The Insurance Bill [HL] was committed to a Special Public Bill Committee on 30 July 2014. The members of the Committee were appointed on 19 November 2014 (although Lord Sherbourne of Didsbury and Lord Tomlinson were appointed later). This Bill arises from the joint report of the Law Commission and the Scottish Law Commission entitled “Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment” (Law Com No 353 / Scot Law Com No 238).

Membership
Lord Ashton of Hyde
Lord Carrington of Fulham
Lord Davidson of Glen Clova
Baroness Goudie
Lord Lea of Crondall
Lord McNally
Lord Newby
Baroness Noakes
Lord Sherbourne of Didsbury
Lord Tomlinson
Lord Woolf (Chairman)

Registered Interests
Committee Members’ registered interests may be examined in the online Register of Lords’ Interests at www.publications.parliament.uk/pa/ld/ldreg.htm. Interests related to this Report can be found in the Appendix.

Publications
The report and proceedings of the Committee are published by The Stationery Office by Order of the House of Lords. All publications of the Committee are on the internet at www.parliament.uk

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Aon UK Limited

Aviva

BLM

Catlin Underwriting Agencies Ltd and Catlin Insurance Company (UK) Ltd

The City of London Law Society
**Oral Evidence**

**TAKEN BEFORE THE SPECIAL PUBLIC BILL COMMITTEE**

**TUESDAY 2 DECEMBER 2014**

**Present**
- Lord Woolf (Chairman)
- Lord Lea of Crondall
- Lord Ashton of Hyde
- Lord McNally
- Lord Carrington of Fulham
- Baroness Noakes
- Baroness Goudie

**Examination of Witnesses:**

DAVID HERTZELL, LAW COMMISSION, LORD NEWBY, and PROFESSOR HECTOR MACQUEEN, Scottish Law Commission

Q1 The Chairman: Good morning and welcome, particularly to our witnesses. We are grateful to them for coming and for assisting us. The first witness that we shall hear from is Lord Newby, who is also of course a Member of the Committee. That is an inevitable part of this procedure. First, the members of the Committee will declare any interests that it is right to disclose. Perhaps we can start with Baroness Noakes.

Baroness Noakes: Thank you Chairman. I would like to declare my interests as declared in the register of interests, making particular reference to shareholdings in Prudential and in Legal & General. Also, in consequence of my past and present directorships of listed companies, I am a beneficiary of D&O insurance policies from other companies.

Lord Ashton of Hyde: I draw attention to my entry in the register in respect of my ownership of Marsh shares. I will also benefit from a pension from Marsh, in nine years' time I hope. Technically, I do not think this has to be disclosed but in a former life, just for information, I was the chief executive of a Lloyd’s agency and reinsurance company, a member of the Council of Lloyd’s and a non-executive director of a Lloyd’s agency.

The Chairman: I have no direct interests that I should declare, as far as I am aware. I turn to those on my left.

Lord McNally: I have no interests.

Baroness Goudie: No interests.

The Chairman: Good. We can go straight on to questions. Lord Newby, would you like to make an opening statement?

Lord Newby: I would like to make a short opening statement. Members of the Committee will be pleased to know that I do not intend to repeat the speech that I made at Second Reading going through all the provisions in the Bill, but I thought Members might find it useful if I outlined the high-level reforms that the Bill contains. It is a short, principles-based Bill. It is modest but important, and clarifies and modernises the law governing a sector that is key to the UK’s financial strength.

The policy underlining the Bill has been the subject of extensive consultation by the Law Commission, and the Government also consulted on the text. The reforms are supported by a wide cross-section of the insurance market, including insurers, brokers, insurance buyers and lawyers. It considers two different topics: the law of insurance contracts, which forms the core of the Bill, and some provisions allowing the Third Parties (Rights against Insurers) Act 2010 to be brought into force.

The current law in this area is set out in the Marine Insurance Act 1906. Given that the Act is over 100 years-old, it is hardly surprising that it is rather outdated. Its main fault, from the modern perspective, is that it gives insurers many opportunities to refuse liability for claims, even when that seems completely out of proportion to any wrong done by the policyholder. This leads to many disputes and can mean that insurance fails to respond as expected, or at all. This, of course, can significantly hinder UK business. The principles underlying the existing law reflect a bygone era when underwriters were individuals who knew very little about the marine activities undertaken by their prospective policyholders and communications were poor. Other jurisdictions that in the past took their lead from the UK and the 1906 Act have long recognised that it no longer reflects modern realities. Countries such as the US, Australia, Hong Kong and Japan have already introduced reforms.

UK law is, as a result, out of step with modern commercial practices in the bulk of the insurance market worldwide. The Bill seeks to replace the most outdated of the existing rules with a more appropriate default regime—in an evolutionary rather than revolutionary way—and to reflect the best practice of modern insurers in the market. For example, in respect of the existing duty on prospective policyholders to disclose risk information to the insurer before the contract is agreed, the Bill updates and replaces the current law by obliging policyholders to make a fair presentation of their risk. It retains the duty to search for and disclose information about the risk,
but provides businesses with further clarity as to what amounts to a fair presentation. That includes new rules about whose knowledge is relevant in a big company, reflecting the complexities of today’s corporates. There is also a new obligation on prospective policyholders to gather necessary information about the risk from all parts of the business, and from outside agents such as brokers, and to ensure that this information is presented in a clear manner. The insurer has a new duty as well in that it now has to ask for more information if the information it does receive suggests that further investigation is needed.

The new rules envisage a two-way dialogue between the parties at the inception of contracts, mitigating the risk of passive underwriting. If the policyholder ultimately fails to make a fair presentation, the insurers will no longer have an automatic right in every case to refuse all claims as if the contract had never existed. Instead the new remedies aim to put the insurer in the situation it would have been in had it received a fair presentation. However, the Bill retains strong remedies for insurers where a policyholder has deliberately withheld relevant information or has made a claim tainted by fraud.

The Bill also updates the law on warranties—terms of insurance contracts, which, if broken, currently discharge the insurer’s obligation to pay any claims arising from the point of breach. It is still the case under the Bill that the insurer need not pay claims that arise while the policyholder is in breach of the warranty, but the Bill restores cover if the policyholder remedies its breach before a loss occurs.

In summary, the Bill updates the legislation. It is long overdue. The way in which the markets operate has changed very considerably since 1906 and it is important that we now ensure that the law reflects that. You are going to ask me some questions on specifics, which I will come to in a moment, but I suggest that I ask David Hertzell, who has been working on this for a long time, to explain a bit more of the background.

**The Chairman:** If that is the case, perhaps you could indicate when you give any response that you would rather leave it to one of the Commissioners. **Lord Newby:** I am happy to deal with the questions, but I do not know whether you would like to hear from Mr Hertzell now or ask me my questions now. **The Chairman:** I am really in the hands of you, the witnesses, as a trio. Do you think it would be more helpful to make your opening statements now? **David Hertzell:** It might be helpful just to cover some of the background initially so that we are all on the same page, as it were. **The Chairman:** If you would be kind enough, Mr Hertzell, please give your opening statement now.
a central point of agreement. Given the range of people we have spoken to, it is inevitable that there are different opinions, and that is exactly as you would expect to find. In effect, we held a mirror up to the entire insurance market and reflected back what they said to us in the draft that is before the Committee. Where we were unable to achieve a strong consensus on what should be done, we have not included those points in the draft Bill.

We found initially that the discrepancies between the law, the FCA regulation—the FSA as it was then—the Financial Ombudsman Service and guidance from bodies such as the ABI and other industry bodies were most acute in the consumer area. We took forward, using the same procedure that we are using today, the Consumer Insurance (Disclosure and Representations) Act 2012. We dealt with consumers first and now we are looking at both consumers and business insureds in this particular Bill. It is fair to say that although the concerns were most acute for consumers, there were also strong concerns in the business market—96% of members of the UK Risk Management Association (AIRMIC) expressed concerns about the way insurance law was working for them and requested some form of reform to be considered. AIRMIC is among a group of people who devote an awful lot of time and resource to their insurance programmes and have a lot of ability to handle that—the more sophisticated end of the market.

However, although our consultees were extremely generous with their time and advice to us, they presented us with a problem when it comes to business insurance as such. Consultees recommended that we separate consumers from business, and we did. Consultees were also clear that they wanted a single business regime: that is, a business regime that has to cover a microbusinessman insuring his van to a global reinsurance programme at the other end of the spectrum.

It is absolutely impossible these days, and probably always was, to draft law that can cover both ends of this huge spectrum of different types of business. We have drafted something that we think fits the vast majority of businesses that sit within the middle of the bell curve. At the more sophisticated end, we expect businesses to take care of themselves, as they do now with their individual contracts, and at the less sophisticated end we have the Financial Ombudsman Service. This legislation is intended to be focused on the mainstream commercial marketplace. We expect the people who operate outside that marketplace to contract on different terms, as they do now. It is a default regime that essentially seeks to achieve as neutral an outcome as possible for its various participants.

The Law Commission, as I said, has no agenda in coming to this. We reflect back whatever our consultees have said, but it is true to say that we seek to support UK plc. We think that insurance is an important industry for the UK and we are trying to produce something that assists that industry. It is always a concern when you see practices in the UK being criticised from elsewhere, Commercial Risk Europe magazine published the following quote from a risk manager at a recent meeting of European risk managers. This person is a risk manager of a global company operating in 28 countries and employing 9,000 people. He said of insurance generally, bearing in mind that his purchasing programmes are all around the world: “I agree that most claims are paid on time. The London market is a different story. Claims can be harder to deal with in London as you come up against 20 lawyers … The system is not working and a lot of European companies will not go to London any more because if there is a claim you are in deep trouble”. That is very disturbing to read. It may be just one person’s view, but it would be dangerous if that became common currency.

The final point I would like to make about the Bill as we see it is that, like the Marine Insurance Act, it is drafted in terms of principles rather than specific rules. That allows the law to develop and keep pace with technical changes. As we know at the moment, social and technical change is very rapid. Some consultees have expressed concerns that that leads to uncertainty. However, where it is appropriate, we have sought to include as much as we can phrases and terms from the existing law. That includes some rather old-fashioned language that would probably not be used if this were drafted as a new piece of legislation independently. We have kept terms such as “prudent underwriter” and “material circumstances”. Where language or principles are tried and tested and still relevant, we have preserved them and the legal precedents that seek to attach to them.

The Chairman: Presumably that helps to achieve certainty.
David Hertzell: Absolutely.

The Chairman: But at the same time leaving the possibility of the law to develop as circumstances change.

David Hertzell: Exactly right. That is the law reform dilemma. You can either draft something that is absolutely precise and tight but which you know will be obsolete in a few years’ time or, as they did in 1906, draft something that is principles-based and allow the courts to develop it underneath to keep pace as far as you can with social change. If it will be helpful I could run through some of the key clauses, or you may wish to deal with that in the questions.
The Chairman: Perhaps it would be better if we dealt with that in the second way.
David Hertzell: Yes, I want to make one final point here because I should make it clear. This Bill also covers consumers in some areas as well as businesses and we need to remember that. It allows the Third Parties (Rights Against Insurers) Act from 2010 to be implemented.
The Chairman: I wonder if Professor Hector MacQueen would like to add anything.
Professor Hector MacQueen: Very briefly, Lord Chairman, because this has been a joint project between the Law Commission of England and Wales and the Scottish Law Commission. The heavy lifting has undoubtedly been done by my colleagues in London. The job that the Scottish Commission has in the area of law described as UK law is to ensure that as far as possible the end product is compatible with other Scottish law such as contract law, property law and so forth, which are different from the law of England and Wales. We are satisfied that that is the case. The other thing that we do at the Scottish end is to be a critical friend or a friendly critic and try to test some of the ideas that our friends in London come up with, partly as a result of their conversations with the stakeholders and so forth. The point I would make at the outset is that the Scottish Law Commission is very happy with this Bill. There are things that have been omitted from it that we would have preferred to see in it, but we will return to that question, I have no doubt, in due course. We strongly support the Bill and I understand that the Scottish Government are also more than content. This is not a devolved area, and I understand that the Scottish Government are satisfied that that is the case. The other thing that comes at the Scottish end is that we and the Law Commission think is required.

Q2 The Chairman: Thank you very much. Unless Members have any questions of the commissioners at this stage, and we will have an opportunity later, I will turn my questions to Lord Newby on behalf of the Committee. We deal first of all with an omission from the Bill. There are things that have been omitted from it that we would have preferred to see in it, but we will return to that question, I have no doubt, in due course. We strongly support the Bill and I understand that the Scottish Government are also more than content. This is not a devolved area, and it is useful to know that it would not cause any fluffing of feathers in Holyrood.

2 December 2014 David Hertzell, Lord Newby and Professor Hector MacQueen

constituted a reasonable time and some insurance firms anticipated disputes or litigation arising from the clause. There was a lack of the kind of consensus that we and the Law Commission think is required in order for a provision to go into this kind of Bill.

Baroness Noakes: Was that a new position?
Lord Newby: Yes.

Lord Lea of Crondall: Could Lord Newby tell us two things please in regard to this late payment issue? There may be an overwhelming view in industry X about some people who are in a minority, say Y. The Law Commission is strongly in favour of a clause on late payment, and he mentioned reputational issues for the wider market. First, does he understand that the Government would not move until everyone is on board? Is that what happens in every other industry, such as energy? Secondly, does he think that a clause on this would in some sense prejudice the future of the Bill, and why would that be?
Lord Newby: As I said, the Law Commission proceeds on consensus, but I do not think that means that in every single case every last person has to approve—this is not about unanimity. However, in this case there is a sufficient body of people who have objected to what is proposed for the Law Commission to take the view that, on any reasonable definition of consensus, it does not pass that test. Where you cross the line into prejudicing a Bill is a slightly imprecise area, but the advice that I have been given is that, given the degree of dispute about the appropriateness of this clause, it would not be suitable for such a Bill.

Lord McNally: Just to clarify, Mr Hertzell said that the Law Commission itself had been consulting since 2006. Professor MacQueen expressed some regret that there were omissions in the Bill. There is a little bit of a puzzle as to why the Law Commission and, I presume, the Scottish Law Commission both came to the conclusion that it was safe to put this in the Bill but that it somehow got lost in the government consultation. That is the puzzle.

David Hertzell: You cannot look at every consultee as equal. Some consultees with very large market presences expressed concerns here, and we have to factor in the size of the constituency that they represent. We think the law here is very hard to justify but we were concerned about this clause coming in. There are concerns about it, particularly from those involved in international business and about bad-faith-style litigation being imported from the US. Those are, frankly, legitimate concerns, even though they may not be domestic concerns as such. We are a little more relaxed about this, perhaps because we have undertaken some survey work ourselves on this. The FCA, too, has done some survey work on late payments and there is no evidence of any systemic late payment within the market. Of course individual admin errors occur, but there is no evidence of systemic late
payment. In making a decision about whether this was controversial or not, and weighing up all the evidence that we had, we felt that it was probably inappropriate for this Bill at this stage.

**Baroness Noakes:** Where is the source of disagreement? The evidence that we have had to date suggests broad agreement with a late payment clause.

**David Hertzell:** Yes, there is broad agreement from those insurers and others focused on the domestic market; there is not agreement from those who write more international business, particularly from the London insurance market.

**Baroness Noakes:** The Committee has basically only had evidence that such a clause would be favoured. We have not had any contrary evidence. I wonder whether the Government could enlighten us as to which particular sources of dissent they have placed particular reliance on.

**Lord Newby:** Lloyd’s has expressed concerns about this. We could no doubt let the Committee have evidence from Lloyd’s if it has not responded to this consultation.

**David Hertzell:** Absolutely. We will make sure we get that to you.

**The Chairman:** Just as a question of fact, Lloyd’s has of course responded in general, although I am told by the clerk that it has not dealt with the question of late payment in responses so far.

**Lord McNally:** I want to clarify something as well. The Committee is very interested in this Bill partly because it will update the law in an area where we are international competitors. It would be useful to know whether this clause would enhance and help our international competitiveness or would cause problems for it. You just referred to the dangers of American-style bad faith litigation. Something that the Committee would be very conscious of when considering this is how it will affect the international competitiveness of British insurance in what is increasingly a very competitive market.

**David Hertzell:** Absolutely. The change would have brought the law in England and Wales—it is only in England and Wales, and nowhere else, as it is different in Scotland—more into line with the overall marketplace. But one of the consequences of that, and I think Lloyd’s is going to give evidence of that at some point—

**The Chairman:** I am conscious that there is someone from Lloyd’s here, who is making his presence known. It is giving evidence tomorrow.

**David Hertzell:** Okay, so you will hear more perhaps about that then.

**The Chairman:** We will have an opportunity to hear then from Lloyd’s on the subject. Is there anything else that you can add? Lord Ashton.

**Lord Ashton of Hyde:** I just wondered whether, in case late payment does not end up being part of the Bill, it is subject to the regulatory regime.

**Lord Newby:** Yes, it is. I was just going to say that the FCA, as part of its overall responsibilities, looks very carefully at how insurance companies deal with late payments. If there are any suggestions that a company has a systematic problem with late payment, the FCA is down on it like a ton of bricks. To the extent that we are talking about consumers affected by late payment, they of course have recourse to the Financial Ombudsman Service.

**Baroness Noakes:** Is there any evidence that the FCA comes down on late payers like a ton of bricks?

**Lord Newby:** I have heard that the FCA has taken this area very seriously.

**Baroness Noakes:** Can the Government provide evidence of what the FCA actually does about late payers in the insurance market?

**David Hertzell:** There is certainly evidence, if it helps, of the way in which the ombudsman deals with it.

**Baroness Noakes:** I did not ask about the ombudsman, I asked about the FCA. The ombudsman deals only with a very small end of the market.

**The Chairman:** Lord Ashton, do you have a further question on that?

**Lord Ashton of Hyde:** No.

**Q3 The Chairman:** We will leave that subject now and continue. Lord Newby, the question about utmost good faith. The revised version of Section 17 of the Marine Insurance Act deletes the reference to remedies and becomes an interpretive provision. Do you have any views on what impact this might have? Might it give rise to uncertainty?

**Lord Newby:** I wonder if I could refer this. I am not sure that this was one of the questions I was expecting at this point.

**Baroness Goudie:** His face!

**Lord McNally:** That is the right answer.

**The Chairman:** We will leave this. Baroness Goudie, can we have your Question 3.

**Lord Newby:** It was the Law Commission.

**The Chairman:** Yes, I am sorry. It is my fault.

**Lord Newby:** No, no.

**The Chairman:** Baroness Goudie, can we have your Question 3.

**Q4 Baroness Goudie:** Lord Newby, what is your timescale for bringing the third-party insurance Act into force? When do you think we might see that?

**Lord Newby:** Two things have to happen. We have to bring the regulations through, which require an affirmative order. We envisage this will take place some time in the first half of next year. Then revisions or additions will need to be made to the rules of court. We are hoping that the Act will commence next October. That is the timescale to which the Ministry of Justice is currently working.

**Baroness Goudie:** It will bring it back up in 2015?

**Lord Newby:** Yes.
**Q5 The Chairman:** I will go back and deal with Question 2, Lord Newby. Do the Government intend to pursue the Law Commission’s November 2014 revision of the clause governing terms not relevant to the loss?

**Lord Newby:** The same arguments apply to this provision as to the first one. Again, there was not a consensus among stakeholders on this. Certainly, members of the Committee will have seen the evidence submitted by the QC who had a number of arguments as to why he thought this was inappropriate or very difficult. At the moment, the Law Commission does not feel that there is consensus. The Government support the principle here and hope that further work with the Law Commission might get us to a point where we could bring something forward in another legislative instrument.

**The Chairman:** In another instrument?

**Lord Newby:** Of course at that stage, if we did it via that route there would not need to be a consensus. The Government could form a balance-of-opinion view. It would not need the degree of consensus required for a Law Commission Bill.

**The Chairman:** Yes. In the light of the written evidence is there any intention to clarify the Bill so far as reinsurance is concerned?

**Lord Newby:** There is not, Lord Chairman, on the basis that there is no need. There cannot be any real view that reinsurance is not covered by the Bill as it currently stands. A contract of reinsurance is a contract of insurance at common law. Therefore we do not believe it is necessary to state it in the Bill.

**The Chairman:** Is that a view with which the Law Commission is happy?

**Lord Newby:** Yes.

**David Hertzell:** Yes.

**Q6 The Chairman:** Perhaps then I can move to questions directly to the Law Commissioners. I ask what I asked before with regard to the revised version of Section 17 of the Marine Insurance Act, which deletes the reference to remedies. Has it become an interpretive provision?

**David Hertzell:** Yes.

**The Chairman:** Would that give rise to uncertainty or have some other adverse impact?

**David Hertzell:** No. I think the reverse. Insurance contracts are ultimately contracts based on trust. This is a unique provision in English law that good faith is applied to such contracts and is generally not applied to other kinds of contracts. We think it is a good principle to sustain. It makes people act with a higher standard of behaviour than is perhaps normal. It was very strongly supported in consultation. An overwhelming majority of our consultees wanted to maintain the principle of utmost good faith, regardless of which part of the market they came from.

**The Chairman:** You think it should be expressly extended to non-marine insurance?

**David Hertzell:** We are advised by parliamentary counsel that it is not necessary to do that. The 1906 Act said that because it is about marine insurance, but as a general practice in application and in court, the same principle has been applied.

**The Chairman:** That is the way it has been approached?

**David Hertzell:** Yes.

**The Chairman:** There is a settled position with regard to that?

**David Hertzell:** Yes.

**Professor Hector MacQueen:** Could I comment from a Scottish perspective? I have put a comment on this in our written submission in paragraph 9. Good faith as a general interpretive position is consistent with the position that the Scottish courts hold on this subject. There is an underlying principle of good faith across the Scots law of contract that applies to insurance as it applies to other contracts. It just happens to have a stronger application in insurance than in many other areas. The suggested reform is precisely where the Scots common law of contract sits. There is congruence here and the attraction of it from my perspective is that it leaves the courts with a bit of room to continue to develop the law and make it responsive to change.

**The Chairman:** Wriggle room?

**Professor Hector MacQueen:** That is important, but I would not think it would be necessary very often with the other changes we are proposing to the law in this Bill.

**The Chairman:** Perhaps we may move on to fair presentation. Which of the commissioners would like to start and take the lead on this?

**Professor Hector MacQueen:** Over to you, David.

**Q7 The Chairman:** Dissatisfaction has been expressed in the written evidence with rules as they relate to the assured’s knowledge. Can you help me on the specific issues I will now turn to? Are you of the view that an assured is placed in a worse position than exists at the moment at common law and under the 1906 Act? If so, in what respects?

**David Hertzell:** It is probably not the right approach to start picking little bits out of here and asking whether the position has changed. This is a package of measures for both policyholders and insurers. There are advantages for policyholders—proportional remedies and warranties are being dealt with. We have clarified what the policyholder must do when they are making presentation of their risk. We think it appropriate that we should do so. Obligations are being placed on the policyholder here. They have to make a fair presentation. That is the least the insurer can expect. As part of that they cannot do “data dumping” where they take a massive collection of stuff and put it on a CD, or however it is transmitted, and throw it at the
insurer and say, “Sort that out”. On any basis, that cannot be a fair presentation without signposting and various other things to make it clear what you are trying to say.

We have also put an obligation on them to carry out a reasonable search. It seems utterly appropriate to us that they should make the effort when seeking to purchase insurance to at least carry out a reasonable search of their organisation to find the material that needs to be provided to the insurer so that the insurer can accurately assess the risk. Underneath a lot of what we propose in the Bill is a push to increase professionalism in the market on all sides. In this case it is the policyholder. Survey evidence suggested that 65% of SME policyholders were not checking the submissions that were being made to their insurers. It is classic soft-market behaviour. **Lord Newby:** That really is not good enough.

**The Chairman:** So you are saying that the position you have moved to is one where a fair balance exists?

**David Hertzell:** Yes.

**Q8 The Chairman:** You have dealt with the second aspect of this, which I was going to ask you about, but add to it by all means. A specific question that I have been asked to put to you is: is there any need for Clause 4(4) to impose an obligation on the assured to make a reasonable search? Why doesn’t the law simply require the assured to disclose what he knows, what senior management know and what those responsible for placing the insurance, including the broker, know?

**David Hertzell:** If you think back to 1906, we were living in an SME world where organisations were small. They are now absolutely enormous. If you confined the people who had an obligation to give information to the ones that this did, it is pretty likely that the senior management—or even the risk managers—would not have an overall picture of what is happening in a vast, global organisation without actually going out to ask. We think that, in those kinds of companies, they should ask what is going on as part of their fair presentation. When I was in practice, I used to buy insurance for my practice and that is exactly what I did.

**The Chairman:** Just before we ask Lord Lea and Baroness Noakes to come in, should the Bill make specific provision for the disclosure of knowledge of beneficiaries who are not parties, having regard to the precedent of Section 7 of the 2012 Act?

**David Hertzell:** Yes. This is a difficult point. Section 7 of the 2012 Act deals with consumers and this kind of group insurance scheme, which is what this is about, are fairly homogenous because the participants in the schemes are all, obviously, consumers. You could place an obligation on them. In the consumer Act you also have to ask questions of those people, so it was a relationship situation, whereas here there is a duty of disclosure that is entirely passive and a different kind of approach.

The other issue in the commercial market place is that beneficiaries under such a group scheme may range from the subsidiary companies of the holding companies down to casual interns who turn up from time to time. You simply cannot put a duty of disclosure right across that piece. It is impossible for us, in drafting legislation, to say at which point on the scale, between the top and the bottom, you should cut off. So we simply put it in a principle and rely on that. That is the reasonable search principle.

**The Chairman:** There is a final matter I will ask you about before others may ask you questions. What is the rationale for imputing to the assured any non-confidential knowledge obtained by the broker from another source?

**David Hertzell:** A large part of what brokers do is assimilating information in order to provide consultancy services, and other provisions, to the market as a whole. In those circumstances, they will have and retain information which it is difficult to say they should not know, for the purposes of making a presentation for a particular insured. We are more concerned about brokers, and others, being put in to a conflict of interest position where they have confidential information acquired from other clients, unconnected with a particular insurance, but a duty to give information in connection with that insurance. That is more the concern. Brokers will have information in the marketplace and should have; it is part of the added value that a broker brings to this community.

**The Chairman:** Thank you.

**Q9 Lord Lea of Crondall:** I wish to ask a supplementary question, which has two legs, on Clause 4(4). We all know that there are differences of how onerous collection of information is for small organisations and for big ones. That is a dilemma in much legislation, as I know from my background. From information and consultation with people at work, it is unmanageable. But within that, the Lloyd’s Market Association has put it to us, in evidence, that “senior management” means the board of directors. I would like to know whether the Law Commission did probe whether people thought that was what “senior management” meant. That is not always the case in common parlance. Did it have any alternative ideas? This is a general point about your procedure. The LMA has been consulted very widely and we will see them tomorrow. How do you leave a discussion like that, if somebody says “this is unmanageable” or “how do you expect the board of directors to be involved?” The Government have come forward with a Bill with certain language in it and, for their part, that is what “senior management” means.
David Hertzell: As to senior management, we are encapsulating a common-law principle here. We are trying to ask: who is the controlling mind of the company? With people, it is easy to do, it is what they know, but what does a company know? We are saying the board, the senior management if it is not a company, because this also covers unincorporated entities that are not consumers. The senior management are the people who are the controlling mind of the company. However, if you limit it to what might be known by those two entities or collections of people—the controlling mind and anybody else they instruct to buy their insurance—this is actually very narrow. There are a lot of things in a large organisation that most people would not necessarily know without going out to inquire.

Lord Lea of Crondall: I am asking a narrow question. Could you comment on the assertion that “senior management” does mean the board of directors? The contention of the Lloyd’s Market Association is that there are people down the line who have all this information and the idea that the board of directors of a multinational company would be able to know personally about this is not living in the real world. Did they come up with an alternative form of words?

David Hertzell: No I do not think they did. They wanted to include something along the lines of people who may be making executive decisions, but in a complex organisation that distils out to quite a low level of knowledge. We did not think that it was appropriate to attribute the knowledge of the organisation directly to people who may be store managers or whatever. The point of concern is covered by the need for the people who place the insurance and the controlling mind to organise a reasonable search. They need to ask those people and if they do not it is not likely to be a reasonable search. You deal with the point by putting the obligation on them, rather than doing it directly.

Lord Lea of Crondall: You do not think that “senior management” requires it to mean, in practice, a hands-on board of directors? You are comfortable with this wording as not meaning that?

David Hertzell: It may mean the board of directors. It means the management of the company. They have to carry out the search: it is delegated.

Baroness Noakes: The Explanatory Notes suggest that “senior management” means the board of directors and should not go beyond it. The point that Lord Lea was making was that in modern multinational organisations, the board of directors is very unlikely to be the board where many decisions are actually made. Many boards now have very few executive directors and are comprised largely of non-executives. Is there sufficient clarity in what we mean by that phrase, aligned with the suggested lack of clarity about what a “reasonable search” means? My question is whether there is enough certainty in the way Clause 4 has been put together to allow the insured population to know what they should reasonably be doing.

