in any particular case is best left to the court to determine according to the circumstances of that case.

Do consultees agree that the costs of investigating proven fraud should be recoverable if the insurer can show that the costs were:

(1) Actually incurred?

Agree:	Disagree:	Other: X

Comment: We are uncertain whether any change in the law is required, as the common law already provides insurers with the remedy of damages for the tort of deceit and we consider that all of the necessary elements (duty of care, breach, causation and foreseeability of loss) are likely to be present if insurers wish to avail themselves of this remedy - which apparently they have not done in the past. In *London Assurance v Clare* (1937), cited in the consultation paper for the proposition that an insurer cannot recover from the insured the costs of investigating a fraudulent claim, Goddard J is reported as saying: "It is put, ***not as damages for fraud, for which I think there might be something to be said***, [emphasis added] but it is put as damages for breach of contract." The principle that damages for deceit may be available is (as the consultation paper notes) also supported by *Insurance Corporation of the Channel Islands v McHugh* (1997).

We consider that damages for deceit might well include the costs of investigating earlier claims if an insurer was put on enquiry as to the insured's honesty in relation to such claims by the subsequent fraud (or reasonable suspicion of it).

Subject to the foregoing, we would not object to a clear restatement of the law which put the insurer's remedy on a statutory basis - indeed we would welcome it.

(2) Reasonable and proportionate in the circumstances?

Agree: X	Disagree:	Other:

Comment: We agree that a test of reasonableness and proportionality should apply, with the court to determine what is reasonable and proportionate in the circumstances of each case.

(3) not offset by any saving from legitimate, forfeited claims? (8.23)

Agree:	Disagree: X	Other:

Comment: Although we can appreciate the commercial thinking behind this proposal (if the insured forfeits what would otherwise have been a legitimate claim, he should not have in addition to pay the insurer's costs in investigating fraudulent claims, at least not to the extent that the amount forfeited equals or exceeds those costs), we question whether this is the best way to develop the

law. If the law already provides (or is to be amended so as to provide, in accordance with the Law Commissions' recommendations) that any claim made after the fraud is liable to be forfeited - whether automatically or in consequence of election by the insurer to terminate the contract for repudiatory breach - we believe it must follow that the insurer would not actually be "saving" anything because the "benefit" to the insurer of such forfeiture would be an established right.

Admittedly, the consequences of not providing for offset could be harsh for the insured, but -

(a) the consensus of the CLLS Insurance Law Committee is that a fraudulent insured should not benefit - even indirectly or contingently - from his own deceit; and

(b) the factors which insurers are likely to take into account in deciding whether or not to pursue an action for damages representing their costs of investigating a fraudulent claim will include the prospect of actually recovering such damages. We suspect that in practice, insurers will find it difficult to recover anything, as those who indulge in fraud will quite probably lack funds or have hidden their assets effectively. We anticipate, accordingly, that insurers would not be interested in pursuing such claims unless substantial amounts had been spent on an investigation and there were real prospects of recovering substantial damages and costs. We do not think it is right that insurers should be obliged to set off any damages which they do in fact succeed in recovering against payments which they might otherwise have had to make in respect of legitimate claims which had been presented after the fraudulent claim, particularly in circumstances where the insurer is most unlikely to be willing to deal with the insured at all after discovery of a fraud and the insured should not be surprised by the insurer's attitude. We are also concerned at the prospect that an entitlement to set off the amount of apparently valid claims arising after the fraud (and which - but for the fraud - would have been paid) might give rise to a trial to determine that validity (establishing policy coverage, the value of the insured's loss, etc - with additional disclosure and argument on these issues) within a trial whose principal purpose is to establish the measure of the insurer's damages for its investigation costs. If the insured has suffered a genuine post-fraud loss which becomes forfeit, the insurer might consider that, from his point of view, the forfeiture represents sufficient compensation for whatever expense he has incurred in investigating the fraud and, therefore, he may decide not to pursue a claim for damages - but that is a matter of fortuity.

Express terms

Business insurance

1.4 Do consultees agree that in business insurance:

(1) The remedies for fraud should be subject to an express term of the contract?

Agree: X	Disagree:	Other:

Comment: We understand this question to mean that the parties should be permitted to negotiate consequences which are more or less severe than those provided by statute in the event of a fraudulent claim. On that basis, we agree that freedom of contract should govern, although we are conscious that the proposed dividing line between consumer and business insurance takes no account of small businesses which - realistically - may not be able to protect their interests any more effectively than consumers.

