CITY OF LONDON LAW SOCIETY

INSURANCE LAW COMMITTEE

Minutes of the meeting that took place at the office of Norton Rose Fulbright, 3 More London Riverside, London, SE1 2AQ on Thursday 10 April 2014 from 17:00 to 19:15.

Present:

Richard Spiller – Holman Fenwick Willan LLP ("**RS**") (Chair)
Francis Mackie – Edwards Wildman Palmer LLP ("**FM**")
Ken McKenzie – DAC Beachcroft LLP ("**KM**") *[present from approximately 17:30 after being delayed at another meeting]*
Michael Mendelowitz – Norton Rose Fulbright LLP ("**MM**")

In attendance:

David Hertzell – Law Commissioner for Commercial and Common Law, Law Commission ("**DH**")
Will Reddie – Holman Fenwick Willan LLP (Secretary)

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1. **Apologies for absence**

MM thanked DH and the Committee members for attending. He stated that unfortunately some members had had to drop out of the meeting at the last minute.

2. **Update on Insurance Contract Law draft Bill**

2.1 DH provided a brief update on the status of the draft Bill.

2.2 He stated that all of the comments that the Law Commission had received on the draft Bill had been sent to the Parliamentary draftsman. DH confirmed that a revised version of the Bill had been prepared but that it was not yet publicly available, and that a large number of the clauses in the 6 March draft of the Bill (which was available on the Law Commission's website) had been changed, although in many cases the changes were only minor.

2.3 DH explained that the Bill was targeted at the "mass mid-market" and that its provisions would be suitable for approximately 80% of transactions in the market. DH explained that parties would be free to contract out of its provisions and expected the market to do so for the other 20% of transactions in order to achieve the result that they wanted.

2.4 DH explained that the Law Commission would need to consult with the Scottish Law Commission prior to introducing the Bill into Parliament. DH expected to do this in May once the Bill was in near-final form. The Law Commission would then publish a final report on the Bill in June.

2.5 After the final report had been published and the Bill had been sent to the Treasury, the Bill would go through the Treasury's internal process before being introduced to the House of Lords. At this point, the Bill would become subject to the political process and, in principle, anyone would be able to comment on it.

2.6 DH explained that the Bill would also need to be reviewed by the Government's Regulatory Policy Committee, a process which he expected to take approximately six weeks. DH hoped to start this process during the summer but said that it would depend on when the Treasury introduced the Bill. DH also explained that the Law Commission would be required to prepare a briefing on the Bill for the House of Lords, and that the House of Lords may call witnesses to discuss the Bill.

2.7 DH noted that one of the consequences of Maria Miller's resignation was that the Minister who had previously been responsible for the draft Bill (Sajid Javid, the Financial Secretary to the Treasury) had taken on her position. DH explained that it was not yet clear whether the new Financial Secretary to the Treasury would view the draft Bill as a priority. DH considered that, if the new incumbent did not have the same degree of interest as Mr Javid, it could be difficult to get the Bill introduced into Parliament before the autumn, which DH considered to be the cut-off for ensuring that the Bill was passed before the general election in May 2015. DH believed that the civil service was over-worked but generally sympathetic towards the Bill, and that the House of Lords expected to have capacity to review the Bill.

2.8 DH considered that, if the Bill was enacted as an Act of Parliament before the general election, it would be at least 12 months before it came into force, i.e. Spring 2016.

2.9 RS asked what would happen if the Bill did not make it through Parliament before the general election. DH explained that there would be a window to introduce it just after the election.

2.10 RS also asked what would happen to the areas of the Law Commission's proposals that had not been included in the Bill, such as a reform of section 53 of the Marine Insurance Act 1906 (the "**MIA**"). DH stated that the proposals could be included in a future Bill.

2.11 DH also noted that the Third Parties (Rights against Insurers) Act 2010 had not yet been brought into force due to an omission regarding the definition of insolvency events. DH explained that this issue needed to be resolved by an Act of Parliament, so a provision could be added to the Bill to deal with this.