David Hertzell: It is a very good question which I am afraid goes back to the dilemma that I mentioned earlier. You are trying to cover, with a single piece of legislation, very small concerns and very large ones. If you seek to do that, you have to use overarching terms such as “reasonable search” that can be matched to the different level of entity you are considering. The more specific we become, the more difficult it will be to draft something that fits both ends of that spectrum. You are right that there is an inherent uncertainty, but it is an uncertainty that occurs whenever you use a word like “reasonable”, which becomes proportional to the circumstances you are looking at.

Lord Ashton of Hyde: Further to Baroness Noakes’ point, I noticed that it was confined to the board of directors in the Explanatory Notes. I did not understand it because the Bill clearly says that “senior management” means those individuals who play significant roles in the making of decisions, which is obviously much broader than the board of directors.

The Chairman: And can vary, depending on the size of the insured concerned. These are matters which should be pretty certain in a hundred years’ time but they will not start off that way.

David Hertzell: It is just impossible for us to draft something that can provide absolute clarity here and still fit the range of circumstances you are trying to match it to.

The Chairman: Unless you have a mass of different provisions for different sizes of company.

David Hertzell: Absolutely.

Q10 Baroness Goudie: In respect of the fair presentation provisions, what changes in procedure, record-keeping or preparation of underwriting guidelines do you think will be required of insurers in future?

David Hertzell: That is a very good and pertinent question. I have jotted down a couple of notes. It is important to stress that there are obligations on both parties. There is an obligation of reasonable research on the policyholder and a need to make complex presentations. As far as underwriters are concerned, there is a series of different obligations. First, they have the obligation to ask questions. There is also a training issue. They need to think seriously about their internal systems and whether the information is being accurately brought to the desk of the underwriter involved. If there is a legacy system, it may not be; there could be a system fault to be dealt with. They also need to ask whether the data are readily available—can the underwriter access the kind of data that they should be able to access in order to make a decision? There is another training issue in that an underwriter is presumed to
know what an underwriter writing that particular class of business ought to know. They should know what they are doing, and it is important that they are trained to do that. In terms of proportional remedies, they will need to have records that show what they would have done had they been given a fair presentation. There is an element here about making sure that underwriting guidelines accurately reflect what the underwriters should be doing.

Finally, if you are intending to contract out, you need to think about how you are going to tell the other party that you are going to contract out and what it is you are contracting into. There are a number of processes and procedures which all parties need to think about.

**Baroness Goudie:** Do you think that they should start thinking about them now?

**David Hertzell:** I do, and many are.

**Baroness Goudie:** Should they also think about training now?

**David Hertzell:** Yes, they should.

**Lord Carrington of Fulham:** Can I just comment on that quickly? My understanding is that this provision is very similar to the provisions required by the PRA and the FCA. There is really not much difference. They require the boards of financial institutions, of whatever size, to take control of the whole information-gathering and reporting structure.

**David Hertzell:** That is absolutely right. We try to match the regulators where we can.

**The Chairman:** Is there a general consensus with regard to what you have proposed?

**David Hertzell:** Yes.

**The Chairman:** I wonder if we may now leave that subject. We may come back to it in a moment, but I know of Lord Carrington’s personal difficulties and for the moment would just like to go to fraudulent claims and what changes are being made to the law.

Q11 **Lord Carrington of Fulham:** Thank you very much indeed, Lord Woolf. Could you give us a general description of what changes Part 4 of the Bill proposes to make to the law?

**David Hertzell:** The issue is to some extent a technical one and to some extent a practical one. So far as it is a technical one, the Marine Insurance Act says that if you breach your duty of utmost good faith, then avoidance of the policy follows as a remedy. It is difficult to imagine a greater breach of utmost good faith than perpetrating fraud. However, the courts have not tended to follow that particular line. There has been a lot of debate about whether this involves a pre-contract duty or a post-contract remedy, for example in terms of avoidance. We sought to clarify this and say that the right rule to apply is one based on the decisions that the courts have come to over the last years—that forfeiture is the appropriate remedy for a fraudulent claim, whereby you lose the genuine part and the fraudulent part. We have clarified that rather than changed the law; this is what the courts have largely been doing. We have also clarified the timeline of claims, so that if a genuine claim is made before the fraudulent act, that would still be payable, but the insurer has the option to terminate the contract from the date of the fraudulent act, whenever that was. In a nutshell, it is an attempt to clarify the remedies that apply when there has been fraud. We do not touch on what the law on fraud might be; we have left that entirely to the courts to decide.

**Lord Carrington of Fulham:** Was there general agreement in the consultation that this approach was the correct one?

**David Hertzell:** Overwhelming agreement. This was probably the most supported part of the consultation.

**Lord Carrington of Fulham:** I understand that in Australia the judiciary takes a lot more discretion in the interpretation of this type of activity in insurance.

**David Hertzell:** Yes they do. Our concern here was that if we started to introduce discretion, it was very unlikely that we were ever going to get consensus on fraud. It is a highly emotive subject, and it would not be appropriate for this process to do that. As a simple comment—this is an observation rather than the view of stakeholders or anybody else—I think that the courts have been quite harsh in their interpretation of what constitutes fraud when it comes to first-party fraud, like this, although much less so, and inconsistently so, when it comes to third-party fraud. That is something that the courts really need to resolve. The reason why we preferred that the courts do it rather than putting anything into legislation about discretion or what have you is that fraud is one of those things that really depends on judgment of the facts and people when the case is brought before you. It is very hard to define. One person’s fraud is another person’s robust negotiation. It is not something we felt comfortable putting into legislation.

**Lord Carrington of Fulham:** As I understand it, putting fraudulent and exaggerated claims into the same basket has been criticised as being rather harsh. Again, it might be an area where it would be better to apply judicial discretion rather than putting it into the Bill.

**David Hertzell:** Yes. I think there is a case on its way to the Supreme Court that deals with this complex issue of when someone has a perfectly genuine claim but fabricates something in support of that claim. That might be an act of stupidity rather than fraud or it may be a fraud. It is very difficult for us to legislate for that and it is really for the courts to decide, when they look at the facts, whether it was material or substantial and whether it was dishonesty or something else.
Lord Carrington of Fulham: When this comes into effect, will it not clash necessarily with whatever the Supreme Court decides?

David Hertzell: No, this is basically what the courts are currently doing.

Lord Carrington of Fulham: So this is in the mainstream of where the judicial decisions are coming from. Does that apply in Scotland as well?

Professor Hector MacQueen: Yes, I was just going to add that it seems to me that the discretion element in this area really lies in defining fraud. Leaving the courts to define fraud is the equivalent, if you like, of the Australian position. The curious thing in a way—I say this with all respect to the judiciary—is that judges like the open-endedness of fraud. So long as it is not described as a discretion, and you can relate it to rules, it seems much easier for the judges. In my experience, certainly in Scotland, judges do not like open, naked discretions. That is to be avoided. The other thought that has occurred to me in thinking about this issue is that the kind of case that has gone to the Supreme Court is exactly one where the interpretative good faith might have a role to play. I do not have detailed knowledge of that particular case, but I would have thought that it would be open to say that this was more in the nature of a careless slip than an intentional fraud. It might just be a case of saying whether or not it is fraud, but there is, I think, room for thinking about the good-faith dimension within that particular kind of problem.

Lord Carrington of Fulham: Would that apply under this Bill as drafted? Would judges be able to take that position?

David Hertzell: Yes, we have not interfered at all with that. Whatever fraud is—

Lord Carrington of Fulham: It is up to the courts to decide. Okay.

The Chairman: But you have not felt it right to give an express discretion because of the ability to interpret fraud that the judiciary inherently have?

David Hertzell: Yes.

Lord McNally: I think the non-lawyers here all reacted the same way to your concept that you could define fraud as robust negotiation. I hope that in your former role you would have given short shrift to a fraudster who said he was just robustly negotiating.

The Chairman: I make no comment. Anyway, the courts to decide. Okay.

David Hertzell: The short answer is no, but this is a difficult issue that is here now, regardless of anything we propose. We have tended to highlight the underlying problem. A subscription market is a market in which insurers sign up to a contract that provides 100% but their own shares will be a subset of that. Each one of these contracts is an individual contract. Even under the current rules, there is the possibility that some in the market may take one view and others may take another. Very occasionally, that happens and we have not changed that potential outcome. It is true that under these reforms the proportional remedy might apply differently between one subscription market member and another, but that is just the same situation that we have now. We consulted on this very carefully and spent a lot of time with subscription market members. The overall, vastly strong majority did not want to see us change the way the subscription market worked by introducing new rules. In fact, bearing in mind that this is also subject to an EU competition review, this would probably be a project in its own right, rather than a subset of these reforms. It is, after all, the specialist end of the market, where people are pretty capable of looking after their own interests.

The Chairman: The next item is late payment. Lord Lea, do you wish to ask about anything else?

Q12 Lord Lea of Crondall: Yes. It is a question to the Law Commission. Clearly, we had two supplementary, but could you just tell us the kernel of the dispute, which clearly exists, between the majority and the minority? You clearly have some language that you put to them. What was that language? Which consultees were asked whether they had alternative language? Can you take us through the modalities of that, because I am personally a bit baffled, as many of us are? Commercial interests clearly come into this. How far away were you from language that you could get consensus on?

David Hertzell: I will certainly answer that. We consulted on this, and the law in England and Wales is, to put it kindly, unusual and different from that in Scotland and globally. As we have said in the report, this is hard to justify. The concerns were not really domestic. They came, as I said, from insurers that specialise in dealing with international business, particularly those that deal with the US. I will not deny that there was a legitimate concern about bad-faith litigation being imported into the UK. We attempted to produce a wording that gave an obligation to pay valid claimants within a reasonable time—and had consequences if that was not done—but also gave insurers the ability to carry out investigations. We were conscious that insurers act almost like trustees of the insurance fund on behalf of all the other members and must therefore carry out investigations and not pay out claims willy-nilly. So we wanted to make sure they have a reasonable time in which to do that.

The final point was that there was a suggestion that we might be able to come up with some
agreed wording around the liability for reckless and deliberate failure to pay claims. However, that was not acceptable to those at the other end of the market and did not really solve the essential problem we were looking at, which was the fact that, under English law, the liability of the insurer is—very curiously—to prevent the accident happening in the first place. This is slightly counterintuitive and is different in Scotland. We did not come close to solving that particular dilemma, and in the end we came to the conclusion that there was a lack of consensus on it that would be difficult to deal with.

**Lord Lea of Crondall:** But does it not follow—this is my final supplementary—that that is where things rest. It is not a question of looking at it in a later Bill, which is difficult, but of kicking it into the long grass on the grounds that it is insoluble.

**David Hertzell:** It is insoluble if you are using this uncontroversial procedure. It is perfectly up to the Government to take a measure through under its own steam without worrying about this particular consideration.

**Lord Ashton of Hyde:** Is the position today that an insured suffering from late payment can go to court and seek a remedy if they are suffering a damage?

**David Hertzell:** They would have a remedy in terms of getting their original claim paid. If it was a valid claim they would get interest on that, but they would not be able to claim for consequential losses. This is not, I should stress, a part of the Marine Insurance Act. This is case law, so presumably the courts could overturn it should they wish to.

**Lord Newby:** Could I just reassure Lord Lea that the Government think that there should be movement in this area and are committed to looking for another vehicle to bring forward a proposal for it. We have a problem with this vehicle for doing it, another vehicle to bring forward a proposal for it.

**David Hertzell:** It is insoluble if you are using this uncontroversial procedure. It is perfectly up to the Government to take a measure through under its own steam without worrying about this particular consideration.

**Lord Lea of Crondall:** Excellence can be the enemy of the good.

**Q13 The Chairman:** If I may go back now to warranties and conditions, how do we identify whether a provision is a warranty?

**David Hertzell:** How long do we have? We cannot, really. There is a very cursory outline of what a warranty might be in the Marine Insurance Act, which we have left alone. There is various case law on what a warranty might be, but it is an undefined term. It might say in a contract that it is a warranty but it might not be, and it might not say that it is a warranty but the court might decide it is one.

**The Chairman:** There will be one.

**David Hertzell:** It is rather loose.

**The Chairman:** Yes. Putting it in another way, then, what you are treating as a warranty is something that the common law would treat as a warranty?

**David Hertzell:** That is exactly right.

**The Chairman:** That is what you are leaving alone.

**David Hertzell:** Yes.

**The Chairman:** So Part 3 of the Act will not really change the present position?

**David Hertzell:** On the definition of warranties, no.

**The Chairman:** The consequences change.

**David Hertzell:** Yes.

**The Chairman:** Have you any concerns about leaving the position in that way?

**David Hertzell:** Not really. The court has a certain degree of discretion and there is a long history to it. We thought that if we started to try to define “warranty” we probably would never finish our consultation. We left it alone. We have sought to discourage the lazy use of the word “warranty”. This affects both consumers and businesses and many small businesses are affected by this provision. For most people a warranty is what they get when they buy a toaster. They probably have no understanding of this meaning. So we have sought to discourage it by making the effect of it very much like other types of condition.
Memorandum submitted by Lord Newby, Minister in charge of the Bill

I am writing in response to a question raised by Baroness Noakes on Tuesday 2 December at the Committee session on the Insurance Bill, in connection with the clause on late payment of insurance claims that was omitted from the Bill as introduced.

Baroness Noakes asked for details of the steps the Financial Conduct Authority (FCA) take in order to identify and regulate insurers who do not pay claims within a reasonable time. I have consulted the FCA and have incorporated their reply into the response below.

The FCA’s engagement with firms depends on the size of the firm and the risk its activities pose to the FCA’s objectives. They apply forward-looking judgements about firms’ business models, product strategies and how they run their businesses to enable them to intervene earlier, before widespread detriment occurs. For larger firms, the FCA have a proactive schedule of engagement. For smaller firms, routine interaction is through their Firm Contact Centre.

The FCA’s supervisory approach means that they target resources to those firms that pose the most risk.

The Supervision department in the FCA works closely with the Enforcement department to intervene early to tackle ongoing risks to customers. Although the FCA have not taken enforcement action against late payment of a claim, where they identify issues with claims handling, which may include issues relating to delayed claims settlement, they have a range of regulatory tools that they can use. For example, where they have identified issues, they have asked firms to review their claims handling processes to address issues relating to declined and claims backlogs (including undue delay). Where they have found significant failings, they have secured appropriate redress for consumers.

The FCA can also issue private warnings as part of their Enforcement framework. Where appropriate, the FCA will request firms to commission a skilled person review (under section 166 of the Financial Services and Markets Act 2000) where they are falling short of expectations. In addition, the FCA may require the firm’s senior management to attest that any remedial action will be carried out and to ensure that appropriate controls are in place to ensure fair outcomes for consumers.

For consumers, the FCA regulatory rules (ICOBS 8.1.1) specifically require insurers to handle claims promptly and fairly. You may wish to note that the Financial Ombudsman Service (FOS) also has a role to play in terms of dealing with any customer complaint against an insurer that is not resolved to the policyholder’s satisfaction and where they wish to make a complaint to the FOS.

In the FCA’s retail claims thematic review, they looked at the extent to which consumers as claimants are at the heart of general insurers’ businesses, as well as what is important to consumers in how their claims are handled and how their experience of making a claim measures up to their expectations. The FCA found consumer outcomes are broadly positive, but there is still scope for improvement—including better communication and ownership throughout the claim. To build on this work, the FCA is now undertaking a thematic review in relation to the handling of commercial claims. As part of this review the FCA will consider whether commercial customers’ expectations are met in the claims process, where poor behaviours could have a wider impact on trust in the market, as well as leading to poorer claims outcomes.

**Government Position**

The Government recognises the important role performed by the regulators in overseeing insurers’ business processes and, in particular, their approach to claims handling. The FCA has a number of powers to discipline insurers who behave badly in their assessment and payment of claims.

The question remains whether regulation in this area ought to be supplemented by a direct legal cause of action for policyholders in the case of unjustifiable late payment of claims. I have heard some of the views of the Committee and of those parties who have provided evidence so far, and recognise the arguments in favour of making legislative provision along the lines recommended by the Law Commission.

That said, the Government’s view remains that the provision is not sufficiently uncontroversial as to be suitable for inclusion in the Insurance Bill, subject to the special procedure for Law Commission bills, so the Government is committed to considering the introduction of a late payment provision in a future legislative vehicle.

I hope that the above is helpful, but please let me know if you require any further information.

*December 2014*

Memorandum submitted by the Law Commission, David Hertzell

**Insurance Bill**

1. I write in relation to the Insurance Bill, shortly to be considered by this Special Public Bill Committee. I have set out below some of the matters which the Committee may wish to consider. I should be very happy to discuss these and any other matters in my oral evidence to the Committee.
BACKGROUND TO THE BILL

2. The majority of provisions in the Insurance Bill are based on recommendations made by the Law Commission and the Scottish Law Commission in their July 2014 Report, *Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment*. Our review into insurance contract law began in 2006, and the Bill will implement recommendations which have been widely consulted upon over a period of 8 years. The vast majority of consultees, including insurers, policyholders, brokers and lawyers, are fully supportive of the proposals. This is the second Bill based on the Law Commissions’ review. The first was also introduced using the procedure for Law Commission bills and became the Consumer Insurance (Disclosure and Representations) Act 2012.

3. Insurance has undergone many changes since the existing legal framework was developed more than a hundred years ago. A market initially based on face-to-face contact and social bonds is now based on systems, procedures and sophisticated data analysis. The types of risks insured have widened and the volume of information available to market participants has grown exponentially. The law, mostly contained in the Marine Insurance Act 1906, has found it difficult to keep pace.

4. Many provisions are out of step with insurers’ best practices, with the reasonable expectations of insurance purchasers, and with other areas of general law. There are many disputes, leading to delay, expense and uncertainty. This also risks undermining trust in UK insurance in the international marketplace.

5. The provisions in the Insurance Bill apply largely to policyholders other than consumers, though some apply equally to consumers. The Bill introduces a default regime which provides a fair balance of interests between most commercial policyholders and insurers, but allows more specialised insurers to contract on different terms, provided they are clear as to the alternative terms they wish to impose.

6. A brief summary of the provisions on insurance contract law is below. The Bill also allows the delayed Third Parties (Rights against Insurers) Act 2010 to be brought into force.

A SUMMARY OF THE REFORMS

7. The major reform relates to what a policyholder must tell an insurer before the insurance contract is entered into. The Bill introduces a duty of “fair presentation”. This means that the policyholder must provide material information that it knows or ought to know. The information has to be enough to allow the insurer to write the risk or, failing that, enough to put the insurer on notice that it should ask further questions. Information must be provided in a way that is clear and accessible to the insurer. The policyholder is not obliged to provide information that the insurer already knows or ought to know. The Bill gives some guidance as to who is expected to provide information—it clearly cannot be everyone in a large company. However, the policyholder has an obligation to carry out a reasonable search for material information.

8. A major criticism of the current law is that any failure by the policyholder to disclose information allows the insurer to “avoid the contract”. In other words, it may treat the contract as if it did not exist and avoid all claims. This Bill introduces more proportionate remedies. If the failure was deliberate or reckless then the insurer can avoid the policy. Otherwise the insurer is placed in the position it should have been in had a fair presentation been made. If the insurer would never have accepted the risk, it may still avoid the contract. Otherwise, if the insurer would have contracted on different terms, these may be implied into the contract. If the insurer would have charged a higher premium then any claim can be reduced pro rata.

9. The Bill also addresses insurance warranties. Currently, breach of a warranty automatically discharges the insurer’s liability under policy. The Bill provides for warranties to become suspensory. Whilst the policyholder is in breach, there is no cover. If the policyholder remedies the breach then cover is restored. In addition, the Bill abolishes ‘basis of the contract’ clauses. These convert all information provided by the policyholder into warranties. Such clauses are widely used and not well understood.

10. Also on insurance contract law, the Bill removes any confusion as to what should happen if the policyholder makes a fraudulent claim. That claim is forfeited in its entirety, including any genuine part. The insurer is also entitled to terminate the policy from the date of the fraudulent act. However, previous genuine claims are payable.

ISSUES RAISED

11. In the Annex, I outline a small number of technical points which may be raised with the Committee. These are largely points raised by the Lloyd’s Market Association, with whom we have had ongoing discussions.

12. An important point to note is that both the LMA and the International Underwriting Association, who have recently supported the LMA on some points, operate at the specialised and sophisticated end of the insurance market. The default rules put forward in the Bill are designed for the UK general insurance market. We accept that it may be appropriate for LMA and IUA members to provide for more bespoke arrangements in their contracts and the Bill allows for this.

CLAUSES OMITTED FROM THE BILL BEFORE INTRODUCTION

13. The draft Bill produced by the Commissions and consulted on by HM Treasury included two further provisions which are not included in the Insurance Bill. These related to:
(1) Terms relevant to particular descriptions of loss: the draft clause provided that breach of an insurance contract warranty or similar term designed to prevent loss of a particular type (such as theft), should not remove the insurer’s liability to pay for a different type of loss (such as flooding). For example, the policyholder’s failure to maintain a burglar alarm should not remove the insurer’s liability for floods.

(2) Late payment of insurance claims: the draft clause implied into every contract of insurance an obligation on the insurer to pay sums due within a reasonable time. A breach of this term would potentially provide the policyholder with a contractual claim for damages.

14. Although the overall policy in both cases is broadly agreed, there were differing views from insurance market stakeholders as to whether the clauses would benefit the industry and/or operate effectively as currently drafted.

15. The Government, in consultation with the Whips, determined that the clauses did not have sufficient consensus from the insurance market as a whole to make them suitable for the procedure for uncontroversial Law Commission bills.

Late payment

16. Regarding the late payment provision, we accept that our recommendation was to introduce an entirely new cause of action which may impose costs on insurers. It was a discrete provision in the draft Bill, easily removed, which might be more suitable for an alternative legislative vehicle.

Terms not relevant to the actual loss

17. The provision concerning terms relevant to particular descriptions of loss was an integral part of our recommendations on warranties and similar contract terms. Stakeholders who objected to the clause as drafted largely support the policy objective, namely that insurers should not refuse liability for a loss which is of a completely different nature from that contemplated by the breached term. Rather, a few stakeholders were concerned that the clause as drafted would lead to uncertainty for insurers and insureds.

18. We think that these concerns can be met by clearer drafting. HM Treasury has asked us to work on re-drafting the clause with the hope that it can be introduced at the next legislative opportunity.

Conclusion

19. I should be happy to address any of the changes to the Bill in my oral evidence to the Committee, if that would be of assistance. If the Committee would find it useful I should also be grateful for an opportunity to provide further written evidence once the Committee’s evidence gathering process is otherwise complete. In the meantime, please let me know if there are any particular issues which the Committee may wish to discuss.

November 2014

Supplementary memorandum submitted by the Law Commission, David Hertzell

1. Thank you for the opportunity to provide further submissions in respect of the Insurance Bill. The Committee particularly requested a note from the Law Commission on clause 4 and its interpretation of “senior management”, but I have also taken this opportunity to comment on a number of other issues which have arisen in the oral evidence sessions.

2. I therefore also touch on the operation of the knowledge provisions more generally, and the application of the Bill to reinsurance. I also provide some further thoughts on the “deleted clauses”, covering irrelevant terms and late payment.

3. I should be happy to provide further information on these or any other matters if it would be helpful.

Clause 4: knowledge of the insured

4. The knowledge provisions in clause 4 are intended to work as a package, to provide a clearer framework for what an insured has to do to collate information to disclose. The view of most stakeholders was that is far more constructive to set a framework which could be followed at the outset (hopefully to be supplemented by guidance and protocols, as discussed below), rather than for very flexible common law knowledge rules to be applied retrospectively, when a dispute has arisen.

A three-part test

5. The reference to “senior management” in clause 4(3)(a) is one part of a three part test. It sits alongside the reference to those responsible for the insured’s insurance, and the requirement for a reasonable search. Before looking in detail at the definition, it may be useful to outline the test as a whole.

6. Clause 3 requires disclosure of what the assured “knows” and “ought to know”. These terms are defined in clause 4.

(1) What an insured “knows” is defined relatively narrowly as only what is known by:
   (a) senior management; and
   (b) those individuals responsible for the insured’s insurance.
(2) However, this is balanced by the new obligation on the insured to conduct a reasonable search of information available to it—this is what the insured “ought to know”.

7. The effect is that if a senior manager or a person arranging the insurance knows a material circumstance then it must always be disclosed, and failure to disclose is a breach of the duty of fair presentation. However, if a junior employee (not involved with the insurance) knows something material, the test is more flexible. Under clause 4(4) the test is: should it reasonably have been revealed by a reasonable search?

8. It is inevitable that in a large multi-national company neither the senior management nor the risk manager can personally know every circumstance which would be material to the insurer. Nor can the insured disclose everything known by thousands of employees. However, it is both practical and reasonable to require the insured to make an active effort to discover material circumstances by conducting a reasonable search and making enquiries.

9. Clause 4(4) recognises that the relevant information may be held “outside the insured’s organisation”, so it may be necessary to make enquiries of outside individuals or organisations. The drafting gives the example of agents. But how the search might operate, how extensive it has to be, and who it should cover necessarily depend on the individual insured and the particular insurance being purchased.

10. As we explained in our Report, we hope that the insurance market will work to provide guidance and agree protocols on what would constitute a “reasonable search” in different circumstances. We would also urge insurers and large policyholders to reach individual agreements about how the policyholder should conduct the search.

11. It is true that if the parties leave the issue entirely to the courts, there may be some uncertainty until the courts have developed guidelines as to their approach to determining what constitutes a reasonable search in a variety of contexts. However, the solution is in industry hands. We wish to see brokers and insurers remove this uncertainty by working together to agree what a reasonable search should look like in a variety of circumstances.

“Senior management”

12. Everything known to a senior manager is directly attributed to the insured. This means that if a senior manager conceals material information, the clause 3(4) duty applies, even if the risk manager knew nothing about it and has conducted an extensive search.

13. The phrase “senior management” is defined in clause 4(6)(a) as “those individuals who play significant roles in the making of decisions about how the insured’s activities are to be managed or organised”. This is intended to mean people who are making decisions about the whole or a significant part of the insured’s activities.

14. We were guided by the case of Gibson v Barton which refers to:

the management of the whole affairs of the company; not an agent who is to do one thing, or a servant who is to obey orders and do another, but a manager who is entrusted with the power to manage the whole of the affairs.1

15. The definition is less extensive that the definition of senior management set out in the Manslaughter and Corporate Homicide Act 2007, for example, which also includes those who play substantial roles in “the actual managing or organising of the whole or a substantial part of those activities”. We believed these extra categories would create uncertainty and that at a practical level such people would be included in the reasonable search.

16. In our Report we explain that the definition includes the highest level of management such as the board. However, we accept that it is not possible to be prescriptive on this point. Organisations are managed in many different ways. We agree with the point made in the Committee that it is unhelpful for the explanatory notes to go beyond the words of the statute on this point, and we will work with HMT officials to reword the explanatory notes.

“Covered persons”

17. “Covered persons” is the short-hand used to refer to people who are covered by an insurance policy, but who are not parties to the contract (and therefore not “the insured” under the Bill). Depending on the nature of the insurance, “covered persons” could be subsidiary companies, sub-contractors on a construction site, or individual officers, employees and other workers. In the policies we have seen, “covered persons” range from major subsidiaries to temporary interns.

18. The issue was raised by LMA, ABI and Lord Justice Longmore at the oral session on Wednesday 3 December. I mentioned this issue in my original written submission of 21 November (see Appendix paragraph A.2) and we have published a separate paper on our website. The current law on this issue is very flexible and we have sought to preserve this flexibility. For instance, while it might be reasonable for information held by a subsidiary company to be disclosed, the same cannot necessarily be said of all information held by every employee.

19. Stakeholders, including the LMA and BILA, have accepted that it is neither appropriate nor desirable to place a direct duty of fair presentation on every covered person. However, some may hold significant information which the insurer is entitled to be given. If beneficiaries are so significant that they should have their own duty of fair presentation, they can be made parties to the contract. In other cases, it would be right for the insured to ask appropriate questions of other entities covered by the policy. This would be part of the reasonable search.

1 By Blackburn J, Gibson v Barton (1874-75) LR 10 QB 329.
20. We believe the current formulation of clause 4(4) has enough flexibility that it will be applied sensibly by the courts and result in a workable outcome. As pointed out above, there is a specific reference in clause 4(4) to information held “outside of the insured’s organisation”.

21. The clause uses agents as an example. However, this could equally include separate subsidiaries, or other outside beneficiaries. We did consider including a reference to these covered persons as another example, but advice at the time from Parliamentary Counsel was that the more examples given, the more they might have the effect of limiting the intended generality of the principle being illustrated.

22. If the Committee is keen to see a reference to these beneficiaries in the legislation, this could be dealt with as a further example in the brackets in clause 4(4). This would not change the underlying policy and should answer the concerns of the LMA and ABI. However, the Law Commission has not yet discussed this possibility with the Government.