(2) A clause which changes the statutory remedies should be written in clear, unambiguous terms and specifically brought to the attention of the other party? (8.27)

Agree: X	Disagree:	Other:

Consumer insurance

1.5 Do consultees agree that in consumer insurance, any term which purports to give the insurer greater rights in relation to fraudulent claims than those set out in statute would be of no effect? (8.30)

Agree: X	Disagree:	Other:

Comment: Consideration should be given to the question whether small businesses should be treated in the same way as consumers, although we are conscious of the difficulties inherent in deciding where the dividing line between consumers and small businesses should be drawn.

Insurers' remedies for fraud: co-insurance and group insurance

1.6 Do consultees have evidence that the law of fraudulent claims by joint insureds causes problems in practice? If so, we would be grateful if consultees could provide us with such evidence or examples, and also provide us with information on how these issues were dealt with (either by the firm concerned or by any other body). (9.21)

Agree:	Disagree:	Other:	X

Comment: The current law is clear and although in theory it could operate harshly on innocent joint insureds, in practice we are unaware that it causes many problems.

1.7 Do consultees agree that there is no need to legislate on the effect of fraud by one joint insured on the other joint insured's claim? (9.22)

Agree:	Disagree:	Other:	X

Comment: In cases of true joint insurance, premised on a joint interest in the subject matter (as opposed to insurance deemed to be joint simply by virtue of the policy wording), we find it difficult to escape the conclusion that the fraudulent conduct of one insured must have the effect that the whole claim is forfeited, even if the other joint insured(s) is/are entirely innocent. Notwithstanding the preceding comment and our answer to question 1.6, we would favour some modification to the current law: the fact that the evidence suggests the absence of a significant practical problem in England or Scotland does not mean that the law should not attempt to deal with a potential source of injustice when an opportunity to do so is presented. It is unclear whether courts in England would be prepared to adopt the solution to the problem that has been fashioned by judges in other jurisdictions (e.g. New Zealand), where policies have been construed as composite notwithstanding the insureds' joint ownership of the subject matter: see Colinvaux and Merkin's *Insurance Contract Law* para A-0618. We recognise that it will not be easy to draft legislation to deal with this problem. Nevertheless, we would support legislative intervention as follows:

(a) The creation of rebuttable presumptions that -

(i) the insureds' joint interest is severable and if one insured commits a fraud affecting the rights of all joint insureds, the interest has been severed before the fraud is committed; and

(ii) any fraud committed by one joint insured is not committed on behalf or with the knowledge of all the parties.

(b) Then, if the innocent party is able to show on the balance of probabilities (whether with the assistance of presumption (ii) or not) that the fraud was not carried out on his behalf and was done without his knowledge, the severable and severed part of the claim (or such portion of it as represents the loss that

he has suffered himself) should be paid to him.

We would obviously be against a fraudulent co-insured's benefiting from any recovery, but we would not wish an innocent party to be denied recovery on the basis that there might be some remote benefit to a guilty insured.

1.8 Do consultees agree that a fraudulent act by one or more group members should be treated as if the group member concerned was a party to the contract? (9.30)

Agree: Disagree: Other: X

Comment: A group member who makes a fraudulent claim should forfeit that claim (and possibly any subsequent valid claims, but see our response to question 1.1 (2) above, which is relevant to this question as well). Admittedly, the concept of repudiatory breach of contract will need some modification to deal with a fraud by an individual who is not the contracting party. We question, in any event, whether this issue needs to be addressed by legislation, or whether (on the assumption that group policies will be treated as falling into the "business" rather than "consumer" category) the remedy is for insurers to provide in their contracts.

Assessing the impact of reform

Insurers' remedies for fraudulent claims

1.9 Do consultees agree that the proposed reforms to insurers' remedies for fraudulent claims will provide benefits in terms of improved deterrence and reduced legal costs? (21.33)

In principle this seems likely, although we are not able to express an opinion on the actual monetary value of such benefits.

1.10 We invite comments on the view that reforms (when combined with effective publicity) would reduce fraud, leading to savings of around £2 million to £5 million a year. (21.34)

See our answer to question 1.9.

Transitional costs

1.11 What are the likely transitional costs of our proposals on insurers' remedies for fraudulent claims, in terms of training and familiarisation?

We are unable to express a view on this question.