3. **Comments on warranties clauses (clauses 8 to 10)**

3.1 DH explained that the purpose of the Bill was to explain how warranties were to be applied and their effect. DH confirmed that the definition of "warranty" would remain in the MIA, as would the requirement for strict compliance with warranties. DH stated that the warranties clauses were aimed at achieving two things: (i) avoiding the insurer's liability being discharged where the insured committed a minor infraction, and (ii) outlawing basis clauses.

3.2 The consequences of an insurer's liability under a contract being suspended were discussed. It was agreed that the insurer's liability in respect of the entire contract should not be discharged but the insured would not be able to make a claim in respect of any loss suffered during the period in which the policy was suspended.

3.3 MM gave the example of marine policies containing war zone exclusions, which may have carve-outs permitting a vessel to enter a war zone if the insurer was notified and relevant terms were agreed in advance. MM asked whether, if a vessel entered and left a war zone without the insurer's knowledge but suffered no loss, the insurer would be entitled to additional premium after the event. DH explained that the parties would have to provide specifically for this in their contracts, as the provisions of the Bill would not by themselves give rise to this consequence.

Clause 8

3.4 MM queried why the word "*any*" [in "*...by means of any provision of...*"] had been included in clause 8(2), as properly chosen words in a contract would be able to turn a representation into a warranty. DH confirmed that this issue was still being discussed.

3.5 FM asked whether the purpose of clause 8(2) was to prohibit implied warranties. He asked whether, if an insured provided an insurer with affirmative information saying that it did not do something, this could be found to be a warranty. DH considered that it would be acceptable for this to be found to be a warranty and that the aim of clause 8(2) was to prohibit broad basis clauses.

3.6 RS considered that clause 8(2) should refer to "*... or of any other contract or document (and whether by declaring...*" as basis clauses were often seen in the proposal (which was not a contract).

3.7 FM considered that the wording "*converted into*" in clause 8(2) should be replaced with "*construed or interpreted as*", as "*converted*" was a word used when speaking and not the language that would usually be found in a statute.

Clause 9

3.8 FM queried what the words "*but before the breach has been remedied*" in clause 9(2) would involve in practice. DH explained that it would depend on the situation and what remedial action the insurer had asked the insured to take. FM gave an example of where a breach of warranty had existed for all but the final three days of the policy period. If there was a loss, he wondered if it would be necessary to look at whether the loss arose in the period during which the breach of warranty continued, and with only three days or so to remedy it. If so, the insurer should not be liable for the loss.

3.9 RS wondered whether the reference to "*any subsequent law*" in clause 9(3)(b) should be a reference to "*any subsequent legislation*". DH explained that the wording was taken from the MIA and that Parliamentary draftsmen would generally wish to be consistent with previous Acts in order to avoid suggesting that a different meaning was intended.

3.10 MM considered that clause 9(6) should be amended to read "*...at a later time, but before a loss attributable to the breach has occurred, the risk to which...*".

3.11 DH explained that the wording "*essentially the same*" had been used in clause 9(6) because the risk was unlikely to become exactly the same. He explained that "*materially the same*" had not been used because "*material*" would carry the particular meaning given to it by case law. RS considered that this might actually be preferable, given the flexible interpretation of case law in the context.

3.12 The use of "*contemplated*" in clause 9(6) was discussed. RS and MM agreed that "*contemplated*" was correct in this context.

3.13 FM asked about premium payment warranties, under which an insurer's liability would not commence until the warranty was complied with (i.e. premium paid). FM therefore wondered whether an insurer would not be on risk at all until the warranty was complied with, or whether its liability would just be suspended, as at the date of breach. DH considered that it would be the former, but agreed that premium payment warranties raised an interesting drafting question. RS asked whether late payment of premium could have retrospective effect, i.e. if an insured was given credit until the end of quarter one, and then paid six months' worth of premium at the end of quarter

two, would this be allocated to quarters two and three and, if so, did the insured still owe the premium for quarter four? FM answered in the affirmative. DH also considered that late payment of premium could not "resurrect" the insurer's liability in respect of a period during which it had been suspended, so the insurer would not be liable for losses suffered during quarter two in RS's example. However, he was unsure whether the quarter two premium could be reclaimed by the insured, and said that he had seen clauses both permitting and preventing this.