23. In practice, information from covered persons is precisely the sort of matter we hope will be included in industry guidance or protocols.

THE INSURER’S KNOWLEDGE AND “READILY AVAILABLE”

24. Clause 5(2)(b) of the Bill provides that an insurer “ought to know” information which is “held by the insurer and is readily available to” the individual underwriter. We would stress that both tests must apply. It must both be held by the insurer and readily available to the underwriter.

25. This test has been carefully developed to meet insurers’ concerns about the extent of information available.

 THE APPLICATION OF THE BILL TO REINSURANCE

26. We intentionally refrained from defining insurance, or contract of insurance, in the Bill. In order to dovetail with the Marine Insurance Act 1906, the provisions of the Bill which replace or affect provisions of the 1906 Act must have exactly the same application as the relevant provisions of the 1906 Act. The way to achieve this is to leave the matter to common law, as under the 1906 Act.

27. It is very well established that reinsurance contracts are contracts of insurance at common law. The Law Commission’s position is that the Bill as drafted clearly applies to reinsurance, as stated in paragraph 36 of the Explanatory Notes.

28. The Law Commission considered and rejected the idea of referring specifically to reinsurance. Parliamentary Counsel advised that any specific reference could cause problems for other pieces of legislation which do not do this and which assume that insurance includes reinsurance—not least the 1906 Act itself. We understand that this remains the strong view of the Government’s Parliamentary Counsel.

29. If explicit reference is made to contracts of reinsurance it could also cause confusion as to the lack of a specific reference to contracts of retrocession, or further contracts.

AN ALTERNATIVE SOLUTION

30. We understand that the Government is considering whether to table a technical amendment to clause 4(5) to ensure that the clause correctly implements the intended policy and is relatively easy to understand.

31. The draft text of the possible amendment (which we have assisted in preparing) in fact refers explicitly to reinsurance for a particular purpose, but clearly implies that the Bill must generally apply to reinsurance. It is suggested that, if the Government decides to proceed to table this amendment and it is accepted by the Committee, it could satisfy the desire to see a reference to reinsurance on the face of the Bill without giving rise to the potential problems of a specific definition described above.

LATE PAYMENT OF INSURANCE CLAIMS

32. I said in my letter of 21 November that the Law Commission accepted that our recommendation may be controversial. While we very much hope that the Government does take this recommendation forward in the future, we would be reluctant to see it prejudice the passage of the Insurance Bill, or the procedure for uncontroversial Law Commission bills.

AN ALTERNATIVE CLAUSE TARGETING “DELIBERATE OR RECKLESS” DELAYS?

33. The LMA has suggested an alternative clause on late payment, which would be confined to cases where the insurer acted deliberately or recklessly in refusing or delaying payment. However, informal consultation suggested that this would be opposed by other stakeholders, for the following reasons:
   — The onus would be on the insured to show that the insurer refused payment deliberately or recklessly. It was suggested that this would be virtually impossible, as the insured would not know why the insurer acted as they did.
   — It would lead to a greater difference between English and Scots law, when an aim of the reforms is to keep them aligned as far as possible.

2 Delver, Assignee of Bunn v Barnes (1807) 1 Taunt 48, by Lord Mansfield.
— At present, it is open to the Supreme Court to overturn previous cases and introduce damages for late payment. It was suggested that the amendment would effectively block this development, to the detriment of insureds.

34. We reached the conclusion that we should not pursue this policy direction. We hope instead that the clauses in our report will be introduced in another legislative vehicle.

TERMS NOT RELEVANT TO THE ACTUAL LOSS (ORIGINAL “CLAUSE 11” OF THE DRAFT BILL)

35. This clause was also omitted from the Bill before Parliament, though we think that it is much less controversial in policy terms. It is very difficult to argue against the policy, and say that insurers should be entitled to refuse liability for a loss which is of a completely different nature from that contemplated by the breached term.

36. However, some stakeholders were concerned that the clause as drafted would lead to uncertainty. In our original draft clause, we sought to maintain the maximum flexibility. We believe that this flexibility would have operated largely in insurers’ favour. In our Report we make clear what we want the result to be in “easy cases”—such as where a fire alarm warranty is broken and then a property is flooded, or where a night watchman should have been employed and loss is incurred in the middle of the afternoon. We specifically say at paragraph 18.20:

The real mischief this recommendation is designed to address is reliance on breach of blatantly irrelevant warranties in order to escape liability for an unconnected loss (emphasis added).

37. However, we were (intentionally) more open about harder cases. For example, where a warranty relating to locks on a door is breached and intruders break in through a window, would this allow the insurer to refuse payment on the basis? The answer depends on whether the lock warranty relates to all loss suffered as a result of intruders/security breach, or only a security breach via the door which was to have the warranted locks. Where a warranty about fire prevention is breached, can the insurer refuse liability for any fire howsoever caused and even if it is in a totally different part of the building? We said that it would be up to the courts to determine how broadly or narrowly they would interpret “loss of a particular kind”.

38. HM Treasury asked us to continue working with stakeholders in an attempt to reach an alternative wording which has more widespread support. We are currently consulting on a different formulation, which the Committee has seen. We think that this removes much of the uncertainty which was inherent in the original draft, and has been supported by a number of stakeholders. The LMA has suggested that it comes too close to introducing a causal connection test.

39. Again, we do hope that this reform will be taken forward, and in many ways it does appear to “belong” with the other warranties provisions in the Bill. We would not want it to be thought in the future that the absence of this provision confirmed that insurers should be able to rely on irrelevant terms. However, as is our position regarding late payment, we would not wish the introduction of this reform to prejudice the rest of the Bill or to compromise the special procedure for Law Commission bills. The Committee has heard the strength of some stakeholders’ objections on this point, and will draw its own conclusions.

CONCLUSION

40. I hope the Committee will find this additional submission of assistance in explaining how some of the key provisions are intended to operate, and setting out the Law Commission’s position on the “deleted clauses”. I would be happy to provide any supplemental information which the Committee requires, including providing a third written submission after the final evidence hearing on 9 December if that would be helpful.

December 2014

Memorandum submitted by the Scottish Law Commission

1. The Scottish Law Commission was set up by the Law Commissions Act 1965 as an independent body to review and recommend reform to the law of Scotland. It aims to recommend ways of simplifying, updating and improving the law of Scotland.

2. The Insurance Bill 2014 implements recommendations in a Report which we published jointly with the Law Commission for England and Wales in July 2014. The Report is entitled Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment (Law Com No 353; Scot Law Com No 238).

3. The Report is part of a wider joint project to modernise and simplify insurance law in the United Kingdom. Our previous Joint Report on Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation (Law Com No 319; Scot Law Com No 219, 2009) was given effect by the Consumer Insurance (Disclosure and Representations) Act 2012. We should note that the Third Parties (Rights against Insurers) Act 2010 was also based on a much earlier Joint Report of the two Commissions: Third Parties—Rights against Insurers (Law Com No 272, Scot Law Com No 184, 2001).

4. The joint nature of the work on insurance law reflects the fact that the law on this subject has long been essentially the same throughout the United Kingdom, even before the passage of the Marine Insurance Act 1906. Even in the eighteenth century the Scottish courts looked first and foremost at developments in England, although that was often explained as English law providing the best available evidence as to the lex mercatoria of which insurance law (especially marine insurance) formed part.
5. Insurance, especially life and property insurance, has also been a significant dimension of the Scottish financial services industry since early in the nineteenth century. The Scottish insurance industry has never depended solely on its domestic market, and remains outward-looking in its business strategies. In our contribution to the work on the insurance project, we have not been made aware of any demand from Scottish stakeholders to move away from a generally United Kingdom approach to the reform of insurance law.

6. The law of insurance is a reserved matter under the Scotland Act 1998 (Schedule 5 Part II Head A Section A3 Financial services). We do not think it likely that any proposal for change to this position will emerge from the deliberations of the Smith Commission on further powers for the Scottish Parliament. The Scottish Government was however supportive of the reforms made by the Consumer Insurance (Disclosure and Representations) Act 2012, and we do not think that there will be any difficulties over the present Bill.

7. At the same time, as we will show later in this submission, there is concern not to lose present advantages of the law as it applies in Scotland. Insurance in Scotland operates under the general framework provided in particular by the Scots law of contract and property, which is in some relevant respects significantly different from its equivalents south of the border. Our main contribution to the joint work of the Law Commissions has probably been in ensuring that the reforms will work well in that context.

8. Although provisions about damages for late payment by insurers were recommended by the two Commissions in their 2014 Report, we understand that these have not been carried forward to the Bill now before the House of Lords. We should here note that the Scottish courts have developed the existing law in this area rather differently from their English counterparts, in recognising that such a right to damages already exists. This follows from the general principles of the Scots law of contract. The failure of the insurer to pay within a reasonable time is a breach of contract, and damages are payable for any loss caused by such breach. Our main reason for joining in the original recommendation was the significant clarification to be achieved by putting the law in statutory form. While the recommendation’s non-appearance in the Bill is a disappointment, therefore, we take comfort from the existing position at common law.

9. In all other respects we believe that the Bill’s provisions will sit well with the existing general law of contract and property in Scotland. We think in particular that the approach to the requirement of good faith is consistent with the current approach of the Scottish courts, although we think it right to leave open possibilities for further judicial development, especially with regard to the post-contract formation relationship of the parties. The specific provisions on disclosure, warranties and fraud may however make such development un-necessary.

10. We understand that concern has been expressed about the position with regard to fair presentation of the risk when two parties take out an insurance policy which will provide cover for third parties. There are examples of such policies to be found in the Scottish law reports, although the specific question about duties of disclosure in that situation has not, we think, ever arisen. Our view is that should it do so, the answer is probably to be found in the law of third party rights, under which the contracting party otherwise bound to perform to the third party can take against the latter any defences arising from that person’s conduct, such as duress, misrepresentation and, where appropriate, non-disclosure. It is also possible for the contracting party to set-off any debts owed to it by the third party. We do not expect to recommend any change to this position in our forthcoming Report on Third Party Rights in Contract.

November 2014
Q15 The Chairman: Good morning, Mr Kees van der Klugt—I hope that is the correct way of pronouncing it—and Ms Philippa Handyside. We are very grateful to you for coming to give evidence before us and are looking forward to the assistance that we think you can give us. I will say at the outset that the members of the Committee have all read your written evidence, so assume we know about that. So far as possible—this applies particularly to any opening statement you wish to make, for example—I would wish you to supplement or explain what is already in writing rather than repeat it. Do either of you want to make opening statements?

Ms Philippa Handyside: I have not prepared one but it might be helpful if I just set out the position of the Association of British Insurers and its members, which is, broadly, that the Marine Insurance Act was long overdue for reform. The excellent work of the Law Commission has produced a Bill of good quality which the ABI’s members support. We had a good dialogue with the Law Commission along the way and the published draft of the Bill is a great improvement on earlier drafts. The direction of reform in relation to fair presentation of risk and remedies for a breach of the duty of fair representation are all welcomed by the industry and largely reflect modern practice. Also, the industry is supportive of the reforms regarding warranties.

I know that you discussed at some length yesterday further reforms that are not included in the published draft of the Bill concerning irrelevant warranties and paying claims within a reasonable time. The members of the Association of British Insurers have been supportive of reform in those areas too. I will leave any further comments to your more specific questions.

The Chairman: Would you like to say anything? Mr Kees van der Klugt: Lord Chairman, I would like to make a brief opening statement as well. The LMA—the Lloyd’s Market Association—represents the common interests of all the managing agents at Lloyd’s writing for all the syndicates, so we work a lot with the Corporation of Lloyd’s as well as with the IUA and LIIBA, the other associations for the company market and the brokers. The report on the London market by the associations that come together as the London Market Group, which was worked on with the Boston Consulting Group, is referred to in our submission. I thought it was worth mentioning that this report exists because it sets out the London market quite usefully.

The Chairman: If you would like Members to read it, would you be able to provide them with copies?

Mr Kees van der Klugt: I am sure that we could. It is really just to say that it is here, but I could of course make copies available.

The Chairman: If copies are made available, we will certainly look at it.

Mr Kees van der Klugt: I would just like to say one or two other things. The LMA does a lot of work on market processes, for market efficiency, and a lot of educational work in the market. We are ultra-sensitive, on behalf of our members, about anything that might add to costs in the market or decrease efficiency, which is what really informs the way we approach the new Bill. I would like to emphasise that we support the core reforms in the Bill on proportionate remedies for non-disclosure, on banning basis clauses, on warranties becoming suspensory and on the provisions relating to fraudulent claims. We see those as the absolutely central reforms. I should say as well that I am a BILA—British Insurance Law Association—committee member, and that BILA is in the same place in relation to the main reforms as we are. But we have some problems with some of the clauses, as will become apparent. That is what I wanted to say at the outset.

The Chairman: Those problems, with the provisions that are already in the Bill, are dealt with in your evidence.

Mr Kees van der Klugt: Indeed, the problem areas are dealt with in our written evidence.

The Chairman: Thank you very much. Did you want to add anything else?

Mr Kees van der Klugt: There is one point that it is also important to make the Committee aware of. We may be in a slightly different place from the ABI here, but in our market a lot of the insurance contracts come into underwriters having already been prepared in the broker’s office. That is an important thing to realise. The brokers work up a contract with our clients and then bring them...
into the room at Lloyd’s for a quote. When one is talking about things such as contracting out, it is important to realise that that is where the contracts often originate—not always, but often. I just wanted to make that point at the outset.

**The Chairman:** On that point, if Lloyd’s were to think of a standard practice with regard to the placing of business with Lloyd’s, it would be quite easy, would it not, to publish the standard terms that Lloyd’s would trade on?

**Mr Kees van der Klugt:** Not the standard terms of the insurance contract itself. There are model wordings which brokers and underwriters can draw from—indeed Lloyd’s Market Association has a model wordings database—but that is often just self-contained wording that can be part of a contract; it is not the whole contract.

**The Chairman:** I was not suggesting that it was. What you have described as models is really what I had in mind.

**Mr Kees van der Klugt:** But what one could not do is standardise terms of a complete contract, because they are very much bespoke.

**The Chairman:** I was thinking about special areas, particularly about something that Lloyd’s feels very uncomfortable about in the proposed Bill. For example, Lloyd’s could deal with the placing of business with Lloyd’s, it would be quite easy, would it not, to publish the standard terms that Lloyd’s would trade on?

**Mr Kees van der Klugt:** Not the standard terms of the insurance contract itself. There are model wordings which brokers and underwriters can draw from—indeed Lloyd’s Market Association has a model wordings database—but that is often just self-contained wording that can be part of a contract; it is not the whole contract.

**The Chairman:** I was not suggesting that it was. What you have described as models is really what I had in mind.

**Mr Kees van der Klugt:** But what one could not do is standardise terms of a complete contract, because they are very much bespoke.

**The Chairman:** I was thinking about special areas, particularly about something that Lloyd’s feels very uncomfortable about in the proposed Bill. For example, Lloyd’s could deal with the ability to contract out by model terms.

**Mr Kees van der Klugt:** I am not so sure about that. It might become apparent when we get to some of the headline questions that we have been given that, first, if one is talking about the whole disclosure scheme as set out in Clauses 3 and 4 of the Bill, and the knowledge provisions in, I think, Clauses 4 to 7, it is very difficult to contract out of the whole disclosure scheme. Contracting out of that part of the Bill is not a particularly feasible proposition. If a broker comes into the room and says to an underwriter, “I have a huge risk that I would like you to quote on. Here is the slip and here are the terms”, I do not think that the underwriter is really going to say, “Well, before I even look at this and take your presentation, I want to just rewrite the law in relation to how we are going to disclose this particular matter”. I do not see how we can set standard terms for contracting out of the scheme set up by the Bill—hence our worry about contracting out being simplistic. What I will refer to as Clause 11, on terms that are relevant to a particular type of loss, is one of the deleted clauses and is not in the Bill. I know that we are going to be asked about this, as it is a sort of all-pervasive term. You would have to analyse the contract and somehow see which terms fall under this provision of the Bill and which do not. Again, when it is all pervasive, it makes contracting out very difficult, if you see what I mean. Before you can even think about contracting out, you have to analyse the whole wording of the insurance contract even to realise whether the broker, who has put it together with his client, is contracting out.

**Baroness Noakes:** Do you not have to go through the terms of the contract anyway? So what additional burden does this raise?

**Mr Kees van der Klugt:** We are immediately on to what I call Clause 11, if that is all right Lord Chairman. I am very happy to answer the point.

**The Chairman:** You can answer it!

**Mr Kees van der Klugt:** The difficulty it raises is really to do with the uncertainty of the clause. We dealt with it in written submissions because it was in the last draft produced by the Law Commission that was on the table and we felt that we should deal with it there, unlike Clause 14, which we did not deal with—which was why I waved my arms yesterday. Clause 11 raises quite a few uncertainties that will be very difficult for the broker and the underwriter—I am obviously talking for underwriters—to resolve. First, they have to decide whether the clause goes to the whole risk or just to a type of loss than can arise. Even if one takes the Law Commission’s own examples, one can argue it both ways: whether the term goes to the whole risk so that it does not really fall under the controlling mechanism of Clause 11, or whether it goes to just one type of risk. In some ways, one feels that the underwriter would need a lawyer at his hand, and even the lawyer might not be able to answer without a court deciding whether the term goes to the whole contract or just to a particular type of loss. Then one gets into all the causation difficulties when the term goes to a particular type of loss. To give a very short answer, it is something that the Law Commission itself rejected as a route in the very detailed consultations that it did.

**Baroness Noakes:** I do not quite understand why over time you cannot evolve contractual forms that satisfy the market to deal with these issues.

**Mr Kees van der Klugt:** Obviously, we see model wordings being used, some much more often than others, but contracts differ hugely. The underwriter would have the problem of assessing how what I call Clause 11 would impinge on the terms throughout the contract in lots of very different circumstances. The situation is quite different if you are doing business on your own standard terms. This is offering standard terms to your clients, whether it is a mass commercial property risk or whether it is to consumers. Then you can design it very carefully, take advice on it and design it around the law. In our market, it is a very different proposition.

**The Chairman:** That is because you tailor-make it?

**Mr Kees van der Klugt:** Because you have tailor-made it.

**The Chairman:** But if you are going to take on tailor-making, as you do so well, are there not certain things that you know you have to deal with?
Mr Kees van der Klugt: I have explained as best I can that if you have a Clause 11-type mechanism, that can impinge on a contract throughout. It will cause lots of practical problems at the coalface—the broker and underwriter together. It will be difficult for them initially to see whether the broker's wording or the underwriter's wording, if it is bespoke to a particular client, has been put together in a way that is not contracting out. That is our initial question. Even at that stage, it is difficult. Can I just turn it around slightly? There are other factors that make a Clause 11-type provision far less necessary. If one is talking about consumers or micro-businesses, one has the ombudsman. The ombudsman uses the reasonable approach. I really do not think that Clause 11 is particularly necessary. Then we have the financial conduct regulator, and it is deeply ingrained in us that the client is at the heart of the business. The regulator is on top of these things. Again, when one is talking about consumers, there are the unfair contract term regulations 1999. Fairly regularly, but not that often, insurers give undertakings to the regulator not to use certain wordings that are considered to be unfair. All these mechanisms are out there anyway.

The Chairman: They are very real safeguards.

Mr Kees van der Klugt: Yes they are.

The Chairman: But it would be much happier, would it not, for the actual documents that set out the contract of insurance to cover matters without having to rely on the regulator to come in and sort things out?

Baroness Noakes: That is particularly the case in the case of the Financial Ombudsman Service, which is a complaints-based mechanism. It only comes in once there has been a failure to settle a complaint and it is referred on to the FOS. We cannot draft law on the basis that the FOS is going to make it fair and reasonable for a particular sector of the insured community.

Mr Kees van der Klugt: I can only say again, Lord Chairman, that we are very worried about the operation of that sort of clause.

The Chairman: I can assure you that we are concerned about Lloyd's being worried. We want to try to get to a situation where we meet your concerns, and we will bear that in mind.

Mr Kees van der Klugt: Yes.

Q16 The Chairman: Have you said what you want to say about your objections to the proposed new regime on fair presentation?

Mr Kees van der Klugt: I just wanted to make one point on fair presentation—or actually three points. I would like to record our members' concern about the message in Clause 3(4)(b). This is putting the underwriter on notice as opposed to just making fair presentation. We are advised that the law has not really changed; it is just that it is in a different spot. I am really just recording that quite a few members are concerned that putting this in Section 3(4)(b) sends out the wrong message. It should really sit under Section 3(5). It is not a lead point of ours—Section 4 is much more important—but we are getting a strong message from members.

The Chairman: I do not know whether you want to add anything on the points that we have been discussing, Ms Handyside.

Ms Philippa Handyside: I had only one comment that I should express on the part of some members of the Association of British Insurers on fair presentation. Proportionate remedies are very difficult to make work in a liability insurance context. We have members whose business is largely or even exclusively liability insurance. Where an underwriter is indemnifying for a claim made against a party, it will increase costs and delay claims if they pay only their proportionate share of the claim. In reality, to stop costs accruing and to make sure that the claim is paid quickly, they will need to gross it up to seek a contribution. That will often be a very difficult exercise. The liability members of the Association of British Insurers considered that the proportionate remedies worked very harshly in respect of their business. We raised that concern with David Hertzell of the Law Commission and he recognised, as does the industry that I represent, that the need for reform is there and that the reform will not work beautifully in all cases. It may lead to some people being in a worse position. I should register that concern on behalf of that section of our membership.

The Chairman: That is very helpful and clear.

Lord Ashton of Hyde: My question is some way back and I do not want to revisit it.

The Chairman: Lord Lea?

Q17 Lord Lea of Crondall: I am wondering whether we are going to ask the witnesses about the relationship between Clause 3 and Clause 4 and the whole question of the knowledge of the applicant.

The Chairman: Question 2 deals with that.

Lord McNally: Before we leave this, I would like to ask Mr van der Klugt how the particular areas that he is raising affect Lloyd's international competitiveness. I would be very interested to see the document about the London market because part of the motivation of this Bill is to keep London competitive and reputationally competitive.

Mr Kees van der Klugt: The four core proposals in the Bill, which I mentioned at the outset and with which we are in agreement, might potentially produce more cost for the market.

If you take proportionate remedies we think it might be more expensive than at present where there is just the remedy of avoidance. We think it is worth it for those core proposals. There could well
be more costs but the benefits will be greater. For Section 4, in particular, the costs could be much more than suggested in the impact assessment. It could affect the efficiency and competitiveness of the market.

**Baroness Noakes:** That sounds very tentative.

**Mr Kees van der Klugt:** No, it is not. Question 2 on my list is on Section 4, which we have grave concerns about. One can never say exactly what the cost implications will turn out to be.

**The Chairman:** That is the problem. Any reform has certain risks involved. You have indicated that Lloyd's accepts that there is a need for reform in this area.

**Mr Kees van der Klugt:** In the core areas, but not in Section 4. I have flagged one concern from members in Section 3 and have one other point to make on that. On Section 4, we are firmly of the view that there will be lots of costs associated with it and with the litigation that might ensue. We are quite clearly of that view, although we do not have a crystal ball.

**Lord Lea of Crondall:** It would be useful if you could elaborate on that, because in the evidence we have received, which you can corroborate I am sure, the Lloyd's Market Association has a view about Sections 4(4) and 4(6) and so on that is not general in the industry, in particular your own evidence in paragraph 19 and your interpretation of "senior management". Other people think that they can live with that, and in the hypothetical case of trying to define it perhaps the view would be that it would be better not to go down that track. As everybody would agree, the industry as a whole—and Lloyd's has its own characteristics—has such a variety of different types of management structure that "senior management" is a good catch-all phrase. In your case, you say that it simply means the board of directors. Why have you reached that view?

**Mr Kees van der Klugt:** The Bill says, "individuals who play significant roles in the making of decisions about how the insured's activities are to be managed or organised". Is not this question of it meaning the board of directors alone not a red herring that, if true, could lead to the immense contradiction that you want everybody in the company who is putting in the claim to step up to the plate and be responsible? I am not quite clear why you are now not able to satisfactorily accept what is actually in the Bill.

**Ms Philippa Handyside:** I am. **Mr Kees van der Klugt:**: We are advised by two QCs, and going on the Law Commission's own notes, that "senior management" is very restricted. They consider it to be the board. We are saying the same thing; we think that is too restricted. It is the board equivalent. That is our advice.

**Lord Ashton of Hyde:** You have just disappointed a whole lot of the executives.

**Mr Kees van der Klugt:** We think that it is far too narrow, because it does not capture in the disclosure process the information from key executives that should be attributable to the company.

**Baroness Noakes:** You agree but it is just a question of whether the wording achieves what you each want to achieve?

**Mr Kees van der Klugt:** I think that is probably the case.

**Lord Carrington of Fulham:** Does this not mirror what is in the financial services legislation, in practice the PRA and FCA? We discussed this yesterday with the Law Commission, which interprets it as being effectively the board in any case because it assumes that the board is running the company. If the board is not running the company it would pretty quickly tell the board to come off the board, if you see what I mean. Ought this not to apply to insurance companies in the same way? If you are on a board you have responsibilities to run the company and to know what is going on in it. If you do not, you should not be on the board.

**Mr Kees van der Klugt:** I think we are talking about a slightly different situation. Presently—and this is what we are saying should remain the case—a wider group of people than just the board have the relevant knowledge that should be disclosed when buying insurance. In fact, the key knowledge is probably with the key executives, not just at board level but under board level and with the chain of command. The concept, as we have been told by the Law Commission as it understands it, is just drafted or understood too narrowly.
Lord Carrington of Fulham: It is not drafted too narrowly. You are saying that it is too narrow in the Explanatory Notes.

Mr Kees van der Klugt: Our advice is that it is the drafting as well.

Lord Carrington of Fulham: I do not have an insurance background; I have a banking background. I am slightly concerned that you think that a board should not insist on knowing what is in the insurance contracts and therefore the information that has been provided by the senior managers. If the senior managers are not telling the board, there is something seriously wrong in the way the company is being run, just as the PRA would consider there to be a problem in a bank if that was happening.

Baroness Noakes: It is inconceivable that a board knows about individual insurance contracts. Speaking as somebody who sits on boards today, the people who know are actually quite a long way down the organisation. At best, it is the executive committee, where most decisions are made, having been properly delegated to them. The regulators accept that construct of governance, which is widely practised in the Anglo-Saxon world.

Lord Ashton of Hyde: You would have responsibility for it, which is different.

Lord Carrington of Fulham: I think this wording is fine, but delegation is the key. If the board feels confident in delegating, they are responsible for it.

Ms Philippa Handyside: Responsibility is not the same as knowledge, and that is an important distinction. In the PRA/FCA context, you are talking about a notion of responsibility almost in spite of knowledge. That is right and proper in the sense that the board should demand answers to questions, but knowledge of the context of a risk comes from the bottom of an organisation up, rather than the other way round, so I am very much in agreement.

Lord Carrington of Fulham: I have difficulty with junior employees being required to provide information to external parties which they do not provide to the board. Is that not what we are saying? I do not think it should be. It would not be in financial services.

Lord Ashton of Hyde: I do have an insurance background. For example, when you are doing computer modelling you have masses of data provided by individuals. Of course the board has to set up systems and controls to make sure that those data are accurate, but they do not know the individual details. Somebody further down the organisation whose job it is does provide that material information, but every single board member cannot know what is on the CD-ROM that is given to the insurer.

Ms Philippa Handyside: Or whether a warehouse stores oxygen cylinders.
of factual circumstances. This new scheme will introduce a degree of uncertainty. The LMA does not see it as one of the core desirable reforms. We think it is taking quite a big risk in an area that it is not necessary to reform.

Q18 Lord Lea of Crondall: In paragraph 20 of the Section 4 part of your evidence, you say that you are concerned that Section 4, “fails adequately to address the common practice of multi-party insurance”, and that, “Where a parent company with multiple operating subsidiaries takes out insurance in its own name, with the subsidiaries as mere beneficiaries of the policy, those subsidiaries will not be ‘the insured’”, but without the knowledge, necessarily, of the parent company. This is a special case of what we have been discussing for the last 15 minutes, I guess. Are you trying to have it both ways, to use the vernacular? We have a complexity of modern groups and shareholding arrangements. Is it in the broader national interest to stumble over facts like that, which obviously need to be covered if we are going to have a Clause 4? If you have a concern, is the onus not on you to say how you would improve the clause?

Mr Kees van der Klugt: We did forward our own suggestions to the Law Commission and we copied them to HM Treasury on 4 August: it is ingrained in my mind. We put forward some suggestions on trying to reach consensus in this area. Unfortunately, everybody has been working to a tight timescale and our suggestions were rather overtaken.

We are concerned about the area of beneficiaries of cover, how the reasonable search will extend through to them and whether there is a lacuna in the Bill. What if a beneficiary, which is not owned by the holding company that places the insurance, simply does not pass through highly relevant information to the holding company? There is no ownership between them: the holding company has to assimilate what is in its organisation. Does that mean organisations that are not even owned by it? Part of our problem with the clause is knowing what is “the organisation” and what are “the others”. And what if you simply do not get the relevant information from others that you do not own? We are unclear about how this will work.