INSURABLE INTEREST

Indemnity insurance

A statutory base for insurable interest

1.1 Do consultees agree that there should be a statutory requirement that an insured has an insurable interest in the subject matter of the insurance?(12.42)

Agree: X Disagree: Other:

Comment: The current position regarding the need for insurable interest for many types of indemnity insurance is unclear. We agree that it would be helpful to clarify the position by legislating to create a statutory requirement for insurable interest in the case of indemnity insurance.

We do not support the alternative option of legislation to abolish any need for insurable interest in the case of indemnity insurance. The concept of insurable interest is an important feature of insurance and assists in distinguishing insurance from other types of contracts including wagers and non-insurance financial instruments.

Timing and consequences

1.2 Do consultees agree that:

(1) to make a claim, the insured must show insurable interest at the time of loss?

Agree: X Disagree: Other:

(2) An insurance contract is void for lack of insurable interest unless there is a real probability that a party would acquire some form of insurable interest at some stage during the life of the contract?

Agree: Disagree: X Other:

Comment: Insurable interest should be tested at the time of loss, not at inception of the policy. At the point of loss it should be necessary for the insured to have an insurable interest - it should not be sufficient that at inception there had been a real probability of acquiring such an insurable interest. However, the nature of the required interest will depend on the definition of insurable interest – see below.

(3) if the insured shows that the contract was void for lack of insurable interest, the insurer may not sue for premium, and the insured is entitled to a refund of premiums already paid? (12.50).

Agree: Disagree: Other: X

Comment: We agree that if a contract is void for lack of insurable interest the insured should be entitled to a refund of premiums paid. However, this should be the case where the insurer has refused to pay a claim on the basis of lack of insurable interest. It should not be up to the insured to choose to take out a policy and subsequently demand a return of premiums on the basis that he does not have an insurable interest in the subject matter of the policy (in the absence of any misrepresentation by the insurer).

Repealing the Marine Insurance (Gambling Policies) Act 1909

1.3 Do consultees agree that the Marine Insurance (Gambling Policies) Act 1909 should be repealed? (12.53)

Agree: X Disagree: Other:

Repealing the Marine Insurance Act 1788

1.4 Do consultees agree that the Marine Insurance Act 1788 should be repealed? (12.56)

Agree: X Disagree: Other:

Retaining the provisions on insurable interest in the Marine Insurance Act 1906

1.5 Do consultees agree that, for marine insurance, sections 4 to 15 of the Marine Insurance Act 1906 should be left as they are? (12.59)

Agree: X Disagree: Other:

Defining insurable interest for indemnity insurance

1.6 Should the statute state that an insured has an insurable interest if the insured has:

(1) a right in the property which is the subject matter of the insurance or a right arising out of a contract in respect of it;

Agree: Disagree: Other: X Comment: See answer to 1.9 below.

(2) A real probability either of an economic benefit from the preservation of the insured subject matter, or of an economic loss on its destruction, which would arise in the ordinary course of things; or

Agree: Disagree: Other: X

Comment: See answer to 1.9 below.

Please note that a minority of the Committee is in favour of including this wording as part of a statutory non-exhaustive definition of insurable interest. See answer to 1.9 below.

(3) possession of the insured subject matter? (12.66)

Agree: Disagree: Other: X

Comment: See answer to 1.9 below.

1.7 Should other forms of insurable interest be included in the list? (12.67)

Agree: Disagree: Other: X

Comment: See answer to 1.9 below.

1.8 Should the list be non-exhaustive? (12.68)

Agree: Disagree: Other: X

Comment: See answer to 1.9 below.

1.9 Alternatively, should the definition of insurable interest be left entirely to the courts? (12.69)

Agree: X Disagree: Other:

Comment: The majority of the committee do not support enshrining a definition of insurable interest in statute. The case law in this area has shown that insurable interest is difficult to define in a way which suits all cases. Although we agree that it would be useful to clarify in the legislation the requirement to have insurable interest in the case of indemnity insurance, the majority believe that defining what that insurable interest is should be left to the courts. This allows a more flexible and nuanced approach to finding insurable interest than would be possible were the definition to be set out in statute.

A minority of the committee is in favour of including a non-exhaustive definition of insurable interest in the legislation, which would include the approach based on Lucena v Craufurd set out in 1.6(2) above.