3.14 DH noted that breach of a warranty in a consumer contract was not dealt with in the Consumer Insurance (Disclosure and Representations) Act 2012 (the "**Consumer Insurance Act**"), so would be covered by the Bill.

Clause 10

3.15 DH explained the purpose of clause 10 of the Bill. He explained that, under the current law, an insurer would have no liability where a warranty in respect of one circumstance was breached and the insured suffered a loss, albeit from an unrelated event. The Committee considered the example of an insurer avoiding liability for damage to an insured's factory caused by a lightning strike where the insured had breached a warranty prohibiting it from carrying out hot works in the factory.

3.16 DH said that clause 10 was based on a concept of New York law. The purpose was to look at what, from the underwriter's perspective, the warranty aimed to mitigate, and whether the loss came within that scope. He considered that it was the most complicated part of the Law Commission's proposals regarding warranties.

3.17 MM considered that clause 10 was well-drafted as it used simple language. He considered that the courts should be left to decide what was "*loss of a different kind*" and "*loss at a different location or time*". KM asked whether New York law had provided any guidance on these points. DH said that the concepts did not seem to have been tested very often, and that they did not seem to be particularly contentious.

3.18 MM asked whether insurance bodies or consumer bodies had pushed back on clause 10. DH said that there had been a big debate over causation, which he considered was understandable.

3.19 MM suggested that clause 10 as drafted would apply only to warranties and would not affect exclusions. MM considered that warranties were terms which "*would tend to reduce the risk of*" something (as stated in clause 10(1)), whereas exclusions were not: they were more clearly aimed at excluding liability. RS also noted that clause 10(1) required "*compliance with*" such a term, and that it could not be said that a party "complied with" an exclusion. Based on this discussion, FM considered that the only improvement needed to clause 10 was to clarify the scope of its application.

4. Comments on clauses regarding insurers' remedies for fraudulent claims (clauses 11 and 12)

4.1 MM queried the aim of clause 11(2). DH stated that it had now been removed from the Bill.

4.2 DH confirmed that the Bill would not contain a definition of "fraud". MM noted that the judgment in a case that was currently before the Court of Appeal *(Versloot Dredging BV v HDI-Gerling Industrie Versicherung AG (The "DC Merwestone")* [2013] EWHC 1666 (Comm), [2013] 2 Lloyd's Rep 131) might provide some guidance on the meaning and effect of "fraudulent devices".

5. **Comments on contracting out clauses (clauses 15 to 17)**

Clause 16

5.1 FM explained that clause 16 contained a general prohibition on an insurer watering down provisions of the Bill but that, under clause 17, this seemed to be permissible if it was made very obvious to the insured.

5.2 MM asked what the wording "*or of any other contract*" in clause 16(1) meant. DH explained that this meant a contract sitting alongside/related to the contract of insurance. MM did not consider that this was clear from the wording of clause 16(1). FM recommended amending this to read "*or of any ancillary or associated contract*".

5.3 RS stated that clause 16(3)(b) prohibited an insurer from excluding liability for deliberate or reckless breaches of its obligation to pay claims within a reasonable time [*this obligation was contained in clause 12(1) in the draft clauses that were published in January but had subsequently been renumbered*]. RS wondered what would happen if, instead of trying to include in the contract a term which excluded this liability, an insurer deliberately chose to challenge a claim and was in breach of its obligation to pay within a reasonable time because the claim had a "smell" and the insurer wanted to see what would emerge as a result of rejection of the claim.