Baroness Noakes: It would not be reasonable for you to have information from people you do not own if they have no other obligation to give you information.

Mr Kees van der Klugt: It would be absolutely reasonable to have the relevant information from beneficiaries for the purpose of arranging insurance cover; we are just worried about the situation where it is not given. My understanding is that this is currently dealt with by the “agent to know” concept in the common law, under which relevant agents—whoever they are, it could be an employee or an outside agent—need to pass through highly relevant information. If the common law is being ousted, we are into this new area. What if the target of the search simply does not pass through relevant information?

Ms Philippa Handyside: We share a modest concern on this issue with the LMA. Where someone is arranging insurance on behalf of a number of other entities, there is the possibility now that the law could develop to say that a reasonable search by the insured would involve getting all the information from the beneficiaries that would be obtained if the beneficiaries were the insured. The Bill certainly does not go that far, and in fact the Explanatory Notes at paragraph 42 do not really assist in leading to that sensible outcome. Paragraph 42, which relates to Clause 4, says: “The duty falls on ‘the insured’, defined in clause 1. In some situations, one party may enter into a contract on behalf of others. Who is ‘the insured’ in such cases is, and will continue to be, a question of construction of the particular contract”. That just does not help with the question of what happens when your insured is arranging a policy for a number of beneficiaries, corporate or otherwise. It would assist greatly if there was clarification about an insurer being the equivalent of an agent to know in such circumstances.

The Chairman: Have you an amendment in mind that should be made?

Ms Philippa Handyside: I could suggest one, which might be better in the provisions in the Bill than in the Explanatory Notes.

The Chairman: I would not ask you to draft it now, but perhaps you could in due course.

Ms Philippa Handyside: I would like to think I am up to doing it now, but I am not sure.

The Chairman: There are dangers, one knows, in not being cautious.

Mr Kees van der Klugt: My Lord, we can liaise on that point, and perhaps we could resurrect some drafting we worked up with our counsel.

The Chairman: Yes. I am not saying that we are going to adopt it, but we would like to see it. I would be very grateful if you and Ms Handyside could co-operate in any way you think possible.

Lord Lea of Crondall: Lord Chairman, such a codicil to the submission would need to reconcile what is being said in respect of Clause 20—that the subsidiaries are mere beneficiaries and are not the insured. Is there not a rather unbelievable dichotomy in ordinary speech in saying that they are beneficiaries but are not the insured?

Mr Kees van der Klugt: My understanding is that these beneficiaries are people who we as insurers are generally covering. It is just that under the definition of “insured” in the Bill, they are not the insured or the contracting party. But they are people we are genuinely covering for claims.
The Chairman: Yes. Could you do that within seven days?
Ms Philippa Handyside: Certainly we could.

Q19 The Chairman: That would be very helpful. We would be very grateful to receive it. We shall move on. Do you think there is any need to amend the law of warranties?
Ms Philippa Handyside: We have not covered your Question 3, about the knowledge of insurers, on which I had one small point.
The Chairman: I thought we had just been on that.
Ms Philippa Handyside: I am sorry. We covered the knowledge of the insured, but there is just one small point about the knowledge of insurers. Clause 5(2) (b) fixes insurers with knowledge of information that is readily available to the individuals making the underwriting decision. I only express the concern of the modern era that a glut of information is readily available. Almost any information is readily available, and that could infect the insurer with an almost impossible burden of knowledge which in reality they will not live up to. The information that is out there on the internet, which you do not have to pay for, should not necessarily be regarded as information that is readily available to the person making the underwriting decision. You might not know that it is out there or where to find it. There could be some information in the Explanatory Notes covering the point that just because something is on the internet, it does not mean—
Lord Carrington of Fulham: I do not know how you can restrict that. If it is there, you do a Google search for it and you find it. It is there and readily available. Do you say that you can use one search engine but not another?
Ms Philippa Handyside: I agree that it is impossibly difficult. The problem might be in the existence of this imputed knowledge provision. We discussed this at length with David Hertzell. The Law Commission is rightly trying to create a situation where the underwriter cannot live in his little silo and not have regard to information that it would be reasonably easy for him to find out, either within his organisation or more generally, about a risk. That is an aim which we applaud and support. The question is just whether this clause drags in a little too much for those purposes.
Lord Ashton of Hyde: It does differentiate though, referring to information “held by the insurer”.
Ms Philippa Handyside: Yes, although of course everyone has access to the internet.
Lord Ashton of Hyde: But that is not held by the insurer.
Baroness Noakes: Is this not about the insurer’s own information?
Ms Philippa Handyside: The insurer’s own information.

Baroness Noakes: But there is still a question mark in respect of the quantum of information that is held within a large and complex insurance group.
Ms Philippa Handyside: Absolutely.
The Chairman: I know that the Minister would like to ask something.
Lord Newby: Clause 5(2)(b), as Lord Ashton just said, does not simply say that the information has to be readily available but that it has to be held by the insurer and be readily available. That does not mean that we are talking about anything that might conceivably be on Google at all. It is saying that the information has to be held by the insurer. Just being able to access it by Google does not mean that it is held by the insurer, does it?
Lord Carrington of Fulham: Although you would expect the insurer to do due diligence, presumably, to find out what is readily accessible, as you would on anything else these days.
Lord Newby: Yes, but that is a slightly different point.

Baroness Noakes: The point is about information in the claims department and whether that has been passed on. That sounds simple, but in large groups it is not necessarily simple, although that is not the point that was being originally addressed.
Ms Philippa Handyside: You are absolutely right to point out that “held by the insurer” connotes something more than something in the internet ether.
The Chairman: However diligent an insurer is, Google will have more information.
Ms Philippa Handyside: Baroness Noakes is right: in a multinational insurance company there could be information about a risk buried in another country in another claims department which it would not necessarily be reasonable to expect—
Lord Ashton of Hyde: But if it is material to the risk, it would be reasonable, would it not?
Ms Philippa Handyside: There is certainly a question about the practicalities. In fact, there is not that information consolidation and searchability within insurers, and a need to introduce that would result in a massive additional cost.
Lord Ashton of Hyde: It is just a question of the insurer’s systems and controls and how they organise their company.

Baroness Noakes: It is partly how they organise their company and where they book their contracts. It is specific to the insurer: i.e. not all companies within an insurance group. It is a question of whether in practice there are any highly complex companies where that might be an issue. It might not be such a big issue.
The Chairman: Are these not just the sort of problems that are bound to have to be sorted out with regard to new legislation of this sort where there is the background of the previous legislation, which has been in existence for over 100 years?
Cannot the commercial court make it clear relatively quickly where the practicalities lie?

Lord Lea of Crondall: Presumably the alternative would be European or multinational legislation whereby the running of a multinational company—it is a fact of life—means that it has to have a management structure that has to take responsibility. The fact that it is complicated and puts up costs is in relation to the huge benefits of running a multinational company.

Ms Philippa Handyside: I am not sure.

Lord Lea of Crondall: You referred to the fact that somebody could be in another country and it might be difficult to search for this information. If we are talking about an insurable risk, the responsibility extends.

Ms Philippa Handyside: Yes, and the wording does say “readily available”, so it does not mean that you have to have infinite internal search engines to drag something up. It should be possible under this test for a piece of information to be held by an insurer that does not infect the knowledge of the underwriter. You are right that you do not arrive at perfect results. I just wanted to voice a concern about “readily available”. What the Law Commission was trying to achieve here in discussions was the recognition that in complex insurance companies you do not have a perfect flow-through of information held by the insurer to the underwriter.

The Chairman: Thank you very much, Ms Handyside. That is very helpful.

Mr Kees van der Klugt: As Lord Newby said, we had similar discussions with the Law Commission, but in the LMA we took some comfort in the words “held by the insurer”.

The Chairman: I wonder if we may move on. Can I ask Baroness Goudie to ask her question?

Q20 Baroness Goudie: I am pleased that you agreed with the Bill’s approach to fraudulent claims. How do you suggest we treat fraudulent means and devices as a lesser form of fraud?

Mr Kees van der Klugt: Lord Chairman, we are content with the Law Commission’s approach to fraudulent claims, and we simply think when it comes to the question of treating fraudulent means and devices as a lesser fraud it should be left to the courts. That is the clear view that I get from our members.

Ms Philippa Handyside: We and our membership agree entirely with the Law Commission’s approach that this is not a helpful distinction. Fraud is fraud and it is something that the Government are taking seriously. Chris Grayling announced a taskforce yesterday to address issues of insurance fraud. It is not the time to create fraud-lite.

Baroness Goudie: Thank you very much.

Q21 Baroness Noakes: Should there be a duty on insurers to make payment within a reasonable time—that is to say, should the clause that does not feature in the Bill be reinstated, not necessarily in the terms in which it was originally proposed but in the revised terms that I think you are aware of? I think that the ABI has said that it is supportive of the revised wording.

Ms Philippa Handyside: I am not sure that I have seen a revised wording of what was Clause 14. A version of Clause 14 was produced.

Baroness Noakes: I misled you. It is the original one, which has been dropped. It has not been revised.

Mr Kees van der Klugt: This is why I waved my arm yesterday. There is some confusion. I only waved it because I felt that I could answer your question immediately. We did not deal with this in our submission, and I think probably others also did not, because no new draft was proposed by the Law Commission, whereas there was a new draft of the dropped Clause 11.

The Chairman: Is there anything you wish to say? Mr Kees van der Klugt: Yes, most certainly. The first thing to say is that it is already a commercial imperative to pay claims. Our members certainly pride themselves on paying claims. One of our members pointed out in a written submission that league tables are kept by the brokers on who is the best at paying claims, so there is a commercial imperative first of all. Secondly, there is a regulatory imperative. I am not exactly sure where it has got to, but I think that the Financial Conduct Authority is doing one of its thematic reviews. It is moving away from the consumer arena into the commercial arena too, quite rightly. It is doing a thematic review on commercial claims. No doubt there will be guidance and things to look out for in that.

I am just making the point that there is a regulatory imperative as well. One of our main concerns about the Clause 14 damages for late payment, which was deleted, is that it could have given rise to speculative claims in the market. David Hertzell of the Law Commission is worried about that point. He agreed with that point yesterday and had indicated similar worries in fact about the deleted Clause 14. I do not want to put words into his mouth, but I think that is what he said yesterday and it is what I have heard before. There is a very great worry about speculative secondary claims for damages as soon as you have a difficult claim. With a difficult claim, the parties feel that they have to go to the courts or arbitration to deal with it. As soon as that happens, you get a speculative secondary claim for damages for late payment. In fact, you are now in court and it might take three years.

The Chairman: First, we have to understand what you mean about a late payment. I may be wrong and I would appreciate any help that you
Mr Kees van der Klugt: I am so not sure that we have the same understanding of the Law Commission’s intention. Our understanding was that if you went to court for genuine reasons and lost, you should have paid the claim without going to court. The Law Commission is clearly giving time for investigation, adjustment et cetera. However, if you go to court for genuine reasons and lose your action, the reasonable time for payment—

The Chairman: Shall we see whether the Minister could help on that?

Baroness Noakes: If it has gone to court, surely it is open to the party to pay the money into court to stop any further problem arising, so that it has the possibility of limiting its financial exposure once litigation has commenced.

Mr Kees van der Klugt: Certainly. That is the case, but we are talking about another whole segment of potential liability for damages.

Baroness Noakes: But relatively few go to court. We have had evidence that says there are relatively few disputes on insurance contracts.

Mr Kees van der Klugt: I think there are fewer and fewer. In the Law Commission’s consultations it was down to about 25 in the High Court in the last 10 years.

Baroness Noakes: So it is not a very big issue.

Mr Kees van der Klugt: Well, I think there are many more arbitrations going on.

Q22 The Chairman: I am very grateful for having my attention drawn to this. Did the draft clause, which we no longer have, deal with it in subsection 4, which says, “If the insurer shows that there were reasonable grounds for disputing the claim, whether it is the amount of any sum payable or whether anything at all is payable, the insurer does not breach the term implied by subsection (1) merely by failing to pay the claim, or the affected part of it, while the dispute is continuing.”?

Mr Kees van der Klugt: I take that on board. The slight difficulty is that we are talking about a clause that was deleted from the Bill last summer and it is not absolutely fresh in our minds.

The Chairman: I agree. That is why I am so grateful to the learned clerk for the draft of it, because it seems to me to be covering, in very clear language, exactly the point that we were discussing.

Mr Kees van der Klugt: Can I just make some other points?

The Chairman: Yes, certainly.

Mr Kees van der Klugt: There is a technical point there. If the damages for late payment claim is being heard at the same time as the main underlying dispute, there is a technical issue with having to release your privileged advice to show that you are acting reasonably. You would have very prolonged trials, because you would probably have to try the underlying matter first and then have the damages for late payment trial, because only at that point could you start to release privileged advice.

The Chairman: That surely is a molehill in these matters. The situation is that if there is a dispute that engages the court as to the right solution to the principal point, I cannot see that there would be many cases where the subsidiary point would be contested.

Mr Kees van der Klugt: I can only say that we feel that it is quite a practical point. You would have to have one trial after the other, because in showing you were reasonable you would, potentially, have to release your privileged advice. That is a technicality. I just wanted to raise my list of points.

The Chairman: By all means.

Mr Kees van der Klugt: Another very technical point is on limitation. Under the Law Commission’s proposed clause, which was dropped, the limitation period would move away from the date of loss to the time when it would have been reasonable to have made the payment. That could have reserving implications. I am not an actuary, but that is the feedback that we have been getting from our members. I think the Law Commission is quite sympathetic to that issue. There could be reserving issues in terms of more uncertainty. It is a technical point, but a material one.

The Chairman: Any other points?

Mr Kees van der Klugt: No. That is my quota.

The Chairman: Thank you for that.

Ms Philippa Handyside: Do you want to finish before I talk about damages for late payment?

Mr Kees van der Klugt: I just want to throw in another couple of things. One should not forget that the courts can already award interest.

The Chairman: Can they now award compound interest?

Mr Kees van der Klugt: They can award interest, but not compound interest.

The Chairman: I do not think they can.

Mr Kees van der Klugt: They can award indemnity costs for very bad behaviour by an insurer, so there are mechanisms. Because this was dropped from the Bill last summer and the Law Commission did not issue another draft as they did for Clause 11, we put in a suggested draft last August, which we thought was going to the nub of the Law Commission’s problem, about bad behaviour. The draft clause gave a right of action if there was deliberate or reckless mishandling of a claim.

The Chairman: Could you let us have that?

Mr Kees van der Klugt: Yes.
Baroness Noakes: That would be not the law of England but the law of Scotland, which is one of the advantages of this clause, as I understand it.

Ms Philippa Handside: This is a point on which I find that members of the ABI and the LMA are not in agreement. The members of the ABI were supportive of the introduction of Clause 14. It is universally accepted and supported by our members that claims should be paid within a reasonable time. It is not just disputes that dictate a reasonable time. For instance, if a business is flooded it has to dry out before you can start to reinstate. Obviously that goes to what a reasonable time is and the law is more than capable of acknowledging this.

We discussed with the Law Commission our concern about introducing an implied term of paying claims within a reasonable time. There is a very active entrepreneurial claims handling industry in the UK. You could create here a new cause of action so that a claim could be paid—not disputed but paid—and a claims management company could offer a service to the insured saying, “Do you think there was a delay from which you suffered a loss and it could have been paid a couple of months sooner?”. They can do a number of pre-action steps to work up that claim, the costs of which they will recover, even if there is a Part 36 offer or acceptance of the claim at a very early point. This has the potential to add a massive amount of frictional cost to the system. I quote the example of noise-induced hearing loss, which the claims management industry has fastened upon of late payment is not picking on the insurance market would not thrive, and we do. We should not lose sight of that. Those are my points. I was just trying to give some comfort on the broad area.

Ms Philippa Handside: You are absolutely right, and it is part of my day job to make representations for civil justice reforms that achieve that in all sorts of areas.

The Chairman: We do our best.

Ms Philippa Handside: Progress is slow in that sort of reform, as you well know.

Lord Lea of Crondall: I think we are now on Question 8.

Baroness Noakes: We have just addressed it actually.

Lord Lea of Crondall: In that connection, perhaps Lloyd’s could comment on the Clause 14 that was, which we all have in front of us. What in particular is wrong with it?

Mr Kees van der Klugt: Because the clause was taken out of the Bill last July, I do not have it in front of me.

Baroness Noakes: Could we have a note?

Mr Kees van der Klugt: We came up with a revised draft that we put to the Law Commission in August. We are very happy to put that into play again.

The Chairman: Could you be kind enough when you send your revised provision to bring a note at the same time explaining the points in writing?

That will let us get ahead.

Mr Kees van der Klugt: I could certainly do that.

The Chairman: We would be very grateful if you did.

Lord Lea of Crondall: Would it be fair to say that you are conscious of the fact that the issue of late payment is not picking on the insurance industry? A Bill for small firms got a Second Reading yesterday that has major clauses on this very question. There is a normal profile of the great damage done to people by late payment. Is it right for Lloyd’s to feel that it could be for another Bill? You are not opposing it in principle, but what is this hypothetical clause you could live with if it was in another Bill? Why not this Bill?

Mr Kees van der Klugt: If our draft could be lived with, it could be in the Bill very quickly. We put forward another draft and we could do that again. It is not for me to say whether there is enough time to put something else into the Bill. I know time is very short.

The Chairman: You are absolutely right, but if you could let us have it within a week I think we would be able to accommodate it.

Mr Kees van der Klugt: I would like to give some comfort to Lord Lea of Crondall that paying claims is why we are there. It is a commercial imperative. We are in a highly competitive market and if we did not pay claims properly and quickly the London market would not thrive, and we do. We should not lose sight of that. Those are my points. I was just trying to give some comfort on the broad area.
Further to your email of 20 November and the call for evidence by the Special Public Bill Committee, I attach the joint submission of the Lloyd’s Market Association (LMA) and International Underwriting Association of London (IUA) on the Insurance Bill, including a one-page summary.

We explain in the submission that the LMA and IUA are both associations representing some 100 firms underwriting insurance and reinsurance in the London market. The associations have been actively involved in the Joint Law Commissions’ consultations and in responding to drafts of the Bill throughout the process and have previously made joint submissions on behalf of member firms where there is common ground, as here.

The LMA would be pleased to give oral evidence and we thank the Committee for inviting us to do so. The meeting on Wednesday 3 December would be convenient. We leave it to the IUA to contact you separately, if they wish to request an opportunity to make an oral submission.

If it is likely that the Committee would wish to explore, against the background of the London market, detailed matters of the law and the possible legal effect of the Bill, then we would urge that dispensation is given for Alistair Schaff QC, who is advising us on these matters and has done in the preparation of our submission, to attend to give evidence. Following our recent telephone conversation, we understand this would require an Order of the House and the initial reaction of the Committee was not to seek this. We understand this but would simply ask that the Committee reconsiders, when it has had an opportunity to review the attached submission, whether it would find this useful.

The LMA would be content for me to give oral evidence relating to the LMA’s role, engagement in the consultation process and in commenting on drafts of the Bill, reasons for instructing counsel to advise (initially last Spring), main areas of support and concern, and our willingness to assist the Committee relating to any proposals to amend the Bill. If the Committee wishes to take expert legal evidence from our counsel, having examined me, then currently Alistair Schaff QC, who is advising us on these matters and has done in the preparation of our submission, to attend to give evidence. Following our recent telephone conversation, we understand this would require an Order of the House and matters of the law and the possible legal effect of the Bill, then we would urge that dispensation is given for Alistair Schaff would also be available on Tuesday 9th.

A significant area of concern of the LMA and IUA, as will be seen in our written submission, relates to section 4 of the Bill (Knowledge of insured). After HM Treasury carried out its consultation on the Joint Law Commissions’ draft Bill in June/July this year, we worked hard to prepare a suggested revision of section 4 for discussion, with consensus as the aim. We agreed with HM Treasury that we would do this and put forward our suggestions in early August. We have not been able to land an agreed draft with the Law Commission as yet (we have corresponded and met and thank them for this). We do not now put forward any suggestions on section 4 for three reasons: (i) we would need more detailed feedback on our suggestions of last August; (ii) we understand that a revised s4(5) on confidential information will be put forward by HM Treasury and we have not seen this as yet (and so have an incomplete picture); and (iii) other facets of how the Law Commission believes s4 would operate only became apparent during more recent discussions (in particular how s4(4) would operate in the reinsurance context). Our view is that urgent further efforts should be made to prepare an amendment to section 4 which meets with consensus or which retains existing law in this area (see our submission). We remain ready and willing to assist.

We do not mean by this email to have a longer bite at the cherry (our submission stands on its own) but simply wish to point out to the Committee some relevant background and our approach, which it may find useful.

We appreciate the opportunity to make submissions to the Committee and trust they are of value.

EXECUTIVE SUMMARY OF POINTS RAISED BY THE LMA AND THE IUA

1. The LMA and IUA represent a very significant constituency of London market buyers and sellers of (re)insurance contracted for under English law.

2. The LMA and IUA either positively support or do not oppose the vast majority of the Bill’s provisions.

3. However, the Bill raises one significant area of concern, in dealing with the actual or constructive knowledge of the insured for the purposes of disclosure:

   3.1. The LMA and IUA do not accept that the existing law is problematic or in need of reform.

   3.2. The LMA and IUA are concerned that the proposed reforms, far from promoting clarity, will lead to substantial uncertainty, a proliferation of disputes, and an increase in costs.
3.3. The LMA and IUA are particularly concerned about the ousting of the law of attribution of knowledge and deemed constructive knowledge from this area, and their replacement with the “reasonable search” test in section 4(4). That section is drafted in broad and vague terms which are apt to lead to disputes. 

3.4. On the one hand, some important sources of material information (particularly that known to senior employees or agents charged with responsibility for monitoring and reporting on the subject matter insured) may cease to be disclosable at all under the current proposals. 

3.5. On the other hand, creating a positive duty for insureds or reinsureds to undertake a “reasonable search” is, in fact, likely to prove more onerous for policyholders and, in its application of an objective test, will tend to hold all policyholders to the unrealistic standard of a prudent insured. 

3.6. Section 4(5) of the Bill also carves out a new category of “confidential information” obtained by the insured’s agent, which could never amount to the knowledge of the insured. This threatens to inhibit the passage of material information to the insurer.

4. The other area of concern arises from the JLCs’ draft of a new section on “Terms not relevant to the loss”, which does not currently feature in the Bill. This provision is controversial and the LMA and IUA oppose its addition, since it would effectively introduce notions of causation into the law in this area, something which the JLC have previously rejected (following consultation). Moreover, there is substantial uncertainty over the types of contractual term to which the provision would apply.

The Insurance Bill

Written submissions of the Lloyd’s Market Association and the International Underwriting Association of London for the Special Public Bills Committee of the House of Lords

I. Introduction

1. The Lloyd’s Market Association (LMA) represents the interests of the 57 Lloyd’s managing agents underwriting on behalf of the 90 syndicates operating in the Lloyd’s market and also the 3 members’ agents which advise capital providers. The premium income capacity of the Lloyd’s market in 2014 exceeds £26 billion. The purpose of the LMA is to identify and resolve issues which are of particular interest to the Lloyd’s market, and a central area of interest is law reform.

2. The International Underwriting Association of London (IUA) represents 42 international and wholesale insurance and reinsurance companies operating in or through London. The IUA’s London Company Market Statistics Report shows that premium income for the company market in 2013 was £17.445 billion, with a further £6.831 billion controlled by London but written elsewhere.

3. The London market is currently the largest global hub for commercial and specialty risk, underwriting 10% of global commercial insurance gross written premium (GWP); and 13% of global reinsurance GWP. This includes 57% of worldwide aviation GWP, 48% of worldwide offshore energy GWP and 33% of worldwide marine GWP. In terms of market standards, the London market has been ranked first overall, followed by Switzerland and New York, consistently outperforming in product expertise and flexibility of policy wordings (amongst other attributes surveyed).

The LMA and IUA are keen to ensure that these achievements are maintained and supported by the legal infrastructure underpinning English insurance law.

4. Many members of the LMA and the IUA also have a significant interest in the Insurance Bill (the Bill) in that they are themselves significant buyers of reinsurance to which English Law is applicable. Accordingly, they do not solely approach the Bill from their position as insurers, but also as reinsureds. In their capacity as both sellers and buyers of (re)insurance, the certainty of any proposed law reform is as, if not more, important than whether the changes tend to favour one side or other.

5. Over the past year, the LMA’s Law Reform Committee and the IUA’s Legal & Regulatory Committee have made extensive representations to and engaged in a fruitful dialogue with the Joint Law Commissions (JLC) on the subject of the Bill. Together, the LMA and IUA are referred to in these written submissions as “London Market Carriers”, or LMC.

II. LMCs’ approach to the Bill

6. From the outset, LMC have acknowledged that the Bill embodies a number of reforms which are desirable, and which LMC support. These include (i) the removal of the draconian right of avoidance as the sole remedy for non-disclosure and misrepresentation and its replacement with more proportionate remedies; (ii) clarification of the law on fraudulent claims; (iii) the abolition of basis clauses; and (iv) the conversion of warranties from conditions precedent to liability to suspensive conditions. In these key areas, LMC agree that reform is desirable so as to ensure that London continues to be perceived internationally as a competitive insurance market, with a modern legal regime fit for purpose in the 21st century.

5 All references to sections of the Bill are to HL Bill 39, introduced into the House of Lords for first reading in July 2014 (unless otherwise stated).
7. There is a second category of provisions in respect of which, although they harbour doubts about the need for or the possible effect of statutory intervention, LMC have accepted the changes embodied in the Bill. This includes the re-characterisation of the nature of the insured’s duty towards the insurer, described in section 3 of the Bill as the “duty of fair presentation.”

8. There remains, however, a third area where LMC believe that the Bill encroaches on ground where reform of the law is neither necessary nor desirable, and where the proposed changes will lead to unjustifiable results, or will at least create an unacceptable degree of uncertainty, and increase the frequency, length and cost of disputes. This is undesirable for both insurers and policyholders. LMC’s concerns in this area are outlined for the Committee below and focus principally on the subject of the knowledge of the insured for the purposes of the duty of disclosure. Subject to a satisfactory resolution of these matters, LMC are willing to support the Bill, and the use of the special procedure for non-controversial Law Commission Bills.

III. Knowledge of the insured (section 4 of the Bill)

9. The law governing what is known to, or is to be treated as known to, the insured is of great practical significance, since it dictates what information the insured must disclose to the insurer during a risk presentation. This flow of information from the insured (who knows or should know all about the risk) to the insurer (who is not engaged in the insured’s business, and is therefore comparatively uninformed) is the fundamental prerequisite for an insurer effectively to underwrite any risk.

10. The current law enshrined in section 18 of the Marine Insurance Act 1906 requires an insured to disclose every material circumstance “known to the assured” and provides that “the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him.” Although the academic writers disagree on some of the nuances of this test, it is not an area of the law which has spawned significant dispute in recent years. Existing case law provides flexible answers based on the circumstances of each case, flexibility which the JLC have acknowledged is both helpful and appropriate. In an area which is fundamental to the duty of disclosure, LMC do not consider that reform of the law is either necessary or (in view of the uncertainties or changes likely to result) desirable.

11. The impetus for reform of the law on knowledge appears to arise from two practical concerns expressed by the JLC. First, research has suggested that some large commercial insureds do not understand what they must do in order to fulfil the duty of disclosure, in particular, as regards what they “ought to know” for the purposes of section 18(1) of the Marine Insurance Act 1906. Secondly, the duty to disclose all material circumstances is said to be too onerous, particularly for larger businesses, where the volume of material information may be very large.

12. The LMC would respectfully suggest that these are not very compelling reasons for upsetting established legal principles in such an important area. LMC do not accept that changes to the law should be dictated by large commercial policyholders’ perceived lack of understanding of their duty of disclosure, or by the practical difficulty which the act of presenting a risk may entail for them, particularly given the large and sophisticated broking market involved in most commercial insurance, whose role extends to assisting policyholders to present a risk effectively. The policy of the law on knowledge of the insured is to foster disclosure of material circumstances to insurers. Without such a transfer of knowledge, no insurer can effectively underwrite any risk. While the law must not be blind to the practicalities of this process, it should be of secondary importance to the fundamental purpose which the law should encourage. The tail should not be allowed to wag the dog.

The Bill’s approach to knowledge of the insured

13. In terms of the corporate insured, the Bill’s solution to the perceived practical difficulties described in paragraph 11 is twofold:

13.1 Section 4(3) exhaustively defines the people whose knowledge will qualify as that of the insured; namely, those who are part of the insured’s “senior management”, and those who are responsible for the insured’s insurance, including agents.

13.2 Section 4(4) defines what the insured “ought to know”, which is that which should be revealed by a “reasonable search” of information available to the insured, and others.