Life insurance

Insurable interest based on economic loss

1.10 Do consultees agree that an insurable interest may be found where there is a real probability that the proposer will retain an economic benefit on the preservation of the life insured or incur an economic loss on the death? (13.74)

Agree: X Disagree: Other:

1.11 Should the law require that the value of the policy is a reasonable valuation, made at the time of the contract, of the possible loss? (13.75)

Agree: X Disagree: Other:

Comment: It is consistent with the requirement that there must be a probability of economic benefit/ loss that the value of the policy should relate to the possible loss. Otherwise this raises significant moral hazard issues by creating a situation where the beneficiary would be economically better off if the life insured dies.

Imposing this requirement would mean that there are two rules, one for categories of 'natural affection', where there is no restriction on the policy amount, and one for policies based on a probability of economic benefit/ loss. However, it is acknowledged that the two types of life insurance are based on different tests in any event so it does not seem to us to be

overly problematic to have two different valuation requirements.

Insurance without evidence of economic loss

CHILDREN UNDER 18

1.12 Do consultees agree:

(1) that parents should be entitled to take out insurance on the life of a child under 18?

Agree: Disagree: X Other:

Comment: There is no justification for allowing life insurance to be taken out on the life of a child, except where the probability of economic benefit/ loss test is satisfied. If the categories of natural affection are extended to include children, the policy value should be capped at an amount calculated to cover funeral expenses. This could be set at a suitable figure with provision for the amount to be indexed or changed by SI.

(2) that the right would extend to the legal parents of a child and all those who treated a child as a child of the family? (13.84)

Agree: Disagree: X Other:

Comment: See comment re (1) above.

1.13 Do consultees consider that there should be a cap on the amount for which children's lives may be insured? (13.85)

Agree: X Disagree: Other:

Comment: If the categories of natural affection are extended to include children the value of the policy should be capped at an amount calculated to cover funeral expenses. This could be set at a suitable figure with provision for the amount to be indexed or changed by SI.

1.14 If the amount is capped we welcome views on what the amount should be and on how it should be set. (13.86)

Agree: Disagree: Other: X

Comment: See above.

COHABITANTS

1.15 Do consultees agree that a person should have an insurable interest in the life of another, irrespective of whether they can show economic loss, where they have lived in the same household as spouses (husband, wife or civil partner) during the whole of the period of five years ending immediately before the contract of life insurance is taken out? (13.103)

Agree: X Disagree: Other:

Comment: Although the five year period is in some ways arbitrary, for the purposes of extending the category of natural affection and therefore allowing cohabitants to take out life insurance on one another in a straight forward manner this proposal seems appropriate and has the benefits of practicality.

TRUSTEES OF PENSION OR GROUP SCHEMES

1.16 Should the statute clarify that trustees of pension and other group schemes have an unlimited insurable interest in the lives of the members of the scheme? (13.106)

Agree: X Disagree: Other:

1.17 Should an employer also have an unlimited interest in the lives of its employees when entering into a group scheme whose purpose is to provide benefits for its employees or their families? (13.107)

Agree: X Disagree: Other:

Repealing section 2 of the Life Assurance Act 1774

1.18 Do consultees agree that section 2 of the Life Assurance Act 1774 should be repealed? (13.110)

Agree: X Disagree: Other: Comment: If a new statutory requirement for insurable interest in the case of life insurance is introduced it seems to us that the whole of the Life Assurance Act should be repealed, not just section 2.

A new statutory requirement for insurable interest

1.19 Do consultees agree that:

(1) a new statutory requirement for insurable interest should replace that set out in the Life Assurance Act 1774?

Agree: X Disagree: Other:

Comment: This is necessary to set out the new rules on:

(i) extending the category of natural affection to cohabitants; and

(ii) allowing insurance on the life of another where there is a probability of economic benefit/ loss; and

(iii) the valuation requirements for policies falling within (ii).

(2) if insurable interest is not present, the contract would be void but not illegal?

Agree: X Disagree: Other:

(3) for composite policies, where insurable interest was present for some part of the insurance but not others, the policy should be treated as separable?

Agree: X Disagree: Other:

(4) for contingency insurance, insurable interest must be present at the time of the contract? (13.115)

Agree: X Disagree: Other:

Comment: We assume that the status quo will be preserved where there is no further need to show insurable interest at the time of the claim.