5.4 MM commented that an insurer could of course delay paying a claim because it thought it was suspicious, but would always be doing so at the risk of being found not to have paid within a reasonable time. He explained that insurers sometimes delayed paying claims in these circumstances but gave other reasons for doing so, such as that the insured had no insurable interest, or that there had been a material non-disclosure, because it was so hard to prove fraud. MM noted that a "*reasonable time*" to pay the claim should allow an insurer time to investigate a claim if it seemed suspicious, although he considered that lawyers would need to advise their clients that rejecting or investigating a claim meant that the client was running the risk of being found to have failed to pay the claim within a reasonable time.

Clause 17

5.5 The reference to "*sufficient steps*" in clause 17(2) was discussed. It was agreed that what constituted "*sufficient steps*" would depend on the type of insured. For example, the steps that would be necessary to draw a term to a small business insured's attention would be more extensive than those necessary to draw it to the attention of a sophisticated commercial purchaser of insurance.

5.6 RS noted that the transparency requirements in clause 17(5) referred to "*actual knowledge*". He wondered whether a reasonableness test or a reference to "*imputed knowledge*" should have been used instead. This led to a discussion of clauses 3 and 5 of the Bill that had been published in January. RS stated that clause 5(3) provided for imputed knowledge and clause 5(4) referred to what a proposer "*ought to know*". RS considered that insurers should be entitled to take a reasonable view of what should be known by the insured. MM suggested that, once the concept and definition of "knowledge" had been finalised, the definition could be placed in a separate part of the Bill so that all of the clauses of the Bill that referred to knowledge could refer to the same definitions.

6. **Case law of the Financial Ombudsman Service (the "FOS")**

6.1 MM asked about the difference between the approach that the courts and the FOS took to insurance law cases. He gave the example of a case reported in *Ombudsman News* regarding a potential breach of warranty where the FOS had held that, even if the warranty had been observed, the insured would still have suffered a loss, so the insurer should pay in respect of this loss. The warranty related to the type of lock that had to be fitted to a door giving access to business premises; the loss arose from a break-in where the intruder had kicked through a panel in the door, so the deficiency in the lock was irrelevant. MM stated that this appeared to be different to the position under common law and indeed the Law Commissions' proposals [see paragraph 3.15] because the warranty was intended to reduce the risk of break-in and so the breach would result in loss of cover for the insured.

6.2 MM also noted that decisions of the FOS did not always seem to be consistent, although he acknowledged that this was based on the write-up of cases contained in the *Ombudsman News* and that, if the full facts had been available, it may have been clear that there were rational reasons for the apparently inconsistent decisions.

6.3 DH agreed, and explained that, in his experience, the FOS would not always apply the provisions of the MIA, particularly if the insured was a small business. DH also explained that the FOS had in some instances used the Consumer Insurance Act as a basis for decisions regarding business insureds. He considered that this was difficult to understand, as the Consumer Insurance Act had not been designed for disputes involving business insureds.

6.4 MM considered that this could lead to some confusion over whether the jurisprudence of the courts and the FOS were different. DH agreed, and considered that the FOS might make its own jurisprudence. MM believed that cases involving consumer policies would still come before the courts, as the value of some policies exceeded the limit of the FOS's jurisdiction.

7. **Other topics**

7.1 MM asked whether future legislation would be desirable to consolidate the MIA, the Consumer Insurance Act and the Bill (assuming that it was enacted). DH said that the Law Commission had considered this but that any consolidating legislation could be quite messy and was unlikely to happen anytime soon.

7.2 RS briefly reported on the attempts he had made to broker agreement between the IUA, the LMA and LIIBA on a reform of section 53 of the MIA. He reported that the attempts had ultimately proved unsuccessful, although he thought that given less time pressure, all of the associations would have accepted the compromise proposal in the Law Commission's Consultation Paper of December 2011.

8. **Close**

The Committee members thanked DH for attending, and thanked MM for hosting, the meeting.