14. The clauses summarised above exhaustively define the insured’s knowledge, for the purposes of the new duty of fair presentation. In its effect, the Bill proposes two fundamental changes to the existing law. First, the principles of attribution of knowledge and deemed constructive knowledge which currently play a seminal role in prescribing what an insured knows or is treated as knowing for the purposes of its duty of disclosure, are significantly ousted. Secondly, in their place, the Bill introduces an objective concept of the ‘reasonable search.’

6 Although the LMC harbour reservations about what signal may be communicated to the market by what the LMC consider to be an unnecessary recharacterisation of the duty in section 3 of the Bill, they understand that the JLC do not intend (by the changes) to effect any substantive alteration in the law, particularly as regards an insured (or its broker) who intentionally disclosed a limited amount of information in the hope that the insurer would fail to make further enquiries: JLC Report to Parliament 333 (July 2014), [7.39-7.40]

7 This support does not extend to a recent proposal by the JLC for a new section 11 dealing with “terms not relevant to the actual loss”, a subject addressed in Appendix A.

8 JLC Report to Parliament 353 (July 2014), [8.31]

9 JLC Consultation Paper 204 (May 2012), [4.25]-[4.34]; JLC Report to Parliament 353 (July 2014), [5.8]-[5.10]

10 JLC Report to Parliament 353 (July 2014), [5.14]-[5.27]
15. Under the existing law, an insured will be treated as knowing (attribution) or be deemed to know (constructive knowledge) material circumstances which are known by or which ought to be known by (i) the insured himself (if an individual) or the ‘directing mind and will’ of the insured (if a company or other non-individual entity); (ii) the individuals responsible for the procuring of the insurance (including the broker); and (iii) those individuals to whom responsibility for managing, or relaying information about the relevant subject matter insured has been delegated. The category (iii) class of person is sometimes described as “the agent to know,” based on the decision in *Proudfoot v Montefiore*. In big commercial organisations, many individuals below board level exercise delegated responsibility for keeping the company fully informed about the state of property that is the subject of insurance. Under the Bill, material circumstances known by such an ‘agent to know’ will no longer be treated as information known by the insured. Instead, the Bill proposes to address this head of knowledge exclusively under the ‘reasonable search’ limb. LMC submit that the proposed change would be backward development in the law which would risk uncertainty and, quite possibly, less disclosure of material information than insurers currently have the right to expect. Secondly, the proposed enquiry may not throw up the same answer as the current attributed or constructive knowledge test. If the agent’s knowledge in *Proudfoot* is no longer to be attributed to or deemed to be that of the insured, it seems questionable whether the fact of the ship’s loss should reasonably have been revealed by a ‘reasonable search’ of information held by the agent. Although the LMC do not understand the JLC to be intending, by the Bill, to reverse the long-standing decision in *Proudfoot*, the LMC are troubled by the tentative way in which the JLC suggest that the knowledge of an ‘agent to know’ “may well be included as what the insured ‘ought to know’” under the ‘reasonable search’ test. There should be no room for uncertainty here.

16. First, the ‘reasonable search’ enquiry will involve a factual (and very possibly, expert) enquiry, the outcome of which, in the particular circumstances of a given case, may not be self-evident. Although one would expect an ‘agent to know’ to be the subject of a ‘reasonable search’, one should not require a trial of the fact-specific issues of what constitutes a reasonable search and what should reasonably have been revealed by such a search to determine whether information known to such an agent is to be treated as knowledge of the insured.

17. Secondly, the proposed enquiry may not throw up the same answer as the current attributed or constructive knowledge test. If the agent’s knowledge in *Proudfoot* is no longer to be attributed to or deemed to be that of the insured, it seems questionable whether the fact of the ship’s loss should reasonably have been revealed by a ‘reasonable search’ of information held by the agent. Although the LMC do not understand the JLC to be intending, by the Bill, to reverse the long-standing decision in *Proudfoot*, the LMC are troubled by the tentative way in which the JLC suggest that the knowledge of an ‘agent to know’ “may well be included as what the insured ‘ought to know’” under the ‘reasonable search’ test. There should be no room for uncertainty here.

18. Thirdly, the problem is compounded by the Bill’s definition of “senior management” which is central to what a corporate insured is to be known as knowing. The JLC definition of this term is too narrow, because it captures (and is intended to capture) only executive decision-makers responsible for the whole of a company’s affairs, which would usually mean the board of directors alone. The current drafting does not capture the knowledge of “full-time executives,” let alone people who are actually involved, at a senior level, in the actual management or supervision of relevant insured activities or insured property, in spite of the fact that it is precisely such individuals who are likely to possess material knowledge. The JLC appear to have relied on a rule of attribution appropriate in a wholly different context (corporate homicide) and applied it to the duty of disclosure, even though the current ‘directing mind and will’ test would be wider. Although it may be said that the knowledge of individuals who participate (at a senior level) in the actual management or supervision of relevant insured activities or property would be caught by the ‘reasonable search’ provision in section 4(4), that conclusion is not self-evident and should not be left to chance in that regard.

19. Fourthly, LMC are also concerned that section 4 fails adequately to address the common practice of multi-party insurance. Where a parent company with multiple operating subsidiaries takes out insurance in its own name, with the subsidiaries as mere beneficiaries of the policy, those subsidiaries will not be “the insured” within the meaning of the Bill, meaning their knowledge will not (without more) amount to the knowledge of the parent company. Under existing law, relevant knowledge of the subsidiaries expected to be acquired by the parent company in the ordinary course of its business would be deemed that of the parent company. Leaving the disclosure of such known facts to depend on the vagaries of the ‘reasonable search’ test risks introducing significant uncertainty in circumstances where the subsidiaries are the beneficiaries of the insurance, and may be in possession of highly material information.

Section 4(4)—the reasonable search

21. As already foreshadowed, LMC are particularly concerned about section 4(4), which exhaustively defines what an insured “ought to know” test.

11 (1867) LR 2 QB 511. A cargo owner’s agent knew that the ship carrying the cargo had been lost, but purposefully did not inform him of the fact, so that the owner might arrange insurance. The owner was attributed with the agent’s knowledge, since the agent was under a duty to communicate it to him (as an “agent to know”). If the law were otherwise, such agents might be encouraged fraudulently not to inform their principals of material matters: Cockburn CJ at 521–522.

12 If the information was in the agent’s mind alone, it might be said that it should not have been reasonably revealed to the principal by a reasonable search of available information, particularly if the agent was purposefully keeping his principal/insured in ignorance of such matters.

13 JLC Report to Parliament 353 (July 2014), [8.87]

14 Ibid., [8.54-8.60]

15 The UK Corporate Governance Code describes the board’s responsibilities as “setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship”. The board “is to be distinguished from the day to day operational management of the company by full-time executives”.

16 MacGillivray on Insurance Law (12th ed) para 17-012 suggests that the ‘directing mind and will’ test can include “non-directors to whom the exercise of the company’s powers has been delegated by the board of directors, whether generally or in relation to a particular business activity.”

17 Which is defined in the Bill as “the party to a contract of insurance who is the insured under the contract”
22. First, section 4(4) is drafted in broad and vague terms. If one of the principal reasons for its introduction is to clarify to an insured what it must do to fulfil its duty of disclosure, the section as currently drafted does not do so. Amongst the more uncertain elements of section 4(4) are the following:

22.1 Most fundamentally of all, what is the meaning of ‘reasonable search’? In the field of insurance, this is an entirely novel concept. The JLC have suggested that what amounts to a reasonable search depends on the context of the insurance, and will be a question of fact in each case.\textsuperscript{24} This offers little certainty to insureds or insurers. In the absence of any authority on what constitutes a reasonable search, it is highly likely that this question will not merely become enmeshed in factual disputes but will prove to be yet another fertile subject for expert evidence in all but the simplest cases, driving up the costs and uncertainties of litigation.

22.2 What is the meaning of ‘its own organisation’? It might mean the legal entity that is ‘the insured’ alone, but could also include associated companies within the same group as the insured; subsidiaries of the insured, and joint ventures.

22.3 What is the meaning of ‘others’? The term appears to be extremely broad and open-ended, and the JLCs’ commentary suggests that it really could mean any other party which knows of material circumstances, including all manner of third party outsiders.\textsuperscript{25} However, it might also be said that the inclusion of a stated example of ‘others’ (the insured’s agent) or previous restrictions on constructive knowledge derived from case law on section 18 may support the view that the scope of ‘others’ may not be as wide as the provision initially suggests.

23. Secondly, and leaving aside uncertainty over the precise meaning of ‘reasonable search’, LMC are not persuaded that requiring insureds to undertake such a search will in practice make their task in presenting the risk less onerous. On the contrary, the JLC envisage that the search may require the insured to go to such lengths as making enquiries with outside advisors including brokers, lawyers, technical advisers, suppliers and anybody else who may know matters which are relevant to the insurer.\textsuperscript{26} The JLC describe section 4(4) as amounting to a “positive duty” for the insured “to seek out information about their organisation.”\textsuperscript{27} No such positive duty exists at present, particularly if the area of search involves a wider class of persons than those whose knowledge would currently be treated as that of the insured’s.\textsuperscript{28} There is every chance that this duty to undertake a reasonable search may become just as, if not more costly and burdensome than the insured’s existing obligations.

24. Thirdly, and critically, this positive duty to undertake a reasonable search is intended to be measured by an objective standard, “by reference to a reasonable, prudent insured” of the relevant class of the insured.\textsuperscript{29} This is a very significant proposal. It has been suggested that the existing law is unclear as to the extent to which the section 18(1) test is subjective, objective or a combination of both. However, there is a strong foundation for the view that the ‘ordinary course of business’ test allows the insured to be judged by the ordinary practices of the business as he actually runs it, rather than the practices of his business as he should prudently run it.\textsuperscript{30} As was said in Australia & New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd,\textsuperscript{31} insurance should not only be available to those who conduct their business prudently; one of the purposes of insurance is to protect yourself against your own negligence or the negligence of your servants. The JLC acknowledged this very argument in their 3rd Consultation Paper— “the test should accept that not all companies are perfectly run.”\textsuperscript{32}

25. Conspicuously, the current Bill reverses that position. Section 4(4) would hold all insureds to the standard of a reasonable insured for the purposes of deciding what they ought to know. While it may be reasonable and realistic to treat FTSE 100 policyholders with dedicated insurance departments in this way, smaller businesses lacking the time and resources to undertake a ‘reasonable search’ as should have been carried out by a prudent insured will be penalised if they fail to disclose a material circumstance which they did not discover and which would not have been discoverable in the ordinary course of their actual business. This means that policyholders who fail to improve their business practices will lose cases which they would currently win, albeit that the remedy may be (but will not necessarily be) a proportionate one. This is not a recipe for improving the competitiveness of the London insurance market.

26. Fourthly, any dispute involving section 4(4) will compel the courts or arbitration tribunals to undertake an entirely novel factual enquiry in any case where the insured’s knowledge of a material circumstance is called into question. Whereas currently the courts apply a legal test based on the law of agency and section 18(1) of the 1906 Act, under section 4(4) they would be forced to determine what (in fact) should reasonably have been revealed by a reasonable

\textsuperscript{24} JLC Report to Parliament 353 (July 2014), [8.83] et seq.
\textsuperscript{25} Ibid., [8.90]
\textsuperscript{26} Ibid., [8.90]
\textsuperscript{27} Ibid., [8.81]
\textsuperscript{29} Ibid., [8.83]
\textsuperscript{30} MacGillivray para 17-014—“the assured is deemed to know only what he would be expected to know in the ordinary course of his own business, making allowance for its imperfect organisation, prior to the conclusion of the insurance. Therefore, he is not deemed to be aware of matters which should be known to him in the course of a well run business which he would have found out if he had re-organised his schedule or business system at the time in question. The assured need not undertake any special enquiry for the benefit of the insurer.”
\textsuperscript{31} [1960] 2 Lloyd’s Rep. 241 at 252
\textsuperscript{32} JLC Consultation Paper 204 (May 2012), [6.77]
search of information available to the insured, or an undefined category of ‘others’. This may (in effect) turn issues of alleged non-disclosure into a negligence-based enquiry, causing litigation to become more protracted and costly.27

27. Fifthly, a further concern about the effect of section 4(4) arises in the context of reinsurance. An insurance company (who is also a reinsured) will owe a duty of fair presentation to its reinsurer, including the duty to undertake a reasonable search. In conducting its reasonable search, it may now be said that the reinsured is obliged to ask questions of its underlying insured(s) and to disclose to reinsurers material information which should reasonably have been revealed by enquiries made of the underlying insured(s). If so, this could come close to creating a new and wide-ranging duty of care on the part of the reinsured to its reinsurer, which does not currently exist.28 Moreover, the scenario would become even more problematic if the reinsured would have written the underlying policy even if it had known of the material fact, but the reinsurer would not have done so. This would mean the reinsured could not avoid the underlying policy, but the reinsurer could avoid the reinsurance. The prospect of such a result is of very serious concern to reinsureds.

Confidentiality

28. In its current form, section 4(5) carves out a new category of information which would not be capable of amounting to the insured’s knowledge; namely, any “confidential information” which the insured’s agent obtains in the course of a business relationship with a third party. The law does not currently recognise any such limitation on the insured’s knowledge. Section 4(5) did not appear in the initial version of the draft Bill published by the JLC in January 2014. Moreover, subsection 5 represents a material extension of the proposal in the 2007 JLC Issues Paper, in which the JLC proposed that the exception should apply only to “information which the intermediary is under an obligation not to divulge...”.29 Section 4(5), however, contains no reference to an “obligation not to divulge” the relevant information, but to the seemingly broader concept of “confidential” information.

29. As a matter of principle, LMC do not accept that confidential information of the type contemplated in section 4(5) should effectively be rendered incapable of ever amounting to the insured’s knowledge. If the insured’s agent knows of a material circumstance (regardless of how he discovered it, or from whom), the Bill should not encourage the agent to keep that knowledge to himself. The current version of section 4(5) threatens to overrule the decision in Blackburn Low v Haslam.30

30. LMC understand that HM Treasury intends to produce a revised draft of this subsection, in order to take account of the problem. LMC will, of course, give careful consideration to any redrafted provision. They remain concerned, however, that the introduction of any carve-out of information based upon its confidential nature may lead to a proliferation of confidentiality agreements between brokers and beneficiaries of insurance policies in the market, and that this may inhibit the proper disclosure of material information. LMC consider that it would be better to leave agents to manage conflicting interests regarding confidential information as they do currently, on the basis of applicable rules and codes of conduct prescribed by relevant regulators and professional bodies.

Conclusion on knowledge

31. In response to the concerns summarised above, the JLC may simply say that insurers are free to contract out of section 4 where they are unhappy with that provision. LMC consider this to be too simplistic an answer to the problem. The Bill purposefully makes contracting out difficult, in that an insurer must not only draw any “disadvantageous term” to the insured’s attention, but such a term must also be clear and unambiguous “as to its effect”.31 This essentially requires an insurer to explain to its insured what effect any clause purporting to contract out of section 4 would have, failing which the attempt to contract out will be ineffective. There is a concomitant risk that a multitude of dedicated wordings may be produced (and potentially litigated) where that is not currently necessary, resulting in a loss of market efficiency. Finally, as HM Treasury identifies in its Impact Assessment of the Bill, default regimes matter, because they form part of the “choice architecture”, and have a major impact on people’s behaviour.32

32. The summary of concerns above underlines why LMC doubt whether reform of the law on knowledge of the insured is necessary or desirable, and LMC urge the Committee to think very carefully before endorsing it. LMC are concerned that in its Impact Assessment, HM Treasury have significantly underestimated the economic cost of the revised processes and the potential for increased disputes which may follow from introducing new and untested legal concepts with significant factual elements.

27 See the amicus curiae brief prepared on behalf of United Policyholders (a policyholders’ lobby group in the USA) in the Supreme Court of Texas: “The natural result of transforming a question of law into a question of fact is that discovery expands exponentially, litigation costs vastly increase, the time required to reach a resolution expands exponentially, and additional burdens are placed on . . . courts. The resultant increase in litigation costs, protracted discovery, and expansion of time to resolve these coverage disputes naturally favors the party to the transaction . . . that is in the financially superior position . . .”
28 At least, not in non-proportional reinsurance: Bonner v Cos [2006] Lloyd’s Re IR 385
29 Section 4(5), however, contains no reference to an obligation not to divulge the relevant information, but to the seemingly broader concept of “confidential” information.
30 Blackburn Low v Haslam (1888) LR 21 QB 144, per Pollock B at 152-154. Under section 4(5), the result would appear to be different.
31 See sections 15(2), 16(2) and 16(3).
33. The LMC would suggest that the best course of action would be to retain the existing test of knowledge and deemed knowledge in section 18 of the 1906 Act. If that course of action were adopted, the LMC would support the Bill.

IV. Other provisions of concern to LMC

Section 8(6)—burden of proof

34. Under the Bill, where the insured breaches the duty of fair presentation, the question of which remedies are available to the insurer turns on whether the insured’s breach was deliberate or reckless. If an insured deliberately or recklessly suppresses material information, the insurer may avoid the policy ab initio. If, however, the insured negligently or innocently omits to disclose material information, the insurer is entitled to whichever proportionate remedy is applicable in the circumstances.

35. Section 8(6) of the Bill places on the insurer the burden of proving that a breach of the duty of fair presentation was deliberate or reckless, in circumstances where the insurer will very rarely be in a position to know why the insured breached its duty, and will therefore be unable to plead that the breach was deliberate or reckless. This is particularly problematic because a plea of deliberate or reckless breach of the duty would, in most circumstances, effectively amount to a plea of fraud, which the insurer cannot allege unless it has reasonably credible material establishing an arguable case of fraud. In practice, therefore, even where an insurer has good reasons to suspect that the breach was deliberate or reckless, it may be precluded from pleading such a case, and therefore unable to obtain disclosure on that issue.

36. LMC propose that the initial burden should be on the insurer to prove breach of the duty of fair presentation, whereupon the burden should shift to the insurer to prove the breach was neither deliberate nor reckless. The shifting of the burden of proof in this manner is already seen in innocent non-disclosure clauses of many Financial Institutions crime policies, where (the insurer having proved breach of the duty of good faith), the burden is on the insured to prove that breach was (for example) “free of any fraudulent conduct or intent to deceive.” In the majority of cases, the insured would simply adduce evidence of the reasons for its failure to disclose material information (such as human error), thereby precluding the consequence of avoidance.

Section 12—remedies for fraudulent claims: group insurance

37. The current draft of section 12 attempts to address a situation where a fraudulent claim is made by a beneficiary of a group insurance policy, where that beneficiary is not a party to the insurance contract, and therefore not “the insured” under the Bill. In view of 12(1)(c), the section is currently only applicable in circumstances where each of the beneficiaries would be consumers, if they entered into the policy themselves. Its application is, therefore, too limited, and LMC consider that it should be widened, so as to cover any situation of group insurance where one of the beneficiaries makes a fraudulent claim.

V. Conclusion

38. The Committee will find attached an appendix (Appendix A)—commenting on a new (and controversial) proposal by the JLC to introduce a revised section 11 in the Bill concerning breach of a term not relevant to the loss.

39. The LMA and IUA are grateful to the Committee for taking the time to consider the concerns of the London Market Carriers. On account of the significance of the points raised, the LMA and IUA would be pleased to attend and make oral representations if the Committee would consider it helpful.

APPENDIX A

LMCS’ RESPONSE TO JOINT LAW COMMISSIONS’ REVISED SECTION 11

“Terms not relevant to the actual loss”

1. LMC have carefully considered the JLCs’ proposed section 11 of the Bill, which the JLC shared on 12 November 2014.

2. It is agreed by the JLC that issues of causation should not be introduced into this area of the law. Although the original proposal (in 2006-07) was to introduce a causation requirement, the JLC categorically rejected the idea in 2012. A major justification for this was uncertainty surrounding the law of causation. As the JLC concluded:

“Professor Clarke warned that “the history of English law on questions of causation is not encouraging”. That view was shared by other respondents who were concerned that introducing the test would necessitate

33 See section 8 and Schedule 1, para 2.
34 See section 8 and Schedule 1, paras 3 to 6.
36 Unless, of course, para 4 of Schedule 1 is applicable.
37 JLC Issues Paper 2 (November 2006), [7.67] and [7.76]: “we tentatively propose that the policyholder should be entitled to be paid a claim if it can prove on the balance of probability that the event or circumstances constituting the breach of warranty did not contribute to the loss"; see also JLC Consultation Paper 182 (June 2007), [8.45]
38 JLC Consultation Paper 204 (May 2012), [14.39]–[14.57].
a closer assessment of the exact chain of causation and the significance of potentially intervening events and that this could lead to increased litigation...

...The arguments raised have highlighted significant drawbacks with the proposal [to introduce a causation requirement], not least that it would introduce unpredictability into the law. In relation to our proposed reforms Professor Baris Soyer made the acute observation that "the desire to create a fairer regime can carry with it a real price in the shape of uncertainty." 40

3. The central reason for LMCs' opposition to the original form of section 11 (which appeared in earlier JLC versions of the Bill) was that it tended to introduce (albeit indirectly) scope for arguments over causation. LMC consider that the newly revised section 11 suffers from the same problem. They are also concerned about uncertainty over the contractual terms to which the new section 11 would apply. These two concerns are addressed below.

CAUSATION

4. The proposed test involves a consideration of whether "the insured ... shows that its breach of the term could not have increased the risk which actually occurred in the circumstances in which it occurred."

5. LMC consider that the revised section 11 could lead to the introduction of causation arguments into the law in this area. This may be illustrated through the examples which the JLC adopt in their explanatory note.

6. In one example, the insured warrants that the vehicle will be roadworthy, and the term is breached because a headlight is faulty.41 The vehicle skids on black ice. According to the JLC, if the incident occurs at night, "although the faulty headlight did not cause the accident, it is possible that it could have contributed, given the circumstances of the loss (that is, that it was dark and a headlight was defective)" and the insurer is not liable. On the other hand, if a collision with a truck takes place in broad daylight, where "there is no possibility that the defective headlight contributed to the accident, "the insurer is liable."

7. In the LMCs' view, this is a very uncertain distinction. It is likely to prove a recipe for disputes. Moreover, the enquiry comes close to introducing causation by the back door.

7.1 In the night time example, what stops the insured from asserting that the faulty headlight could have made no difference to the occurrence of loss 'in the circumstances in which it occurred', since the driver could not have seen the black ice in any event, even if the headlight had been working?

7.2 In the day time example, what stops the insurer from asserting that the daytime conditions were not so bright so as to dispense with the need for headlights or so as to disable the automatic headlight function and that if the headlights had been on, the truck could have seen the oncoming car and taken avoiding action?

8. In the other example, the insured factory is required to install a five-lever mortise lock on all doors; the term is breached because the insured installs a three-lever mortise lock on door A. The JLC suggest that if thieves broke in through the door, the insurer could rely on the breach (even if they battered the door down and the difference in lock would in fact have made no difference) but that if they broke in through a window, the insurer could not rely on the breach, since "in these circumstances, it would not have made any difference if door A had had a different lock".

9. Once again, the suggested distinction feels inherently uncertain and causal in nature:

9.1 If the cause of the loss is that thieves battered the door down, why cannot the insured argue that the mortise lock would not or could not have made any difference 'in the circumstances in which the loss occurred'?

9.2 If the cause of the loss is that the thieves came in through a window, what stops the insurer from arguing that the breach "could" have increased the risk of the loss which actually occurred, on the basis that if thieves (in general) found out that a building had weak door locks, they would be more likely to target it for a theft? The breach could have increased the risk of the loss which actually occurred in the circumstances in which the loss occurred, perhaps because the thieves targeted the building as a result of its weaker security.

Uncertainty over application

10. LMC note the presence (in subsection 1) of the words "other than a term defining the risk as a whole", in defining the types of contractual term to which section 11 will not apply. They are concerned that this creates yet more uncertainty and scope for dispute.

11. The distinction between what the JLC call a "risk mitigation clause"42 and a term which defines the risk as a whole is unclear and uncertain. The problem is that the concept of a term "defining the risk as a whole" is inherently unclear and uncertain, and is liable to be confused with a mere "risk mitigation" term. There is therefore tremendous scope for disputes over whether section 11 will apply to a given term, even before the actual application of the section is considered.

40 Ibid, [14.39] and [14.56]
41 Although
42 As an aside, the LMC are not at all certain that a roadworthiness clause of this type would trigger section 11, since (rather like the matter of a vessel's class), it seems to be a clear example of a term which "defines the risk as a whole". This is a further example of the uncertainty surrounding the question of the contractual terms to which section 11 will or will not apply.
43 That is, a clause which, if complied with, would tend to reduce the risk of loss of a particular type, or occurring at a particular time or place.
12. For example, in view of the heightened risk of fire at an oil refinery, the insured buys specialised fire insurance. The contract warrants that there will be a qualified fire officer in attendance at all times when the refinery is operational. Would section 11 apply to that term? The answer is not at all clear to LMC.

12.1 On one hand, it might be argued that where the specific risk being insured against is fire, a term warranting the permanent presence of a fire officer at all operational hours would seem to “define” the risk as a whole—because (in the JLCs’ words) it would “tend to affect either the whole risk, or a significant part of the risk”.

12.2 On the other hand, if complied with, the term would clearly tend to reduce the risk of a particular type of loss (i.e. loss caused by fire), or loss at a particular place (i.e. in the refinery). Whether or not section 11 applies seems to turn on the scope of cover provided: if narrow (i.e. only fire risks) then section 11 would apply, but if broader (such as an all risks policy), the exact same term might not be covered by section 11, because in that context, it would only affect the particular risk of a specific type of loss (as the JLC explain in paragraph 1.10 of their explanatory note).

13. The new section 11 therefore appears to be afflicted by precisely the kind of uncertainty which the JLC have, in the past, wished to avoid. Indeed, the JLC have previously stated “…It is clear that a causal connection test is not appropriate for all contract terms, and we think it would generate too much uncertainty to attempt to apply such a test to some terms and not others.” LMC are concerned that the new section 11 would generate too much uncertainty for precisely that reason; it attempts to apply to some terms, but not others.

CONCLUSION

14. LMC agree with the JLCs’ conclusions in 2012 and again in July 2014 that the law in this area should not be subjected to a causation requirement, either generally or as regards some clauses but not others. However, the LMC consider that under the revised section 11, the proposals do just that.

November 2014

Supplementary memorandum submitted by Lloyd’s Market Association and International Underwriting Association of London

We thank the special Public Bill Committee for the opportunity to make further submissions on section 4 of the Insurance Bill and also on clause 14 of the Joint Law Commissions’ draft Bill by putting forward new suggested sections and explanatory notes.

We attach the following:

(1) suggested s4 (Knowledge of insured);
(2) submission on s4;
(3) suggested cl14 (implied term about payment);
(4) submission on cl14.

We should be grateful if you could put these documents and this covering letter before the Committee.

Both these suggested sections and explanatory notes have been prepared jointly with the IUA. We have prepared the revised s4 with Alistair Schaff QC of 7 King’s Bench Walk and David Kendall of Edwards Wildman since the meeting of the Committee on 3 December. We had already proposed the suggested cl14 to the Law Commission last August, having worked this up with Gavin Kealey QC and Harry Wright of 7 King’s Bench Walk.

We have invited the ABI to support the suggested sections—s4 on the basis that it takes care of the concerns raised by the ABI at the meeting of the Committee on 3 December and also the concerns of the LMA and IUA; and cl14 on the basis that it represents a compromise to effect the core proposal of the Joint Law Commissions (a right of action for damages where there has been deliberate or reckless mishandling of a claim) but not to open insurers to potentially material frictional costs in handling a new head of claims (concerns of the LMA and IUA and also expressed by the ABI at the Committee’s meeting on 3rd). The ABI has not yet confirmed whether it would support either suggested section but we wish to send these to you now, so the Committee is able to review them in advance of its meeting on 9 December, if it so wishes. (The Committee asked for sight of our suggestions by 9th, agreed jointly with the ABI in the case of s4, if that was possible.)

We should like to draw to the Committee’s attention the following points in particular relating to the suggested section 4. We believes the revised draft resolves points examined in the Committee’s meeting on 3 December, including widening the definition of “Senior Management” so the knowledge of a wider group of senior executives in addition to the Board (together with knowledge of the individuals procuring the insurance) is attributable to a company for the purpose of disclosure under the s3 duty; and bringing beneficiaries (“Covered Persons”) expressly into the scope of the reasonable search, but otherwise achieving greater certainty as to the scope of the search (missing from s4 in the Bill).

We also believe the suggested section resolves other points not specifically examined on 3 December, in particular in relation to the perceived flaw in s4(5) whereby, for instance, material confidential information passed by a beneficiary

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*JLC Consultation Paper 204 (May 2012),[14.57] (emphasis added). See also [11.10]; “This [i.e. the difficulty of defining a warranty] is a stubborn obstacle which has dogged all previous attempts to reform the law.”