1.20 Should the statute provide a non-exhaustive definition of insurable interest in contingency insurance? (13.116)

Agree: X Disagree: Other: Comment: This is necessary to set out the new rules on: (i) extending the category of natural affection to cohabitants; and (ii) allowing insurance on the life of another where there is a probability of economic loss; and (iii) the valuation requirements for policies falling within (ii).

POLICIES AND PREMIUMS IN MARINE INSURANCE

The need for a marine policy: proposals for reform

1.1 Do consultees agree that:

(1) a marine insurance contract may be enforced even if it is not embodied in a formal policy document?

Agree: Disagree: Other: Comment: Market practice is no longer aligned with section 22 and related

provisions of the 1906 Act. We agree that this is a damaging state of affairs.

N.B. In this and other responses in this paper, the words "Agreed" or "We agree" mean that we also accept the Law Commissions' reasoning unless otherwise stated.

(2) the statute should not require a marine insurance contract to be in any particular form? (17.3)

Agree: Disagree: Other:

Comment: We agree that there should be no formal requirements imposed on marine insurance contracts by legislation.

Repeals

1.2 Do consultees agree that the following sections of the Marine Insurance Act 1906 should be repealed:

(3) Section 22? (17.7)

Agree: Disagree: Other:

Comment: It follows from the above that we agree that section 22 and the four related provisions should be repealed.

(4) Section 23? (17.11)

Agree: Disagree: Other:

Comment: Agreed: please see above.

(5) Section 24(1)? (17.14)

Agree: Disagree: Other:

Comment: Agreed: please see above.

(6) Section 89? (17.17)

Agree: Disagree: Other:

Comment: Agreed: please see above.

(7) The model policy referred to in section 30 and contained in the First Schedule? (17.20)

Agree: Disagree: Other:

Comment: Agreed: please see above.

(8) Section 52? (17.23)

Agree: Disagree: Other:

Comment: Agreed, providing that it is understood that "policy" in section 52 is used to mean a specific document.

Reforms

Where policy means contract

1.3 Do consultees agree that most references to policies in the 1906 Act should be interpreted as references to marine insurance contracts? (17.26)

Agree: Disagree: Other:

Comment: We agree.

Section 2(2): activities analogous to a marine adventure

1.4 Do consultees agree that where an insurance contract covers shipbuilding, a ship launch or “any adventure analogous to a marine adventure”, the parties may include an express term to designate the insurance as marine insurance for the purposes of the 1906 Act? This would apply the provisions of the Act “in so far as applicable”. (17.32)

Agree: Disagree: Other:

Comment: We agree, though we wonder whether the reduction in the body of marine insurance contract law will shortly remove any purpose in such a provision.

1.5 Alternatively, should section 2(2) be repealed, leaving the parties free to apply any specific provision of the Act to the policy? (17.33)

Agree: Disagree: Other: Comment: Please see the response to the last question. At some point, the removal of so many provisions of marine insurance contract law leaves the remainder anachronistic and scarcely viable, and the repeal becomes logical.

Section 21: when contract concluded

1.6 Do consultees agree that the following words should be removed from section 21?

> whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract. (17.36)

Agree: Disagree: Other: Comment: We agree.

Section 50(3): assigning a policy

1.7 Should section 50(3) be amended to say that a marine insurance contract may be assigned in any customary manner or as agreed between the parties to the transfer? (17.39)

Agree: Disagree: Other: Comment: We agree.

1.8Are there any other issues or related matters which we should take account of in relation to our proposal to amend section 50(3)? (17.40)

Agree: ☐ Disagree: ☐ Other: ☐ Comment: It is important to foresee that changing methods of communication may render even electronic commerce obsolete in the lifetime of the new Act. The introduction of "or as agreed between the parties" at least reduces the likelihood of obsolescence.

The broker's liability for premium

The policyholder should be liable to the insurer for premiums

1.9 Do consultees agree that where marine insurance is effected on behalf of an insured by a broker:

(1) the policyholder should be liable to pay the insurer?

Agree:	Disagree:	Other:

Comment: We agree that the primary obligation to pay the premium to the insurer should remain with the policyholder, with any right on the part of the insurer to recover premium from the broker being a matter of private contract.

(2) when the broker collects the premium, policyholders should pay the broker as an agent?

Agree:	Disagree:	Other:

Comment: The proposition does not state for whom the broker is an agent. However, the starting point in agency law is that the broker is the agent of the insured, and it is logical that this should apply to the collection of premium.