**JLC Report to Parliament 353 (July 2014), [18.38] et seq., albeit commenting on the JLCs’ previous version of the draft.*
of the insurance to the broker would not be discloseable to the insurer; and the potentially destabilising effect the current s4 may have in the reinsurance market if it introduces a duty of care on the reinsured to its reinsurers (see para 27 of the LMA/IUA 27 November submissions).

These concerns were set out in the LMA and IUA joint submission of 27 November, and the attached explanatory note contains relevant cross-references. Our concerns relating to the contracting-out provisions are set out in paragraph 31 of the LMA/IUA submission of 27 November. We mention this because of the difficulties we envisage in any attempt to contract out of Part 1 of the Bill (as mentioned in examination on 3 December) and therefore the high degree of importance that Part 1 is an appropriate framework for London market business, including reinsurance.

We would very much appreciate the Committee considering the suggestions we put forward in the attached documents. If the Committee is sympathetic to our suggestions, then this would remove the main point of contention we have with the Bill (s4); and it would enable another main policy area of the JLC to be included in legislation (c114).

December 2014

THE INSURANCE BILL

LMA/IUA SUGGESTED AMENDMENTS TO SECTION 4 OF THE BILL

4 Knowledge of insured

(1) Subsections (2) to (6) provide for what an insured knows or ought to know for the purposes of section 3(4)(a).

(2) An insured who is an individual knows –

(c) what is known to the individual, and

d) what is known to one or more of the individuals who are responsible for the insured’s insurance.

(3) An insured who is not an individual knows only what is known to one or more of the individuals who are –

(c) part of the insured’s senior management, or

d) responsible for the insured’s insurance.

(4) Whether an individual or not, an insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured (and whether the search is conducted by making enquiries or by any other means).

(5) In this section, information is available to the insured if it is known or held (in physical or electronic form or otherwise) by –

(a) the insured or any covered person;

(b) any individual responsible for the insured’s insurance;

(c) any officer, employee or agent of the insured or of any covered person; and

(d) any other person from whom the insured would reasonably be expected to obtain the relevant information for the purpose of complying with its duty of fair presentation.

(6) In this section, references to an individual’s knowledge do not include confidential information acquired by the insured’s agent (or an employee of the insured’s agent) through a business relationship with someone other than the insured or a covered person and which the insured would not reasonably be expected to have obtained for the purpose of complying with its duty of fair presentation.

(7) In this section –

(a) an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, or as an employee of the insured’s agent, or in any other capacity),

(b) “senior management” means those individuals who play significant roles in the making of decisions about how the insured’s relevant activities are to be managed or organised, or who participate at a senior level in the actual management or organisation of those activities,

(c) where a contract of insurance which is entered into by an insured also provides cover for one or more other persons, such other person (or persons) who is not an insured is a “covered person”.

December 2014

Memorandum submitted by the Lloyd’s Market Association and International Underwriting Association

London on their Proposed Revised Wording of Section 4 of the Insurance Bill

1. INTRODUCTION

At the hearing of the Special Public Bill Committee on the Insurance Bill on Wednesday 3 December 2014, the Lord Chairman invited the Association of British Insurers (ABI) and the Lloyd’s Market Association (LMA) to submit their proposed revised wording of Section 4 of the Insurance Bill. We attach the wording proposed by the LMA and The International Underwriting Association (IUA) and a version showing the suggested amendments to the current Section 4.
2. Amended section 4(4)

2.1. Reasonable search

On reflection, the LMA accepts, with some reluctance, that what would have been revealed by a reasonable search is an appropriate way of identifying material information to be disclosed to insurers.

2.2. Defined class of persons whose knowledge may be attributed to the insured

In order to clarify what the insured must do to make a fair presentation of the risk, the revised wording provides for a narrower, specifically defined category of persons to meet the concerns expressed in paragraph 22 of the LMA/IUA’s submissions dated 27 November 2014 (the LMA/IUA submissions). The reference to “others” in the current wording of the Bill is vague, open-ended and unlikely to be able to assist insureds in determining those persons from whom they ought to request information to satisfy the requirement to perform a ‘reasonable search’. It is also not clear what the term “its own organisation” embraces. The revised draft seeks to give certainty as regards the classes of person holding relevant information which would be regarded as available to the insured (subject always to the dictates of what would be regarded as a reasonable search in any given case).

2.3. Knowledge of beneficiaries of policies

The concept of a “covered person”, introduced in the new sub-section 4(5)(a), provides that the knowledge of a party who is a beneficiary of the policy, but is not the “insured” itself, will qualify as the knowledge of the “insured”. This revised wording aims at reflecting the nature of modern insurance practices in medium-to-large corporate insureds in which group policies are frequently obtained by a holding company in its own name but which also insure its subsidiaries, employees and contractors (see paragraph 20 of the LMA/IUA submissions). The ABI expects to make its submissions on this point by close of business on 9 December.

2.4. Employees

As the search has to be a reasonable one, employees who are not likely to possess any relevant information will not be expected to be subject to it. Information held by the cleaning staff will not be included; information held by the management of a major operating subsidiary will be.

3. Revision of section 4(5)

Under the proposed revision to the current section 4(5) (section 4(6) in the attached draft), the insured will be fixed with knowledge of information held by its agent that was acquired confidentially only if the insured would reasonably be expected to have obtained that information. This would retain the current flexibility of the common law and mirrors the current common law position outlined in the case of Blackburn Low v Haslam (1888). The current section 4(5) was, in any event, to be revised by HM Treasury—see paragraphs 28-30 of the LMA/IUA submissions.

4. Amended section 4(7) (section 4(6) in the current draft)

4.1. “Senior Management”

The definition of “senior management” in section 4(7)(b) has been amended so as:

(i) to make it clear that it is the insured’s activities that are relevant to the insurance that are the subject of disclosure; and

(ii) to include those “who participate at a senior level in the actual management or organisation of [the insured’s] activities.”

We believe this addresses the concerns raised by members of the Special Public Bill Committee during the hearings on 2 and 3 December 2014 about which individuals involved in the management of a corporate insured are likely to hold relevant information.

4.2. “Covered Person”

Section 4(7)(c) defines the beneficiary of an insurance policy (see paragraph 2.3 above) as a “covered person”. This definition could also be used to extend section 12 of the Bill to non-consumer beneficiaries (see paragraph 3.2 of the ABI submissions dated 27 November 2014 and paragraph 37 of the LMA/IUA submissions).

PROPOSED LMA CLAUSE 14

14 Implied term about payment

1) It is an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must not deliberately or recklessly fail to pay, within a reasonable time, any sums due in respect of the claim.

2) A failure to pay a sum due in respect of the claim is:

a) deliberate only if the insurer knew that the sum was due, but nonetheless decided not to pay it in a reasonable time.
b) reckless only if the insurer did not care whether or not the sum was due, and therefore decided not to pay it in a reasonable time.

3) The insurer shall always have a reasonable time in which to investigate and assess the claim (whether as to any liability to pay in respect of the claim, or as to the amount of any sum payable).

4) In this section, “a claim under the contract” does not include any claim for breach of the term implied by subsection (1).

5) Remedies (for example, damages) available for breach of the term implied by subsection (1) are in addition to and distinct from –
   a) any right to enforce payment of the sums due, and
   b) any right to interest on those sums (whether under the contract, under another enactment, at the court’s discretion or otherwise).

6) This section does not affect any other implied term of the contract of insurance relating to the time of payment.

7) Nothing in this Act shall alter any rule of law according to which, in any contract of insurance, the insurer’s promise is to hold the insured harmless against loss caused by an insured peril, the breach of which gives rise to an action for unliquidated damages.

December 2014

Further memorandum submitted by the LMA and IUA on Clause 14

Introduction

1. These further submissions are made by the Lloyd’s Market Association (LMA) and the International Underwriting Association of London (IUA) in response to the request made by the Lord Chairman of the Special Public Bill Committee on the Insurance Bill at the hearing on Wednesday 3 December 2014 that the LMA provide a note of its views of clause 14 (Implied term about payment) of the Joint Law Commissions’ draft Insurance Contracts Bill dated 17 June 2014 (the Bill). The views set out below are based on the advice received from Gavin Kealey QC and Harry Wright and reflect the concerns of the LMA and IUA. We also attach the LMA’s proposed alternative clause 14 as requested.

The implied duty

2. Clause 14(1) of the Bill would imply into every contract of insurance a term that the insurer must pay any sums due within a reasonable time (the implied duty). This is a material departure from existing cases, which have refused to imply any such duty into contracts of insurance.45

3. “A reasonable time” includes reasonable time for the insurer to investigate and assess a claim (14(2)). The clause offers (in 14(3)) fairly bland guidance on considerations which may be relevant in assessing reasonableness: the type of insurance; the size and complexity of the claim; whether relevant statutory or regulatory rules have been complied with; and, any factors outside the insurer’s control.

4. Importantly, 14(4) provides that “If the insurer shows that there were reasonable grounds for disputing the claim” whether as to liability or quantum), the insurer does not breach the implied duty merely by failing to pay the claim. However, it goes on to say that the insurer’s conduct in handling the dispute may be a relevant factor in considering whether the term was breached.

5. Finally, 14(5) provides that remedies which may be available for a breach of the implied term are in addition to and distinct from both the “right to enforce payment of the sums due” and “any right to interest on those sums”. The “sums” must means sums due under the policy. This means that if the insurer breaches the implied term to pay in a reasonable time, the insured may claim damages for additional losses it has suffered as a result of that breach (plus interest). The insured’s claim for breach of the implied term is separate from its claim for an indemnity under the policy.

6. By way of illustration, an insured under an all risks policy suffers fire damage to its factory, whereupon the insurer denies liability for alleged breach of the Duty of Fair Presentation, and does not pay the claim. The insured cannot remedy the fire damage itself, and is forced to cancel three particularly (indeed, unusually) lucrative contracts. At trial, it is held that there was no breach of the Duty of Fair Presentation, and the insurer pays the claim (plus interest). The insured then claims damages for breach of the implied term, claiming the losses arising from the cancellation of the lucrative contracts, plus interest. If successful46, the insured will receive damages (plus interest) on this sum, and this will be additional to and distinct from the payment of the claim.

46 In practice, we suspect that the insured would “tack on” a claim for damages for breach of 14(1) to their pleaded claim for the indemnity, provided there are facts to support it. This may become common practice for insureds if this change is enacted; we consider the implications of this below.
47 And this is by no means certain—as to which see below.
7. We have already noted that the proposed duty is based on an implied contractual term, and not on the insurer’s breach of the duty of utmost good faith, as the Joint Law Commissions previously suggested. Further, this change does not involve the re-characterisation of an insurer’s liability under an insurance contract as sounding in damages; nor does it abolish the common law rule against damages for late payment of damages.

8. The relevance of this analysis lies in the fact that any damages for breach of the implied term to make payment within a reasonable time would arise in contract, and would therefore be subject to the usual contractual rules on foreseeability. In essence, this means that an insured claiming under 14(1) would only recover losses which may fairly and reasonably be said to have arisen naturally, “according to the normal course of things”; or from special circumstances, but only if they were communicated to the insurer at the time the policy was concluded.

9. In practice, we suspect that many claims under 14(1) would struggle with foreseeability. Take, for example, the cause célèbre behind this proposed reform, Sprung. In short, Mr Sprung insured his factory against sudden and unforeseen damage, whereupon vandals broke in and caused considerable damage. Insurers rejected his claim (for reasons which do not presently matter). Importantly, Mr Sprung lacked the means to carry out repairs to his factory himself, and was unable to raise a loan. He went out of business. Four years later, after protracted proceedings, his insurers dropped their defence, and paid his claim, with interest. Sprung attempted to claim damages for loss of the opportunity to sell his business for £75,000, a sum which Mr Sprung said was caused by the insurer’s failure to make timely payment of his claim. The Court of Appeal rejected this claim, applying the authorities we have cited above.

10. Importantly for our purposes, it seems that even if 14(1) had then been in force, Mr Sprung would have struggled with the matter of foreseeability. This is because, as Evans LJ noted in the appeal, the cause of his loss (in being unable to sell his business) was Mr Sprung’s own choice not to reinstate the factory himself (a result of his own financial situation, and his inability to raise a loan). In those circumstances, Mr Sprung’s claim for damages under 14(1) (had it existed) may well have failed on the grounds that any loss he suffered was not in the reasonable contemplation of the parties at the time the contract was formed.

11. Foreseeability may, in practice, stymie many claims under 14(1), since to succeed, the insured would have to show that the kind of loss it suffered was in the reasonable contemplation of the parties at the time they contracted. In our example above (the factory owner who has to cancel the unusually lucrative contracts), unless the insured told the insurer of these contracts at the time the policies were concluded, the losses may well not be recoverable, since they may not be contracts which the insurer should have known the insured would have needed to fulfil in the ordinary course of things. The experience in Scotland (where damages for late payment may be available) demonstrates that many insureds fail to recover such damages for reasons of foreseeability. Indeed, even the Joint Law Commissions do “not anticipate many successful cases”, based in part on the Scottish experience.

12. Notwithstanding this point, in the context of smaller insureds especially, it may well be that loss of the type suffered by Mr Sprung (a small business owner) would (under the current law) be foreseeable. In particular, a court may well conclude that it is foreseeable that if an insurer fails to pay a small business insured’s claim in a reasonable time, that small business may well not be able to raise a loan, and may thereby suffer loss. This matter will, therefore, vary depending on the type of insured.

13. Notwithstanding our conclusion that in practice, successful claims under 14(1) would probably be rare, there are certain specific concerns arising from this reform, which we consider below.

Uncertainty over when breach occurs—in practice

14. For the purposes of limitation, since this would be a claim for breach of an implied term of a contract, time would start to run from the moment of breach. In practice, breach occurs when the insurer fails to make payment within a time that is reasonable. For example, on the facts of a given case, payment of a claim by 30 September may be reasonable, whereas by 1 October, for some reason, it may no longer be considered reasonable. In certain cases, declination of a claim from the very outset may not be reasonable.

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46 This would not be possible under the Bill, since (as discussed below) the insurer is not subject to that duty under the Bill.
47 Insurance Contract Law, Issues Paper 6 (Damages for Late Payment and the Insurer’s Duty of Good Faith), The Law Commissions, 80.
48 This is a result of the “hold harmless fiction”, a legal fiction whereby an insurer’s duty under the contract is to prevent harm from occurring. If harm does occur, the insurer is in breach of contract, and his liability to the insured therefore sounds in damages—see Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti); Secomoy Mobil Oil Inc v West of England Shipowners Mutual Insurance Association (The Padre Island) [1991] 2 AC 1. Although it has been strongly disapproved by the Joint Law Commissions, this fiction would be entirely unaffected by the Bill, and would remain good law.
49 The President of India v Lips Maritime Corporation (The Lips) [1988] AC 395, Lord Brandon at 425.
50 Hadley v Baxendale (1854) 9 Exch 341
51 Sprung v Royal Insurance (UK) Ltd [1999] 1 Lloyd’s Rep IR 111
52 With whom Pill and Beldam LJ agreed (118 and 119).
53 [1999] 1 Lloyd’s Rep IR 111, 118
54 At least, as the law on impracticability of an insured then stood it would have failed.
55 See, for example, Hawkins v Scottish Mutual Assurance Plc [2005] CSOH 101, RF MacDonald QC at [22], where the claim for damages for late payment failed on Hadley v Baxendale principles. See also Plews v Plaistead [1997] SLT 804, Temporary Judge TG Coutts QC at 808.
56 Insurance Contract Law, Issues Paper 6 (Damages for Late Payment and the Insurer’s Duty of Good Faith), The Law Commissions, [8.32].
15. This practical question on when breach occurs is mired in uncertainty and potential arbitrariness. Indeed, it may only be at the end of trial, when the court has fully assessed the reasons for the insurer’s delay in payment (and in particular the reasons it disputed the claim), that it is possible meaningfully to assess (i) whether the refusal was reasonable and (ii) when the refusal may have become somehow unreasonable (because new evidence emerged, for example). This will be a matter of fact. The inevitable result is real uncertainty over when breach occurs, which inevitably causes equal uncertainty over limitation.

**When would a claim for late payment be made?**

16. We envisage two possible opportunities for an insured to make a claim for late payment, both of which entail potential problems. First, the insured may claim under 14(1) after trial, i.e. after a court has determined (for example) that the insurer had no reasonable grounds for declining the claim. This would involve the insured bringing (and the insurer defending) a separate set of proceedings, thereby lengthening the process of litigation even further, and creating additional costs for all parties.

17. As a result, we suspect that it would become normal practice in most cases for an insured to ‘tack on’ a claim for breach of 14(1) to its ‘main’ claim for an indemnity under the policy. The court would therefore be required to decide, at trial, whether the insurer had “reasonable grounds” for disputing the insured’s claim from the outset (14(4)).

Further, in deciding whether the implied term has been breached, the insurer’s conduct may be a relevant factor (14(4)(b)). In considering either or both of these factors, an insurer may well be compelled to disclose privileged legal advice taken before disputing a claim, in order to prove that there were reasonable grounds for doing so (under 14(4)), or in order to evidence its conduct as being reasonable (under 14(4)(b)). While such advice would ordinarily be privileged from inspection, the insurer may be left with no choice but to disclose it (thereby waiving privilege) in order to support its contention that there was no breach of 14(1). The disclosure of such advice may nonetheless materially prejudice its defence of the ‘main’ claim for an indemnity under the policy. This mischief may be mitigated by the court hearing the claim for breach of 14(1) after it has decided the main claim, but this would lengthen proceedings and increase costs in the way described above.

“Reasonable grounds” for disputing a claim

18. Under 14(4), we suspect that there would be a factual burden of proof on the insured to prove that there has been a late payment (which would be fulfilled in the event that the insurer lost at trial, and had to pay). We think that the legal burden would then be on the insurer to prove that there were (in most cases) reasonable grounds for disputing the claim (viz. “If the insurer shows that there were reasonable grounds for disputing the claim...”).

19. The reasonableness of the grounds for disputing the claim will be objectively assessed. In considering reasonableness, if an insurer relies upon legal advice in declining a claim, and that legal advice turns out to be wrong (because, for example, the insurer’s case fails at trial), the insurer will not necessarily be in breach of the duty, provided the grounds for refusal are, objectively, reasonable. However, if the insurer could demonstrate that the advice was negligent (because, for example, it was demonstrably wrong in law), we think that the grounds for refusing the claim could not be “reasonable”, meaning the insurer would likely be in breach. We have already noted the potential problem of an insurer having to disclose privileged legal advice in order to defend a claim for breach of 14(1).

**The reasonableness of a refusal vs. the reasonableness of time**

20. Our comments above demonstrate that, regardless of the time the assessment of reasonableness is made, 14(1) will in most cases come down to a posthumous assessment of the insurer’s claims handling decisions, particularly the reasonableness of the grounds of refusal. This is clear from 14(4). The decisive factor as to whether the duty was breached will not, therefore, be *when* the claim is paid (which is the emphasis of the implied duty in 14(1)), but *why* the claim was declined (which is mentioned in 14(4))—i.e. an assessment of legal and/or factual merit.

21. In view of the above, we suggest that it may be more logical to reframe the implied duty as being one to refrain from refusing to pay a valid claim where the insurer either knows that the claim is valid, or is reckless as to whether or not it is valid. This, we think, would effectively tackle the mischief of bad claims handling, which appears (rightly in our view) to be the Joint Law Commissions’ primary target. Currently, the focus of the implied duty is on the timing of the payment; if the Joint Law Commissions seek to prevent bad claims handling, it is more logical to focus the implied duty (as 14(4) does) on the actual claims handling decision. We attach a proposed Clause 14 which addresses these concerns.

**Summary of Concerns**

22. In meetings and correspondence with the Joint Law Commissions and HM Treasury, the LMA and IUA have expressed the following concerns about the enactment of clause 14 of the Bill:

(a) Difficult questions will arise relating to foreseeability of loss and assessment of damages, leading to costly litigation;

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50 We say “from the outset” because under clause 14(4), the material time for assessing whether there were reasonable grounds for an insurer to decline a claim must be (or at least must include) the time the claim is initially declined, (viz. “shows that there were reasonable grounds”).

51 We say this based on the fact that under 17(2)(b) of the Bill, a deliberate or reckless breach of the implied duty would be non-excludable, meaning any such breach would be actionable by the insured, regardless of whether the parties have attempted to contract out of 14(1).
(b) Insurers will have disproportionate exposure for consequential losses compared to the insurance cover purchased and premium paid;

(c) Claims for damages for late payment will be tacked on to insurance claims as a matter of course whenever an insurance claim becomes difficult or contentious (for example when a difficult task is faced in assessing and agreeing a business interruption claim under a business interruption policy; or when hull and machinery insurance cover is purchased by a special purpose vehicle, i.e. a one-ship company, and that company has not also purchased business interruption cover but is unable to use its vessel pending settlement of a claim in normal course);

(d) Such speculative claims will lead to additional claims handling and other attritional costs, and therefore to higher loss ratios and higher premiums generally to the detriment of policyholders;

(e) Uncertain limitation periods will lead to the need for increased levels of reserving by insurance carriers and higher capital requirements (which again would affect premium levels);

(f) There will be difficult practical problems where an insurer may have to waive legal privilege on advice given on the underlying claim to show it had acted reasonably under clause 14;

(g) The problem of how these matters would be settled without resort to the courts;

(h) Clause 14 of the Bill is aimed primarily at the wrong target—the primary question should not be “Has payment been made late?” (when is late when a complicated claims assessment has to be made?) but “Has the insurer handled the claim properly?”

(i) The Financial Conduct Authority regulates the behaviour of insurers (including Lloyd’s managing agents) in precisely this area, so that there is no need to open the industry (and ultimately policyholders) to speculative claims and attritional costs (the work of the FOS, and the FCA under the Unfair Terms in Consumer Contract Regulations 1999 were mentioned during evidence on 3 December as additional protection for consumers).

23. The LMA and IUA understand that the Joint Law Commissions accept that clause 14 gives rise to real grounds for concern, particularly in respect of US-style speculative litigation and the creation of uncertain limitation periods, with consequent issues for insurers establishing loss reserves. As stated in our letter dated 30 June 2014 responding to HM Treasury’s consultation of June/July on the Bill, and for the reasons outlined above, our members would find clause 14 as it appears in the Joint Law Commissions’ draft Bill controversial. Notwithstanding our reservations, and those of the Joint Law Commissions, the LMA and IUA would be content to see the clause we suggest included in the Bill.

December 2014

Further supplementary memorandum submitted by Lloyd’s Market Association and International Underwriting Association of London—(10 December 2014)

BARONESS NOAKES’ AMENDMENTS

1. The LMA and IUA welcome the addition of third party beneficiaries of the insurance contract to clause 4(4). It is concerned that the words “any person who may benefit from the contract of insurance” may extend beyond those intended to be covered by the insurance to, for example, shareholders of the insured, and would prefer its own, narrower, definition of “covered person” at clause 4(7)(c) of its attached suggested amendments to clause 4.

2. We would prefer that the clause makes it clear that a search may be conducted by making enquiries to ensure that there is no doubt that this is the position.

3. For the reasons given by Lord Mance in his evidence on 9 December (at paragraph 10 of the transcript) and the LMA/IUA in paragraphs 28 to 30 of their submissions of 27 November, there is concern about the effect of clause 4(5) of the Bill. The LMA and IUA welcome the proposal to extend the excepted class of informant to “covered persons”, but in order to address the concerns of Lord Mance and the LMA and IUA, we would encourage the addition of the words “and which the insured would not reasonably be expected to have obtained for the purpose of complying with its duty of fair presentation” (see clause 4(6) in the attachment) to avoid the risk of obvious unfairness.

4. The LMA and IUA concur with Baroness Noakes in the need to make it clear that “senior management” is not confined to decision-makers for the purposes of clause 4(3)(a). Where the insurance is in respect of a part only of the insured’s business (for instance, insurance of cargo shipped by a large multinational), the relevant senior management may be those responsible for that part of the business (in our example, the shipping department) and we suggest that the word “relevant” be used to qualify “activities” in the definition of “senior management” rather than the words “whole or substantial part of the insured’s activities” as proposed in the amendment (see clause 4(7)(b) in the attachment).

As “senior management” is only applicable to an insured who is not an individual, we respectfully doubt whether the words “in relation to an organisation” in the amendment are necessary.

5. As regards the proposed re-introduction of clause 14 of the Joint Law Commissions’ draft Insurance Contracts Bill of 17 June 2014 concerning damages for late payment of a claim, for the reasons given by the LMA and IUA in their submissions of 8 December, and by Lord Mance in his evidence on 9 December (at pages 6 and 7 of the transcript), the LMA and IUA continue to object to this clause.
LORD NEWBY’S AMENDMENTS

6. As explained in paragraph 3 above, the LMA and IUA are concerned about the mischief that clause 4(5) may cause. As with Baroness Noakes’ amendment, we welcome the inclusion of “covered persons” in the excepted class of informants, but would encourage consideration of the additional words set out in paragraph 3 above to the clause. We should be very grateful if you could draw this letter to the attention of the Special Public Bill Committee.

THE INSURANCE BILL

LMA/IUA SUGGESTED AMENDMENTS TO SECTION 4 OF THE BILL

4 Knowledge of insured

(1) Subsections (2) to (6) provide for what an insured knows or ought to know for the purposes of section 3(4)(a).

(2) An insured who is an individual knows –
   
   (e) what is known to the individual, and
   
   (f) what is known to one or more of the individuals who are responsible for the insured’s insurance.

(3) An insured who is not an individual knows only what is known to one or more of the individuals who are –
   
   (e) part of the insured’s senior management, or
   
   (f) responsible for the insured’s insurance.

(4) Whether an individual or not, an insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured (and whether the search is conducted by making enquiries or by any other means).

(5) In this section, information is available to the insured if it is known or held (in physical or electronic form or otherwise) by –

   (e) the insured or any covered person;
   
   (f) any individual responsible for the insured’s insurance;
   
   (g) any officer, employee or agent of the insured or of any covered person; and
   
   (h) any other person from whom the insured would reasonably be expected to obtain the relevant information for the purpose of complying with its duty of fair presentation.

(6) In this section, references to an individual’s knowledge do not include confidential information acquired by the insured’s agent (or an employee of the insured’s agent) through a business relationship with someone other than the insured or a covered person and which the insured would not reasonably be expected to have obtained for the purpose of complying with its duty of fair presentation.

(7) In this section –

   (a) an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, or as an employee of the insured’s agent, or in any other capacity),
   
   (b) “senior management” means those individuals who play significant roles in the making of decisions about how the insured’s relevant activities are to be managed or organised, or who participate at a senior level in the actual management or organisation of those activities,
   
   (c) where a contract of insurance which is entered into by an insured also provides cover for one or more other persons, such other person (or persons) who is not an insured is a “covered person”.

December 2014

Further supplementary memorandum submitted by Lloyd’s Market Association and International Underwriting Association of London—(12 December 2014)

I am writing on behalf of the LMA and IUA, having taken further soundings from our members and the IUA. We should be grateful if you could bring this email to the attention of The Lord Chairman and members of the Special Public Bill Committee.

The LMA and IUA would be content with The Lord Chairman’s proposed amendment number 17 which is the new clause on “Interest on sums due in respect of a claim”. We consider this would be a fair way of dealing with the issue of late payment without giving rise to the deep concerns which we and others have expressed in evidence about the clause proposed by Baroness Noakes (amendment number 18), and which apply equally to the clause proposed by Lord Lea of Crondall (amendment number 16).

We write this respectfully to inform the Committee of the LMA’s and IUA’s support for amendment 17 as a solution.

December 2014
Memorandum submitted by Association of British Insurers

1 INTRODUCTION
1.1 The ABI is the voice of insurance, representing the general insurance, protection, Investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK. The ABI’s membership is interested in the Insurance Bill both as insurers and as purchasers of reinsurance.

1.2 I am the Head of Legal Affairs for the Association of British Insurers and have co-ordinated the ABI’s response to the Insurance Bill prior to its publication. The membership of the ABI has been very supportive of the reforms to insurance law contained in the Bill and our consultation responses have been limited to raising concerns about drafting and whether they achieve the intended outcome of the reforms. Subject to some residual drafting concerns, the membership of the ABI remains fully supportive of the published Insurance Bill.

1.3 We are aware of the possibility of a further amendment to the Bill to re-introduce a clause concerning the application of terms not relevant to the actual loss. This clause (and another on damages for late payment) was the subject of a limited consultation by Treasury in July 2014 and both were omitted from the published version of the Bill before the Special Bills Committee. Our response to the Treasury consultation supported inclusion of these reforms but raised concerns about drafting. The latest version of the clause on terms not relevant to the actual loss has been circulated by the Law Commission (and is appended to this response) and addresses the majority of our concerns with the previous version. The ABI, on behalf of its members, would therefore support an amendment to introduce a clause in these terms.

1.4 When considering my evidence on behalf of the ABI, the Special Committee should be aware of the context into which the Bill is Introduced. The UK insurance industry is the third largest in the world and the largest in Europe. It is a vital part of the UK economy, managing investments amounting to 26% of the UK’s total net worth and contributing £10.4 billion in taxes to the Government. Employing over 290,000 people in the UK alone, the insurance industry is also one of this country’s major exporters, with 28% of its net premium income coming from overseas business.

1.5 Insurance helps individuals and businesses protect themselves against the everyday risks they face, enabling people to own homes, travel overseas, provide for a financially secure future and run businesses. Insurance underpins a healthy and prosperous society, enabling businesses and individuals to thrive, safe in the knowledge that problems can be handled and risks carefully managed. Every day, our members pay out £147 million in benefits to pensioners and long-term savers as well as £60 million in general insurance claims.

1.6 It is in this context that the industry has supported reforms contained in the Bill which rationalise the law on insurance in a manner which reflects the modern context of insurance arrangements and the existing practices of our membership whose success and regulatory compliance rests on treating customers fairly.

2 SUMMARY
2.1 The ABI has been supportive of the Law Commissions work to date on reforming insurance contract law. The Marine Insurance Act no longer reflects either the commercial realities of the situations in which insurance is purchased and claims arise or of the way modern insurance companies operate. We appreciate the care taken by the Law Commissions to ascertain the views of as many stakeholders as possible in order to ensure that the reforms are as effective as possible. We consider the Insurance Bill effectively implements the reforms and, subject to some minor specific comments about drafting, has the full support of the ABI on behalf of its members.

2.2 The membership of the ABI is also supportive of the introduction of an amendment to the Bill of the clause relating to terms relevant to particular descriptions of loss in the terms of the draft made available to us by the Joint Law Commission and which is appended to this evidence, together with the explanatory note provided with it. Given that law reform in this area has been historically difficult to achieve the membership of the ABI are of the view that this opportunity for appropriate modernisation ought not to be missed.

3 COMMENTS ON SPECIFIC PROVISIONS OF THE INSURANCE BILL

Clause 12
3.1 An “and” should be added to the end of 12(3)(b).

3.2 Our members support the principle that the remedies for fraud in group insurance policies should be extended to non-consumer insurance business. While most commercial policies which cover groups of business are properly considered to be composite policies with multiple insureds, there are cases where a group policy as specified in 12(1) is written in a business context and in such cases there is no reason why the clause 12 regime should not apply. Our membership do not agree with the limitation to this reform expressed in clause 12(1)(c) as the qualification unnecessarily and without good reason limits the circumstances when the fraud of a beneficiary would impact on a group policy.

Clause 16(2)
3.3 In clause 16(2) “sufficient” should be replaced by “reasonable”.

4. PROPOSED AMENDMENT—TERMS NOT RELEVANT TO THE ACTUAL LOSS

4.1 Our membership positively supports the reform embodied in the Joint Law Commission wording for a clause on Terms not relevant to the actual loss. With the exception of paragraph 4.5 below, all our comments could be addressed in explanatory notes to the clause and we would not wish them to be read as conditional to our support for the introduction of this clause.

4.2 The Joint Law Commission draft aims not to introduce a causation requirement between breach and the loss but to limit consideration to the intent of the term in question. We are not sure of the extent to which this is really possible. Paragraphs 1.16 and 1.17 of the explanatory note say that, rather than show a lack of causation, the insured needs to show that the breach could not have made any difference to the loss. How would this be achieved in practice without the insured showing that the breach did not, in fact cause the loss? The 2nd example (vehicle skidding on black ice) states that because it is possible that the faulty headlight could have been a contributing factor then the insurer does not pay and the footnote implies this is the case even if the insured can prove that it didn’t make any difference. This is likely to produce bizarre outcomes.

4.3 It is worthy of note that, in a consumer context, ICOBS 8.1.2(3)R states that it is unreasonable to reject a consumer policyholder’s claim for breach of warranty unless the circumstances of the claim are connected to the breach. In other words, the FCA consumer equivalent provision introduces a causation requirement.

4.4 The relevance or otherwise of causation arguments needs to be clearly addressed so that the intent is very clear.

4.5 Paragraph 1.8 of the explanatory note states that the clause is not intended to apply to terms which “reduce the risk profile as a whole”. The draft itself states only that it does not apply to a term “defining the risk as a whole”. We do not consider these two to be the same. We marginally prefer the language of the explanatory note.

4.6 We remain of the view that there is scope for uncertainty and a risk of litigation associated with identifying the terms to which this clause applies. Some terms expressed in general language address specific risks and other clauses framed narrowly address a number of risks. For instance, term setting out the geographical limits of the policy is quoted in paragraph 1.8 of the explanatory note as a term reducing the risk profile as a whole (and not the target of the clause) but geographical limits can be aimed at addressing particular risks, such as piracy or weather risks.

4.7 The example given in paragraph 1.9 of the explanatory note is another example of the problem. A term relating to the qualifications of a ship’s captain can clearly be considered as specific to the risk of collision/damage and yet is quoted as an example of a term to which the clause does not apply.

4.8 In addition, paragraph 1.9 of the explanatory note refers to ship’s captain qualifications as affecting ‘the whole risk, or a significant part of the risk’. The emphasised words are not the meaning of the draft clause and should not appear in any explanatory note.

4.9 We consider that clause 11(2) of the draft Clause and any explanatory note should clarify the situation where breach relates to only part of a loss and whether payment should be made for the balance.

**REVISED CLAUSE II**

**II Terms not relevant to the actual loss**

1. This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it 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,
   (c) loss at a particular time.

2. If a loss occurs, and the insured has breached a term to which this section applies, the insurer may not rely on the breach to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3).

3. The insured satisfies this subsection if it shows that its breach of the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

4. This section may apply in addition to section 10.

**STAKEHOLDER NOTE: TERMS NOT RELEVANT TO THE ACTUAL LOSS**

*Draft Clause Dated 7 November 2014*

1.1 HMT has asked the Law Commission to look again at clause 11 of the original draft Bill to find an acceptable way of encapsulating the Commission’s policy on this issue.

1.2 Although there was general agreement on the policy behind the clause, a small number of stakeholders objected to the original draft on the basis that it was uncertain. There was concern that the clause might apply to terms which defined the risk as a whole. We have therefore worked with Parliamentary Counsel to address these concerns.

1.3 We would welcome your comments on this new draft.

**The underlying policy**

1.4 The new clause retains the following aspects of our policy:
(1) It only concerns contractual terms which contemplate a particular kind of loss, or loss at a particular place or time.

(2) It does not apply to terms which affect or define the risk, or the limits of the policy, more generally.

(3) If the term is covered by our policy, then breach of that term should only give the insurer a remedy if the loss which is suffered is of the particular kind contemplated by the term, or is loss at the time or place contemplated by the term.

A new draft

1.5 Parliamentary Counsel has prepared an alternative draft clause, with the heading “Terms not relevant to the actual loss”. The clause is largely new but retains some elements of the original clause.

1.6 We explain the thinking behind the clause below.

To which terms should the clause apply?

1.7 Our policy is that the clause should attach to specific risk mitigation clauses. In other words, the clause only applies to terms which could affect the risk of a specific type of loss taking place at all, or the risk that a particular type of loss would be more extensive.

1.8 The clause is not intended to apply to contract terms which reduce the risk profile as a whole. This is now stated explicitly in clause 11(1). These words are intended to exclude, for example, terms which set out:

(1) the use to which insured property can be put (eg commercial/personal);
(2) the geographical limits of the policy;
(3) the class of ship being insured; or
(4) the minimum age/qualifications/characteristics of a person insured.

1.9 For example, if one was insuring a ship, terms relating to its class, the qualifications of the captain and the commercial use made of the ship would tend to affect either the whole risk, or a significant part of the risk. However, terms relating to locks would only affect risks of intruders in the part of the ship kept locked. Similarly, terms relating to sprinkler systems would only relate to the extent of fire damage.

1.10 Sub-clause (1) therefore specifically provides that the clause does not apply to terms which define the risk as a whole.

When should the insurer pay even when the term has been breached?

1.11 The short answer is that the insurer should pay the claim when the breach of a specific risk mitigation term is totally irrelevant to the loss that has taken place.

1.12 In the original clause 11, we tried to encapsulate the principle by saying the insurer had to pay for losses of a different kind, or at a different location or at a different time.

1.13 We have worked to make this more certain. We believe the new clause more closely captures the idea that the insurer should only have to pay if the insured can show that the breach was totally irrelevant and could not have affected the actual loss suffered.

1.14 Sub-clause (3) of the new draft says the insured must show that:

its breach of the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

1.15 If the insured fails to show this, the insurer does not have to pay.

1.16 Neither the insured nor the insurer would have to prove what actually caused the loss, or what would have happened if the term had been complied with, so evidential matters are far less important than they would be under a causal test. Even if an insured can show that compliance with the warranty would not have actually made a difference to the loss (thus satisfying a causation test), the fact that it could have made a difference means that an insurer does not have to pay. Instead, there would be a more objective assessment of whether it is obvious that the breach could not have made any difference—and the onus is explicitly on the insured to show this. This keeps the focus looking forward from when the risk was underwritten (the breach could not have increased the risk of the loss)––as opposed to looking backwards from the actual circumstances of the claim (whether it contributed to the loss which occurred––a causation test).

1.17 The reference to “the circumstances” in which the loss occurred is intended to look at the issue in a broad way. There is less suggestion of causation in these words, as there would be if the court was required to consider “the way” in which the loss occurred.

1.18 Some examples may assist:

(1) There is a clause in the policy requiring the insured factory to install five-lever mortise locks on all door. This is breached because the lock on one door (door A) only has three levers. Thieves break in through door A. The lock might have made a difference given the circumstances of the loss (which are that the door did not have
the requisite lock, and the thieves broke in through it), so the insurer does not have to pay. The policyholder cannot argue that the thieves would have just found another way in, or that the crow-bar they used would have shattered the wood even with the right lock.

Same warranty; same breach. Thieves break in through a window, or a different door (B) which does have the required lock. In these circumstances, it would not have made any difference if door A had had a different lock. The insurer should not escape liability based on the breach.

(2) The insured warrants that the insured vehicle will be roadworthy. This is breached because the left front headlight is defective. The vehicle skids on black ice in the dark. Although the faulty headlight did not cause the accident, it is possible that it could have contributed, given the circumstances of the loss (that is, that it was dark, and a headlight was defective). The insurer does not have to pay.

Same warranty; same breach. The vehicle collides with a truck in broad daylight. There is no possibility that the defective headlight contributed to the accident given the circumstances in which it happened (it was daylight and the headlights would not have needed to be on even if they were working properly). The insurer should not escape liability based on the breach.

CONCLUSION
1.19 We think this clause captures our policy aims, as set out above, which we know are very widely supported. We think it gives more certainty to insurers and insureds—and makes it clear that if an insured wants the benefit of the statutory provision, they have to prove it applies.

1.20 We think it is principled and easy to explain with examples. It does not leave open the same uncertainties which were left by the original clause 11, such as whether a break in through a window is the same “kind of loss” as the loss which a requirement for locks on doors was designed to reduce.

1.21 It may still be possible to include “clause 11”, in some form, in the Insurance Bill if general agreement can be obtained in time. If not, the Law Commission may not be involved in any future action by the Government on this policy issue.

November 2014

Supplementary memorandum submitted by Association of British Insurers

I write in relation to the undertaking given in evidence to the Special Bills Committee on 3 December 2014 by myself, on behalf of the ABI, and Kees Van Der Klugt, on behalf of the LMA, to provide a further submission in relation to certain provisions in clause 4 of the Insurance Bill which relate to the knowledge of the insured.

Since that occasion I have seen:

— The further submission, including suggested amendments to clause 4 with explanatory notes made on behalf of the LMA and IUA;
— The further submissions by the Law Commission dated 5 December; and
— The further amendments suggested by Baroness Noakes on 9 December.

I would be grateful if you could place these further submissions before the Special Bills Committee both to answer the undertaking I gave in evidence on 3 December and to respond to the further amendments suggested by Baroness Noakes.

CLAUSE 4

(a) Composite policies and the insured’s knowledge

The LMA and IUA have advocated wider changes to clause 4 than the ABI is able to support. In evidence, my concern was limited to the situation where an insured is arranging a composite policy covering a number of beneficiaries who would not be regarded an “insured” but whose knowledge was relevant for the purposes of what constituted a reasonable search.

I attach to this submission an amended draft of clause 4 which incorporates my suggested amendment to cover the issue described in the preceding paragraph, together with those of Baroness Noake’s amendments with which I agree.

In giving evidence I suggested that the law might develop so that a reasonable search by the insured should involve getting all the information from the beneficiaries that would be obtained if the beneficiaries were the insured. On discussion with representative members of the ABI, I believe that this goes too far. The situations in which insurance policies are taken out for the benefit of others are numerous and the beneficiaries often enjoy a very different category

61 The “way” in which the loss occurred might be that the thieves battered the door down rather than picked the lock, which raises questions about whether the five lever lock would have stopped them. We think this question strays too far into questions of causation and evidence.

62 The “way” it happened might be more to do with the way the car hit black ice, and therefore could raise questions about whether having a working headlight would have made any difference. Again, we think this would be a “causation” type debate, which we do not want.
of benefit and present a very different category of risk than the insured. It would not be appropriate to replicate the insured’s duty of reasonable search on every beneficiary.

Similarly, the LMA/IUA’s suggested inclusion of a new clause 4(5) which sets out categories of person in relation to which information would be regarded as “available to the insured” for the purposes of clause 4(4) appears to us to go a little too far. In particular, while we recognise that a “reasonable search” would not comprise eliciting information from all such individuals, the LMA/IUA inclusion at their clause 4(5)(c) of officers, employees and agents both of the insured and their concept of a “covered person” seems to unwind the intended reform comprised in section 4(3)(a) which restricts knowledge to that held by the insured’s senior management (see below for further comment). Similarly, their 4(5)(b) seems already covered by clause 4(2)(b).

On reflection, I consider that the best way to address my concern is to retain the concept of the insured being responsible for a reasonable search of information available to them but making a little clearer than the Law Commission’s version of clause 4(4) about the entities which might be regarded as having available information. For these purposes, I have borrowed from the LMA/IUA wording at their suggested clause 4(5)(d) and added Baroness Noakes’ suggested inclusion of a reference to “any person who may benefit from the contract of insurance”.

By my suggested amendment to clause 4(4), I aim to capture those beneficiaries whom it might be reasonable to obtain information from, the insured’s agents and other third parties of whom it would be reasonable to make enquiries (the Proudfoot scenario). The reasonableness of the search going to both the manner and type of enquiry and of whom it is made.

(b) The Insured’s “senior management”

In evidence on 3 December I raised a concern that paragraph 54 of the explanatory notes to clause 4(3)(a) indicated that the Insured’s senior management was limited to its Board of Directors. This was not what I understood to be the intention of that provision and its interpretation in clause 4(6). The Law Commission has now indicated it will work to amend those explanatory notes. Lest there be any doubt about whether “senior management” goes beyond a company’s Board, we are supportive of the additions suggested by the LMA/IUA to clause 4(6). The kind of wording proposed by Baroness Noakes and the inclusion of additional categories of management is dealt with in paragraph 15 of the Law Commission’s further submission with which we agree.

Clause on Paying within a Reasonable Time

We have seen the suggested reintroduction by Baroness Noake of what was clause 14 of the Law Commission’s draft Bill which effectively requires payment of claims within a reasonable time. Our membership was and continues to be supportive of a reform of this kind.

I have only two comments on this clause; one specific and one general and which I made at the Committee hearing on 3rd December.

Subsection (3) lists some examples of what amounts to a “reasonable” time and those examples are, of course, not exhaustive. Claims which, of their nature, require time for indemnification because repairs and reinstatement can only be undertaken after certain prior steps are an obvious example of situations where paying the claim after a long time might be “reasonable”. I accept this can be accommodated in the interpretation of “reasonable” without specific reference in the subsection (3) examples and is possibly covered anyway in the “type of insurance” example, but as it is the concern raised by my members, I favour the inclusion of a further example along the lines of “(-) the amount of time needed to effect any reinstatement or repair provided for under the policy;”

Our wider concern is that claims management companies might see a new revenue stream in the fees recoverable from instigating claims for damages for late payment potentially adding considerable frictional costs to the system.

I would be grateful if the Special Committee could consider these further submissions in the course of its consideration of the Insurance Bill.

THE INSURANCE BILL—ABI SUGGESTED AMENDMENTS TO SECTION 4 OF THE BILL

4 Knowledge of Insured

(1) Subsections (2) to (5) provide for what an insured knows or ought to know for the purposes of section 3(4)(a).

(2) An insured who is an individual knows:

(a) what is known to the individual, and

(b) what is known to one or more of the individuals who are responsible for the insured’s insurance.

(3) An insured who is not an individual knows only what is known to one or more of the individuals who are:

(a) part of the insured’s senior management, or

(b) responsible for the insured’s insurance.

(4) Whether an individual or not, an insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured (whether within its own organisation or held by others from whom the insured would reasonably be expected to obtain the relevant information for the purpose of complying with its duty
of fair presentation, for example its agent or a person who may benefit from the insurance contract, and whether the search is conducted by making enquiries or by any other means).

(5) In this section, references to an individual’s knowledge do not include confidential information acquired by the insured’s agent (or an employee of the insured’s agent) through a business relationship with someone other than:

(a) the insured or
(b) a person who may benefit from the insurance contract.

(6) In this section:

(a) an individual is responsible for the insured’s insurance if the individual participates on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, or as an employee of the insured’s agent, or in any other capacity).

(b) “senior management” means those individuals who play significant roles in the making of decisions about how the insured’s relevant activities are to be managed or organised, or who participate at a senior level in the actual management or organisation of those activities.

December 2014
Q23 **The Chairman:** Lord Justice Longmore, we are most grateful to you for rearranging your affairs so that you could give evidence before us. I am sure it is going to be of great assistance. You have had a very good opportunity to listen to proceedings.

**Lord Justice Longmore:** Yes, it was very useful and informative for me to hear your questions and the responses. I would say initially—and this is really only the personal view of someone who has been involved in insurance litigation for most of their professional life—that I am very supportive of the Law Commission’s proposals. The world has not stood still since 1906. It is a very long time since Parliament has taken commercial insurance into its purview. Two or three years ago it dealt with consumer insurance, but the terms of the Marine Insurance Act, which itself was a codification even in 1906, have become very creaky. In my view, the Law Commission has done sterling work over a number of years to try to bring the law into the modern age. I am very supportive of what it has done.

Q24 **The Chairman:** You have heard the concerns from Lloyd’s about certain aspects of the Bill. While its evidence is clear and fresh in our minds, do you wish to make any comment about it, having listened to it with your great experience?

**Lord Justice Longmore:** Perhaps a little. On the whole in expressing its concerns, Lloyd’s has accepted the core principles of the Bill, particularly the fair presentation of the risk. That seems to me to be rather essential. It is a concept which the courts have themselves been moving. What is so deleterious about the 1906 law is the fact that an insured has to disclose what is material in the view of a prudent insurer—the insured has to look into the insurer’s mind to know what material means. I do not think that the concerns expressed go to that. If one can at least achieve that, it would be quite a considerable step forward.

**The Chairman:** Could I interrupt you there, if I may—and please forgive me for doing so—because it seems to me to be directly relevant to what you have just said? Do you have any views as to whether the Bill should extend to reinsurance?

**Lord Justice Longmore:** I am not very clear whether the intention is that it should or should not. My view is that it would be beneficial if it did.

**The Chairman:** I was hoping to hear your view.

**Baroness Noakes:** Should it say so explicitly?

**Lord Justice Longmore:** It would be better if it said so explicitly. One could have a nice legal case, I suppose, about whether insurance includes reinsurance. I think it has actually been held in the sense that when an insurer is authorised or not authorised to do business, it includes a reinsurer. However, that is a very different question. If the Law Commission’s intention, and your intention, is to include reinsurance, which I would support, it would be better if it said so expressly.

**The Chairman:** Thank you very much. I apologise for the interruption. Please carry on with what you were going to say.

**Lord Justice Longmore:** I was going to have a word about the concerns that you have heard expressed this morning. They are mainly in the area of non-disclosure: what the insured should know. Concerns have been expressed about what the Bill says not going far enough as to what the insured should know. I think the discussion about senior management concluded really that the Explanatory Notes, which I have not actually seen, may not be quite reflective of what the Law Commission intends. I think the Law Commission intends that those in a senior position responsible for insurance, whether at board level or not, should be caught by the concept of “senior management”. The question of reasonable search has been raised in a comparatively neutral way by members of Lloyd’s because they say that it will be a departure from the common law that will make it more difficult for the insured because they will now have to do a reasonable search and they did not have to before. Also, it may not go far enough because of the concerns of beneficiaries in particular.

I am not sure that it is such a departure from common law as Lloyd’s may be thinking. The common law requires the insured to disclose that which he knows or ought to know. Here, we are talking only about things that, ex hypothesi, the insured does not know. So the question is: what ought he to know? These days it seems to me that the concept of a reasonable search is itself a reasonable concept. You do not have to research everything; you have to do a reasonable search. I will come back to the uncertainties behind that in a moment, but it seems that that may be right as a concept. It is not very different from referring to what the insured ought to know, although it probably qualifies it, because under the 1906 Act the insured might be said to be in a position where he ought to know things that perhaps would not be covered by a reasonable search. But there are not many, so I do not believe that it is a great departure from the common law.
I would accept, however, that “reasonable search” is a slightly uncertain concept. It may give opportunities either for an insurer to say, “You have not done a reasonable search”, or for the insured to continue to dump material on the insurer, but it is a fairly finite matter. It might of course depend on litigation, but once one has had two or three cases I would hope that the judges of the commercial or mercantile courts up and down the country would be able to know and explain what a reasonable search does require.

There may be a point about beneficiaries that needs to be ironed out. I do see that. If a big company insures for the benefit of its employees, and if the employees know something, should that be disclosed? Not if it is a mere employee, unless it is something which the insured should have discovered by a reasonable search. But I think myself that that is fair enough.

The Chairman: Would anybody like to ask anything?

Q25 Baroness Noakes: Certainly. Sir Andrew, could you let us know your view of the Bill’s treatment of warranties?

Lord Justice Longmore: I certainly support the current Bill in what it says about warranties, in Clauses 9 and 10. The law is currently extraordinarily strict, as you no doubt know. You have to comply strictly with any warranty, and if you do not the whole contract is discharged. That can lead to serious injustice, so I certainly support Clauses 9 and 10 so far as they go. There is the question of whether the Bill should also include the old Clause 11, which is not in the Bill but which is very pertinent to any discussion about warranties. I am afraid I am not quite clear why it has been taken out of the Bill at the moment. I think the original proposal was desirable. I see that it changes the current law quite a lot, and again may lead to a bit of uncertainty, but in most cases where there has been a breach of warranty it will be fairly clear whether or not it had anything to do with the loss. Most European countries, I think, have some concept that any breach of a warranty or of a term in the insurance contract must have some connection with the loss before the insurer can rely on it. I myself had a case where there was a warranty on a fish farm where there should be a 24-hour watch and there was not. However, the loss was caused by a tremendous storm that took place in a Norwegian fjord, and whether there had been a watch or not it would not have made any difference to the fact that the fish farm was totally lost. The case could have had a very unfair result if it had been dealt with solely under English law. Clause 11 would certainly have ameliorated that.

The Chairman: One hopes that under English law as it is at the moment, in the sort of situation that you have given the responsible insurer will actually accept and adopt an approach that reflects the law as it is proposed to be.

Lord Justice Longmore: One would hope so, but it would not necessarily happen. I have to say that in that case that was not the approach taken by Lloyd’s.

Baroness Noakes: So you would favour the reinstatement of Clause 11, as redrafted?

Lord Justice Longmore: I would encourage that, yes.

The Chairman: I must point out that the insurer may be in run-off or something of that sort.

Lord Justice Longmore: Of course, and the liquidators may have to take technical points for the creditor’s benefit.

Q26 The Chairman: Do you think there is a need for a clause regulating the operation of other conditions? Do you foresee any issue with the distinction drawn between risk definition and exclusion or the possible introduction of a causation test?

Lord Justice Longmore: I think that is what Clause 11, which is not currently in the Bill, is getting at, in particular subsection (2), which says, “if a loss occurs and the insured has breached a term then the insurer is not to rely on the breach to exclude if the insured satisfies condition 3”. I would be in favour of that. The other matter that you discussed, which I am afraid I have not thought about in detail because it is not currently in the Bill, is late payment. Again, I can see that the proposed clause could give some scope for encouraging litigation. If an insurer does not pay, these days a claims management company may come along and say, “They could have paid it three or four months sooner. Don’t you think it might be worth having a case?”. I am not sure if that is why the Law Commission has currently withdrawn it from the Bill.

The Chairman: I think it was considered somewhat controversial and was not suitable because of this procedure.

Lord Justice Longmore: I can see that it is a matter of some controversy and perhaps therefore should not be subject to this procedure.

The Chairman: We would be grateful, if it does not impose on you, if you would take the opportunity to have a look at that at your leisure—if you have any—and let us have a note on what you would say.

Lord Justice Longmore: About Clause 14?

The Chairman: Yes. That would be quite useful. We would be grateful for that.

Lord Justice Longmore: I would be happy to do that.

The Chairman: I do not know whether you heard me mention sending it within seven days.

Lord Justice Longmore: Yes. I think that it could probably be done in seven days.

Q27 Baroness Goudie: Sir Andrew, do you regard it as appropriate to treat fraudulent means
and devices in the same way as other cases of fraudulent claims?

Lord Justice Longmore: Yes. I am certainly supportive of what the Law Commission has done in the Bill on fraudulent claims. There is a sort of satellite law in this area about fraudulent devices, which are not exactly claims. It does not seem that this clause is intended to deal with fraudulent devices but the courts may be a little more sensible than they have been and adapt the word “claim” to include devices, which I think might happen if this clause is in its present form.

The Chairman: What do you mean by “fraudulent device”?

Lord Justice Longmore: It is something that is done by an insured not directly in the claim but in order to improve his chances in the claim. I had a case where an insured told a lie in order to achieve a more favourable jurisdiction for the purposes of a claim being determined, so it was not exactly a fraudulent claim but a fraudulent device to secure a more favourable result than he would otherwise get. He thought that he would do better in England than in some other place, so he pretended that there was a clause that said that England should determine the case. So technically, it is a bit difficult to call it a fraudulent claim.

The Chairman: So it was a procedural device?

Lord Justice Longmore: Yes, it is usually something like that. Suborning a witness is not necessarily making a fraudulent claim, although it might be. These things merge into one another, and I think that the Law Commission and the Bill are probably well advised to leave fraudulent devices on their own and deal with fraudulent claims that require the reform that is in the Bill.

The Chairman: The courts may have finally to adjudicate on what is a claim.

Lord Justice Longmore: Yes, that may be right.

Lord Lea of Crondall: As a judge in those circumstances, when there is a flagrant abuse of some device—I did not know that a lie was a device, but I think that is a category of point—would you as a judge feel under any obligation to set in motion some process of rectifying that or doing something about it? Or is it a case of it not being in your jurisdiction so nothing is done about it?

Lord Justice Longmore: Well, if it is a fraudulent claim, you dismiss the claim. But I think you are asking whether you do anything more than that.

Lord Lea of Crondall: No, if it were not a fraudulent claim because of the technical point you are making, if it were some other device, including a lie, would you simply accept the fact that a lie had been told? Is that okay?

Lord Justice Longmore: No it is not, not once the lie is exposed.

Lord Lea of Crondall: So what happened in that case?

Lord Justice Longmore: I think I am right in saying that we ensured that the case took place in the right jurisdiction.

Lord Lea of Crondall: No, I do not mean that. Is the fact of telling an untruth something that you would then need to do something about as a judge?

The Chairman: I think what is being asked is whether you would refer the matter to be Director of Public Prosecutions, for example.

Lord Justice Longmore: No, one would not normally do that. I am afraid that sitting as a judge in the commercial court one comes across lots of very questionable conduct. If you referred every witness who told a lie to the Director of Public Prosecutions he would get fed up pretty quickly.

Lord Lea of Crondall: I am glad to see that on the record.

Q28 Lord McNally: I wonder if we could ask one more piece of advice from you, Sir Andrew. For a layman, listening to advice from Lloyd’s, one gives due respect. Everyone who comes before us seems to tell us what a wonderful piece of legislation this is, but—. Lloyd’s has been particularly “but”-y. Apart from issues that have to be deferred because they are too controversial for this process, is there anything in the evidence that from your experience you think Lloyd’s has really pushed a button on that we should take very seriously?

Lord Justice Longmore: I was rather impressed by what was said about the beneficiaries point, which I touched on. If a large company insures its employees or even its contractors, has the bill got quite right the obligations of disclosure about that? An employee or contractor may know that he has a very bad claims record, for example, but that is not known to the senior management. That is something that one should perhaps look at again. That was one matter that certainly struck me while we are hearing the evidence.

Lord Lea of Crondall: Have you come across difficulties at present about where responsibility lies in the insured, in terms of the board of directors? We have always assumed that the pyramid goes to the board of directors. Do you have any comment on that? It has become a bone of contention.