(3) as a general rule, the broker should hold the premium as agent for the policyholder, but this should be subject to a contract between broker and insurer?

Agree:	Disagree:	Other:

Comment: Please see above. We agree that the capacity in which the broker holds the premium should be subject to variation by contract between the broker and the insurer but, if so, the consent of the policyholder should first be obtained.

(4) the broker's liability to pay premiums to the insurer should be a matter of agreement between broker and insurer? (19.22)

Agree:	Disagree:	Other:

Comment: We agree.

A default rule that marine brokers are responsible for premiums?

1.10 Do consultees agree that where a marine insurance contract is effected on behalf of a policyholder by a broker:

(1) the default rule should be that the broker is jointly and severally liable with the insured to pay the premium to the insurer?

Agree:	Disagree:	Other:

Comment: We agree that arguments for and against any default rule which renders marine brokers liable for the premium are finely balanced. We consider that broker liability should be secondary to policyholder liability in any event, but on balance regard it any liability of the broker as more appropriately a matter of private contract between insurer and broker. We do not regard it as necessarily for the good of society that the uncreditworthy of the 21st century should receive insurance on the back of their brokers.

(2) the broker and insurer should be able to contract out of this provision?

Agree:	Disagree:	Other:

Comment: Should there be any statutory presumption, then there should be freedom for the insurer and the broker to contract out of the provision.

(3) the default rule should apply equally to initial and adjusted premiums?

Agree:	Disagree:	Other:

Comment: We agree.

(4) the default rule should apply whenever the broker/insurer relationship is governed by English or Scots law, irrespective of the law under which the insurance contract is written? (19.31)

Agree:	Disagree:	Other:

Comment: We agree.

The Broker's lien and other provisions

1.11 Do consultees agree that section 53(2) should be repealed and replaced by a new provision which applies to both marine and non-marine insurance? (20.31)

Agree: Disagree: Other: Comment: We agree, and accept that the present statutory lien cannot be justified unless the broker has a primary liability to pay the premium.

1.12 Do consultees agree that the statute should provide that where the broker is obliged to pay any premium to the insurer and has done so:

(1) the broker should be entitled to exercise the insurer's rights to recover the debt from the policyholder?

Agree: Disagree: Other: Comment: We agree.

(2) the broker should have a statutory right to set off any premium or commission against the proceeds arising from that policy?

Agree: Disagree: Other: Comment: We agree.

(3) where no third party interests are involved, the broker should have a general right to set off any debt owed to it by the insured against any money held by the broker on behalf of the insured? (20.32)

Agree:	Disagree:	Other:
Comment: We agree.		

1.13 We welcome views on how third party interests should be defined. (20.33)

Agree:	Disagree:	Other:
Comment: We foresee that an investigation of this subject will lead to the conclusion that only the widest possible definition will work, i e that any action by the broker must not affect the rights of any third party, since otherwise the dividing line will be too complicated to express in any way that will assure a fair balancing of the respective rights and interests.		

Section 54

1.14 Do consultees agree that section 54 should be repealed? (20.39)

Agree:	Disagree:	Other:
Comment: We agree.		

Assessing the impact of reform

Policies and premiums in marine insurance

1.15 We welcome comments on the costs and benefits of our proposals on policies and premiums in marine insurance. (21.51)

We are not in possession of the necessary information to be able to offer detailed comment, but we do not expect any great increase in the cost or reduction in the benefits of marine insurance to result from these proposals – and certainly not by comparison with Solvency II and FSA regulation.

Transitional costs

1.16 What are the likely transitional costs of our proposals on policies and premiums in marine insurance, in terms of training and familiarisation?

We are not in possession of the necessary information to be able to offer valid comment.

THE CITY OF LONDON LAW SOCIETY
INSURANCE LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Geoffrey Lord – Kennedys (Chair)

Michelle Bramley – Freshfields

Beth Dobson – Slaughter & May

Christopher Foster – Herbert Smith

Jonathan Goodliffe – Freshfields

Charles Gordon – DLA Piper

Catherine Hawkins – Berrymans Lace Mawer

Francis Mackie – EAPD

Ken McKenzie – DAC Beachcroft

Martin Mankabady – Meyer Brown

Michael Mendelowitz – Norton Rose

Terry O'Neill – Clifford Chance

Christian Wells – Hogan Lovells

David Wilkinson – Kennedys

Paul Wordley – Holman Fenwick & Willan

Stephen Lewis – Clyde & Co