Lord Justice Longmore: It seems that it has, but currently the insured is deemed to know what his agents or employees know, so that does not really arise. But I can see that under the reforms it may arise because the obligation is now confined to senior management and senior management have to ensure that there is a reasonable search. It seems to me that that is exactly what senior management should do. We have to differentiate between the board and senior management as far as insurance is concerned, because quite a lot of boards will of course be anxious to ensure that their company is properly insured but the details of the insurance will inevitably be dealt with by an insurance
department, and probably by an insurance broker. It would be a completely independent firm. The extent to which the board should, on what is just one aspect of its business—the risk aspect of its business—actually take active steps to know everything that the insurance department knows, let alone what an insurance broker knows, is almost a counsel of perfection.

Lord Lea of Crondall: Thank you.

The Chairman: Are there any other questions? Thank you very much indeed. If you have nothing that you can usefully add, just let us know.

Lord Justice Longmore: I will submit a note about late payment.

The Chairman: That concludes the evidence that we are hearing today. We will continue on Tuesday 9 December, at 10.00 am in Room 4.

Memorandum submitted by Lord Justice Longmore

1. I warmly support old clause 14 to the effect that it be an implied term of every contract of insurance that the insurer must pay any sums due within a reasonable time. There will, of course, be debate about the meaning of “reasonable time” on the facts of a particular case. But the principle that payment be made within a reasonable time is not really one that a reasonable insurer should object to. There will not have to be many decided cases before the principles of a “reasonable time” will become well-recognised.

2. Having said that, I can see that some costs to insurers could result from this change in the law in that more claims assessors might have to be employed so as to ensure payment of proper claims is made within a reasonable time. It should, however, be possible to absorb these costs without any severe difficulty.

3. I understand that the LMA would be moderately happy with a clause which applied if the insurer acted deliberately or recklessly in refusing payment. But I think that would give great rise to difficulty in practice because such deliberateness or recklessness would be expensive and acrimonious to prove. The concept of a “reasonable time” is, to my mind, preferable.

4. I do not think, however, that this issue is the most pressing one and if objections to the proposed implied term might delay the progress of the Bill I would be happy enough for the proposal to be deferred to a more appropriate time.

5. I think it more important to include old clause 11 of the Bill if possible, about Terms not relevant to the actual loss. This has wide support and is highly desirable for reasons touched on in my oral evidence. But even this clause should not be allowed to frustrate the Bill. I understand that the Law Commission is, in any event, drafting a modified form of clause 11 which I certainly consider to be acceptable.

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Q29 The Chairman: Has any Member of the Committee anything they wish to disclose?

Lord Tomlinson: I have no interests to declare.

The Chairman: Lord Mance, we are very grateful that you have made it possible to attend here this morning. We look forward to receiving your help and appreciate that you are prepared to do this. I turn to your evidence. There was some question as to whether the Bill was intended to refer to reinsurers. At the moment, everything indicates that it is so intended but it does not say so expressly. When Lord Justice Longmore gave evidence at the last meeting, he thought it should do so. What is your view?

Lord Mance: I do not believe that express confirmation is necessary as a matter of law, but I notice that is has been suggested—I think by the Law Commission—that a clause might be inserted that referred to reinsurance but had a different purpose. This would assist the general body of insurance readers and the public to understand that the concept of insurance includes reinsurance, and that might be a sensible way of avoiding confusion and doubt.

Lord Carrington of Fulham: Before we leave that and I go on to my question, to avoid confusion and doubt and just for clarity, is it your view that the Bill, as currently drafted, covers reinsurance as well as insurance?

Lord Mance: The answer is that you can almost never exclude argument, and it is possible that somebody might argue the contrary, but my view is that insurance includes reinsurance as a matter of law, in general terms. There is no reason why it should not do so here and it might be rather anomalous if it did not, but I welcome the idea that it should be clarified, at least indirectly.

Q30 Lord Carrington of Fulham: That is very clear. Thank you very much. I come to the provisions in the Bill on the duty of fair presentation, particularly in respect of the concept of reasonable search. Do you think that a change in the law is necessary and workable?

Lord Mance: I share some of the concerns that have been expressed in the LMA-IUA submission and I would add that I took care to formulate—and put in writing—my own view before really studying that submission. I was then interested to see how many common points there are. There is one point that I do not go along with in those submissions, but it is an ancillary one. Generally, this Bill is extremely welcome and proposals for law reform in this area are a good idea. This seems to me to be one of the few areas being focused on where there may be a problem. It is part of a reformulation by the Law Commission of the duty of disclosure. The thinking is that it is not sufficient simply to refer, as the common law does, to what the insured knows or ought to know although, as the Law Commission says, the common law has developed helpful principles from which the commission recognises that assistance can be gained.

However, the Law Commission aims at greater predictability in the common law and the question is whether it will achieve that. In the short term, at least, they will certainly achieve room for argument. That can, of course, be said of many changes in the law. The dichotomy that it draws has two parts. The first is what is known to senior management or persons responsible for the insurance. The second part is what you ought to know, which is defined in terms of the reasonable search. As to senior management, I notice that although the explanatory Clause 4(6)(b), which contains a definition, speaks of “individuals who play significant roles in making decisions about how the insured’s activities are to be managed or organised”, there have been a number of contradictory statements about what that means. That is an unsatisfactory start. Paragraph 8.59 of the Law Commission’s report quotes a very old case, Gibson v Barton, which was on a particular statutory provision that would suggest, if read literally, that the only senior management outside the board would be someone entrusted with the whole management of the company. That seems to be completely inapposite and contrary to the language of the Act. I hope I am not putting it too bluntly, but it is not a good starting point. Modern authorities such as Meridian Global v Securities Commission [1995] UKPC look at the matter of who is the senior management in a much more context-specific way. Certainly modern companies do not generally operate on the basis that you entrust the whole of the business to a senior manager even if, as is very common, the board does delegate. It seems to me that the statutory wording, as has been pointed out in this Committee, is perfectly acceptable. What has gone
wrong is a lot of encrustation. I fear that people do refer back to the Law Commission report and to Explanatory Notes and raise arguments on them. So in some way or other, although I think the statutory wording is acceptable, Parliament should make very clear that that is the definitive wording, otherwise there is going to be argument.

Perhaps I can come on in a moment to the specific point that you asked me, but I will complete this part by saying that the two categories of senior management, and those responsible for the insurance, omit a third category that exists very clearly at common law. That is an agent responsible for managing the property or activity that is the subject matter of the insurance. In other words, an agent not charged with insurance but with managing it. The common law operates at the moment on the basis that that is an “agent to know” and he has a duty to disclose material matters within limits. Obviously, on the Australia, New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd case [1960] 2 Lloyd’s Rep. 241, he does not have a duty to disclose his own negligent operation of the company’s business, but otherwise he has a duty to disclose what is going on and there is no need to search or ask.

Cases like Proudfoot v Montefiore, and the cases in it, deal with situations where the insured would have absolutely no reason to inquire of the agent. The agent there had specific knowledge, which he ought to have disclosed, about the object to be insured—the ship or the goods—but deliberately concealed it from the insured to enable the insured to place the insurance while it was still possible to do so in ignorance. Not surprisingly, the agent’s knowledge was deemed to be knowledge which the insured had and the insurance was voidable. It seems to me quite arguable that the current proposal would reverse that line of authority because, instead of the information of the “agent to know” being imputed to the principal, you have no third category of imputed knowledge. Instead, you have the obligation of reasonable search. Reasonable search is very sensible if you do not expect to have information already, but where you have an agent whose duty is to pass you information and who is charged with responsibility for the subject matter of the insurance, you will, on the face of it, have no duty to search or inquire. I am not sure how the language works in that situation. Is the language saying that you have a duty to ask people whose duty it is to tell you without asking? In other words, do you have to go through a formality before every insurance of asking all your agents who are charged with the property or activity to be insured: “Do you have information which you ought to have disclosed to me, pursuant to your ordinary duty?”.

That seems a rather artificial interpretation of the concept of making a reasonable search. It may be what is intended, but I do not think it is clear.

The only other point about reasonable search is that what ought reasonably to have been revealed by it is not beyond argument. If you do ask someone who ought to tell you, but he fails to do so, is that something that ought reasonably to have been revealed by your inquiry? I suppose it is, but it is not quite so obvious what the position would be if the inquiry is made of some third party who is not under a duty to tell you. I think there is room for argument in that area.

**Lord Carrington of Fulham**: So are you saying that, as drafted, it leads to some confusion as to what the position should be?

**Lord Mance**: Yes. As drafted, the scheme omits the third category of imputed knowledge: the knowledge of those who manage the insured activity or property. It presumably intends to cater for that under the reasonable search, but the reasonable search provision is not apt because you do not normally make inquiries from someone who you would expect to have volunteered it pursuant to a duty. You may have no reason to make an inquiry of your agent abroad who knows something.

**Lord Carrington of Fulham**: So how would one get round this problem without, in the way you described, having to get a formal note from all the agents saying they have disclosed everything, which would be very cumbersome?

**Lord Mance**: The Law Commission is obviously much better informed than I, because it does very valuable research work, but my own feeling when I looked the proposal was slight surprise that the common law was felt to be so unsatisfactory because of the threefold categorisation. I was not personally aware that this was giving rise to litigation. Business problems are outside my direct knowledge and the Law Commission obviously received representations to the effect that there were concerns. I notice that the LMA-IUA have taken issue with that, so it is a difficult one to judge, but I would not personally have suggested that a change to the common law in this area was critical. On the other hand, I welcome the Bill generally. The excellent should not drive out the good and I do not want to suggest that the Bill is not, in general, a good thing.

**The Chairman**: If I may, I will press you a little further on what you have just been dealing with, Lord Mance. I suppose one possibility—and you may disillusion me if I am wrong—is that the Law Commission thought it was hard on the insured if he was in a position where there is something which the agent knows and which, being a conscientious agent, he feels he should disclose, but he deliberately decides that he will not disclose it. If the standard is going to be reasonable search, might it not be asked: what more can we do than...
ask the question? As I understand it, and correct me if I am wrong, the common law imputed knowledge to the insured if the agent seeks to hide something from him. It is possible that we will get clarification on whether I am right or wrong in my speculation that that is what they had in mind. That could be an explanation for why they deliberately omitted to deal with the third category. I am sure they were aware of the three categories and, as you say, it seems surprising that they have not included them. However, that may be because they were not actually moving forward from the point from which you were moving: namely, that there was nothing wrong with the common law.

Lord Mance: To my mind, there is nothing particularly surprising about the proposition that if your agent withholds information, with a view to misleading a third party, the insurance is invalid. That is a matter between the principal and the untrustworthy agent. That is certainly the view that the common law has taken and I do not think that the Law Commission’s change can be rationalised in the way you have suggested, Lord Chairman, because the principle that an agent’s fraud is not imputed to a master or principal is not applicable in that situation. The Belmont finance principle, which you have described, (Belmont Finance Ltd v William Furniture Ltd [1979] ch 250) is thought to apply where the agent’s fraud is on the master—the insured in this case—rather than directed to a third party. This is a complicated area and I will not say too much on it because it comes before us rather too often.

The Chairman: Thank you very much for bringing that point to the surface. We will obtain clarification later about what is said.

Lord Mance: The other point, if I can just add it, is that the postulate of “reasonable search” seems to be that anything that ought reasonably to have been revealed by a reasonable search is then imputed, so that, unless the fraud exception applies, the agent’s silence, even in the face of a question, would not matter; it would still be something which he ought reasonably to have revealed to the principal and therefore something of which the principal was taken to be aware so that the insurance would fail. Subject to the fraud point, which I do not think would apply, the “reasonable search” formality would lead to the same result as would happen under the “agent to know” principle at common law.

The Chairman: Thank you very much. Lord Lea.

Q31 Lord Lea of Crondall: Lord Mance, good morning. As you will be aware, the current Bill does not include the Law Commission’s proposed clause on late payment; in other words, “the insurer must pay any sums due in respect of the claim within a reasonable time”. Could you tell us whether you believe that such a clause is desirable, and, if so, could you address the objections that we have received from a minority of witnesses to the contrary view?

Lord Mance: The Law Commission’s attitude and tentative proposals have changed with time, and the current proposal is simply for an obligation to pay any sums due within a reasonable time, which would include a reasonable time to investigate and assess the claim, and there would be no breach while a dispute was continuing if the insurer could show reasonable grounds for disputing the claim. But it is a fact that any breach would sound in damages, and I do have a feeling that this could change somewhat the nature of insurance, and in particular insurance disputes. It could become not uncommon to add a complaint that the insured had delayed or was delaying unreasonably. This would appear then to throw the onus on the insurer to disclose what was motivating it behind the scenes. Sometimes when insurers are investigating matters, it could even prejudice continuing investigations. Insurers often have suspicions that need careful handling and take time to explore, and there might be problems about waiver of privilege in some circumstances. How would the insurers demonstrate that they were disputing the matter reasonably without waiving privilege as to legal advice being received?

More fundamentally, this risks the introduction into insurance claims—let us say a property insurance or a liability insurance claim—of what would effectively be a business interruption element. You would have a claim that was brought for damages. The damages would say, “Because of lack of funds, we were unable to run our business properly”. That sort of claim involves quite different experts and, as is well known, quite complex considerations, where the people’s business really has been affected. There would be associated questions about foreseeability: at what stage do you measure whether the insurer had sufficient knowledge or anticipation of the suggested loss? Is it at the time of the insurance contract, which is the normal rule in contract claims where damages are later claimed, or would it exceptionally be at the date of the alleged breach?

My feeling is that, at the moment, insurance contracts operate on the basis of assessment of risk—a defined amount of cover for a defined amount of premium. There is a risk that open-ended damages claims introduce unpredictable exposure. The general rule is that if you are kept out of money, interest is the compensation. I have no objection here to the idea that interest should also be compound—that might be a worthwhile suggestion—but while you have an outstanding claim, the general rule is that you are taken to be able to borrow on the market and interest is sufficient compensation. So I question the introduction into this area. I certainly understand why a provision
has not been introduced relating to late payment, even though it is in a more moderate form than the previous provisions and allows for the qualification of reasonable grounds for disputing the claim.

**Lord Lea of Crondall:** Are you saying therefore that the present law is fine as it is, or that the clause may be over the top or not the right provision to deal with perhaps anybody who systematically pays late? Do you think that the law as drafted, relying on interest, is satisfactory redress for the insured?

**Lord Mance:** Yes, I do. As I have suggested, it might be more desirable if compound interest were available and commonly awarded in this area. That seems more a realistic way of assessing the actual financial loss, but I think there is a balance to be struck. As I said, insurance is above all an area where insurers need to be able to predict. There is such a thing as business interruption cover; you can take out separate cover if you concerned about your business being interrupted. I am not aware of whether it would be available if, due to lack of funds, you cannot rebuild your factory or restart your business, but I can see some problems if you introduce into property insurance or liability insurance the risk of quite different losses: namely, business interruption claims.

**The Chairman:** People take a different view about the desirability of compound interest, as I know well, but would it be sensible to get involved in compound interest in a Bill dealing specifically with an area of insurance?

**Lord Mance:** I have floated the idea. I have not thought of the full implications. Certainly in the case of Sempra Metals, we recognised that compound interest was acceptable in certain areas. I am not aware of whether it would be available if, due to lack of funds, you cannot rebuild your factory or restart your business, but I can see some problems if you introduce into property insurance or liability insurance the risk of quite different losses: namely, business interruption claims.

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**Q32 The Chairman:** Perhaps I should disclose that there was a dispute in which I was involved when I sat as a Law Lord as to whether compound interest should be awarded. I was in favour of compound interest being awarded, but others took a different view. Thank you very much for that.

**Could I move on?** The Government have dropped a proposed clause that would prevent insurers from relying on the breach of terms not relevant to the actual loss in excluding, limiting or discharging their liabilities. Can we have the benefit of your views on such a clause?

**Lord Mance:** I understand the thinking, and I have considerable sympathy for it. When I moved a very long time ago into our present house, I observed that there was in our household insurance a warranty that the cellar pump would be kept in working order. That seemed to me rather stringent if there was a burglary and I insisted that they confined the warranty in its operation to flooding in the cellar. I see that the warranty has now disappeared from my insurance policy with the passage of time. The general idea I fully understand. The difficulty seems to be that it is proposed to have a formula which I think is unusual and curious in the latest version, whereby the insurer will be able to rely on the term “the warranty” unless the insured shows that its breach could not have increased the risk or the loss that actually occurred in the circumstances in which it incurred. Some examples are given. I have said that I wrote this before reading the evidence of the LMA-IUA and I came across exactly the same thoughts as they do: namely, that the examples are not watertight. Almost each one of them will be argued. If the door was broken down, why should not the insured try to prove that the thieves had set out so well armed that whatever precaution had been taken by way of locks they would have got in: in other words, that the risk of loss would not have been affected by failure to have a five-bolt rather than a three-bolt lock? Similarly, even in the black ice example, again, if the black ice is round a corner where the headlights would not have been shining as the car turned the corner, why could the insured not argue that lack of headlights was completely irrelevant to my slipping on the black ice, as no one would have seen it?

Having said that, there are very welcome changes to present the law of warranty, which I am afraid I was partly responsible for as counsel in the leading House of Lords case. I welcome the changes from the stringent position of the present law. The alternatives seem to be (a) to treat them as going far enough or (b) to have something that is causation-based—that does not seem to be accepted; in other words, it would mean the breach of warranty is relevant only if it can be said directly to have caused the loss, which would lead to a lot of disputes, too—or (c) to have the present halfway house, which I am afraid I see as giving rise to almost as many disputes, although one would hope that judges would look at the Law Commission's explanations, take a robust line and try to do what the Law Commission had intended. I do not think the present formulation is wholly satisfactory.

**Lord Carrington of Fulham:** Does that mean that you would leave it in its present form?

**Lord Mance:** I would like to find some other formula, but I have not found it, so I probably would leave it at the moment. Certainly, for the purpose of this Bill, I would think that it was going to be difficult to find a formula in time.

**Lord Carrington of Fulham:** So rather than make this change, just for clarity, you would leave it as it currently stands.

**Lord Mance:** I think so, because a change would lead to a lot of disputes.
The Chairman: Thank you very much.

Q33 Baroness Goudie: Good morning, Lord Mance. Do you think it is appropriate to treat fraudulent means and devices in the same way as other classes of fraudulent claim, such that insurers can avoid paying out for a perfectly genuine claim because a piece of supporting evidence was fraudulent?

Lord Mance: The restatement of the law regarding fraudulent claims, leaving aside fraudulent devices, seems very sensible. As to the specific point, in the Court of Appeal in a case called Agapitos v Agnew (The Aegean) [2002] EWCA CIV 247, I put forward a tentative framework for dealing with fraudulent devices. As David Hertzell mentioned, there may be a case on the way to the Supreme Court on fraudulent devices. All I know is that permission to appeal has been sought, so I had better say nothing more about the substantive law. I will not express a view as to whether the present law might not impose. It depends how that is interpreted by the courts, so there is an open question there.

The only other point was on Clause 4(5), on confidential information. Again, I think that this is problematic. First, confidential information is an unusual concept in this area. There is a reference to it in one case—Blackburn v Haslam in (1888) 21 QBD 144. The result achieved there was completely the opposite of the result that would flow from this clause. I think that the clause is probably undesirable law. If an agent obtains confidential information from some other source and then goes ahead and places an insurance on behalf of his principal without telling the principal or the insurer, I am not sure why the insurer should suffer. The agent should not be acting at all, unless he can get a release from the confidence to enable him to disclose it to his principal or to the insurer, or both. If he continues to act and places an insurance, I would have thought that Blackburn v Haslam gives effect to what you would expect: namely, that the insurer has been effectively deceived, so the insurance is voidable and the insurer has a remedy against the agent. I am not really sure about the drive of this clause or its appropriateness.

The Chairman: I think that Lord Lea would like to ask a question.

Lord Lea of Crondall: Yes. It is a short supplementary, if I may. Lord Mance, you referred to the LMA and paragraph 25 of its submission, where a distinction is drawn between large firms with big insurance departments and smaller firms. The conclusion of the paragraph is that the proposal “is not a recipe for improving the competitiveness of the London insurance market”. Would you agree with that sentiment? Is it not the case that the competitiveness of the London insurance market vis-à-vis the rest of the world is presumably carried by larger firms?

Lord Mance: I imagine, Lord Lea, that you are right. Whether the London insurance market is competitive is probably only tested by larger firms that are able to shop around across the world. This is at the conclusion of the two paragraphs that suggest that insureds might find unrealistic standards being expected of them. That is a proposition that I have rather questioned. There is some force in the suggestion that because it is open-ended, reasonable search could impose on the insured some obligations that the present law might not impose. It depends how that is interpreted by the courts, so there is an open question there.
Q35 The Chairman: Thank you very much for that. Could I just go back to the question of interest? Our expert has helpfully drawn my attention to the fact that if interest is to be relied on, that normally only rises when there is litigation.

Lord Mance: Yes.

The Chairman: Were you presupposing that that would continue to be the situation? It would be a claim for interest under the general discretion given to the court. Is that what you were thinking of, or were you also thinking that we should have some specific provision dealing with the question of the award of interest?

Lord Mance: I think that there is a lot of force in that proposal, if I may say so, Lord Chairman. I had not thought through the implications, but fairness suggests that in a case where an insurance claim is, for whatever good reasons, a long time in settlement, consideration might be given to an award of interest. It would probably have to involve a change of law. There is a measure in relation to small claims for interest, I think as a result of European legislation, but I am not aware whether it would apply here. I do not think that it would apply here, but if it does not apply I would welcome your suggestion on the whole.

The Chairman: Thank you very much. If hereafter you would like to make a further comment to us, in the short time that will elapse before we finish with our responsibilities, by all means do so. That apart, we are most grateful to you for the help that you have given us in teasing out problems with such clarity.

Lord Mance: Thank you very much indeed. I will probably focus a little on the subject of interest, which I had not thought through sufficiently but which has been discussed here. It is an interesting subject.

Memorandum submitted by Lord Mance

1. If an insurance claim goes to court, the court has always had power to award simple interest on any judgment from the date the cause of action arose and now has power to award simple interest from the same date on any debt of damages paid before judgment—see s.3 of the Law Reform (Miscellaneous Provisions) Act 1934 and/or now s.35A of the Senior Courts Act 1982. It will commonly do so (or certainly used to in the days when I sat in commercial cases) at say 1% or 2% above base rate running from the date when it judges that the claim would in the ordinary course have been expected to be paid.

2. In some contexts, interest, including compounding, may be recoverable, e.g. either as special damages for breach of contract or on a restitutionary basis under the principle established in Sempra Metals Ltd v Inland Revenue Commissioners [2007] UKHL 34.

3. According to current legal theory, insurance claims to be indemnified are themselves claims in damages and the common law does not recognise any claim for interest for non-payment of damages (for that would be to award damages on damages).

4. Insurance claims are also outside the scope of the Late Payment of Commercial Debts (Interest) Act 1998, which only applies to debts created by contract in respect of contracts for the supply of goods, or of various services for consideration.

5. The Law Commission reported on Pre-Judgment Interest on Debt and Damages (HC 295, published 25 February 2004, pre Sempra Metals), and favoured a power for the court to award compound interest on judgments. But its report does not appear to have been taken up, and the Law Commission was not concerned with cases which did not litigate.

6. It would merit examination whether a scheme could be devised to give insureds a prima facie claim to (at least simple) interest, when an insurance claim is long-drawn out in settlement but no litigation is actually commenced.

7. Under the present position, an insured can of course always threaten or actually commence litigation, to put pressure on insurers to pay some interest. A new scheme might involve some way in which insureds could, without having to do this, claim interest after a certain period, whether or not the insurer was at fault in not paying earlier, on the simple basis that (a) the insured loss had been sustained, (b) the insured had not yet received its indemnity and (c) the insurer still had the use of the money.

8. What I questioned in my evidence, and still question, is the desirability of creating a new right to damages based on insurer’s unreasonable failure to indemnify the insured earlier. This would, as I indicated, have wider and in my view undesirable potential ramifications.

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Q36 The Chairman: Thank you very much for attending. We are grateful to you. I do not know whether you would like to make an opening statement. If so, by all means do.

John Hurrell: Thank you, Lord Chairman. Let me say by way of introduction that AIRMIC represents about 1,200 risk managers, who sit in about 500 companies in the UK. We estimate that the annual premium expenditure is around £5 billion. The issues being covered by the proposed Bill have topped the “keep awake at night” list of our members for as long as we can remember. Over the last three years, we have produced guidance for our members on a number of the issues. We have issued draft policy wordings on non-disclosure, basis clauses and conditions precedent. Those have been available to our members and available, therefore, in the insurance market.

We strongly support the reform of the Marine Insurance Act 1906, as proposed by the Law Commission. We are disappointed that the proposals relating to irrelevant warranties and damages for late payment are currently not included in the Bill and we believe that they should be reinstated. We have some comments on each of these points in response to what we believe your questions will be to us in a few minutes. In specific member surveys relating to the proposals, over 90% of respondents were in favour of each of the reforms as proposed, including those where there would be additional obligations on the insured, such as the requirement to undertake a reasonable search.

I would just like to add in my opening remarks that we have been very impressed by the level of support for the reforms in most of the insurance market. We have undertaken our own lobbying over the last 18 months, particularly in relation to the draft clauses that we have been proposing. The senior management of most insurers used by our members have been very positive and supportive, based on the fact that they recognise that the law as it stands is unfair on policyholders and they wish to be seen as part of the solution. Senior claims managers and underwriters no longer have the discretion that they might have had in the olden days to ignore legal defences to large claims, even if those defences are based on out-of-date legal principles that would not be understood by the policyholder. This is why, when we produced our wordings last year on basis clauses, which we believe to be the antidote to basis clauses, they were widely accepted in the market. That is all that we wanted to say by way of opening remarks. We are very happy to answer your questions.

The Chairman: Does that statement also cover you, Mr Hopkin?

Paul Hopkin: Yes, as far as introductory remarks are concerned. Of course we are willing to address the specific questions that we have been notified of, as well as any introductory questions.

Q37 The Chairman: Then we will turn to those specific questions. In your written evidence, you support the new duty of fair presentation of risk in terms of what the insured are deemed to know. Are you clear about what the Bill means by “senior management” and what that would mean in practice for your members?

John Hurrell: Lord Chairman, I would like to ask my colleague Paul Hopkin, our technical director, to respond to that. Apart from anything else, Paul has been part of senior management as a risk manager in industry.

Paul Hopkin: Thank you Lord Chairman. As has been said, we publish guidance for our members, drawing on their experience and best practice to produce consolidated advice. I have brought along some samples to show the weight of the reports that we produce. One report was specifically about disclosure of material facts and information in business insurance. This guidance, which we produced three or four years ago, drew on my own experience as an insurance buyer for a large multinational plc with a turnover of about £2 billion. The guidance refers to and sets out a suggested process which many insurance buyers follow and identifies roles for: a responsible person who, in a large organisation, will typically be the insurance manager; a series of knowledgeable people who have relevant information and know the material facts to be disclosed; and an authorised person who will sign off on the submission. Technically, within a large organisation where there is an insurance manager, that manager will undertake the reasonable search that has been described and contact all the people within the organisation whom the responsible person—the insurance buyer—knows, or has reason to believe, has the knowledge required to develop the submission to the insurance market. The reasonable search will consist of contact with all the knowledgeable people in the organisation and then consolidation of that information into a market report. That represents a reasonable process for the discovery of that information. Having consolidated the information, the market submission will then be taken to a senior person within the insured
organisation who will validate the information that has been collected and authorise the release. I have, myself, been in the position of being asked some very challenging questions by the chief executive officer and chief finance officer. When I have gone to them and said, “This is our submission”, the challenge has come back, “How do I know this is correct? Why should I put my signature on the bottom of this proposal form?”. That is validation that the process has been followed and, within that process, there is contact with senior management throughout an organisation and then consolidation of the information into a report that goes to the insurance market. From our perspective, we are confident that our members recognise the role of senior management and interact with them in compiling reports for the market.

**Lord Carrington of Fulham:** By the sound of what you are saying, it is the senior person inside the organisation with the final sign-off whom you would identify as the “senior management” in terms of this Bill.

**Paul Hopkin:** I identify that person as the ultimate authorised person on behalf of the company and they will be a part of senior management.

**Lord Carrington of Fulham:** And that is whom the insurer should then rely on to have given all the relevant information that was required to enable them to assess the risk under the insurance?

**Paul Hopkin:** Yes. That member of senior management, in signing off on the proposal form that goes to underwriters, is validating that that is the information, collected after a reasonable search. But one of the features in the proposed legislation that AIRMIC members are very keen on is the clause that says that underwriters should then challenge the information they have been given. If they are given information that gives them cause to seek further clarification, they should ask questions at that stage. We think that it is highly appropriate both for underwriters to ask about the process by which the information was compiled and to ask further questions if they feel that they do not have enough information once they know the risk and have read the proposal.

**Lord Carrington of Fulham:** However, some of the evidence rather suggests that the proposal is for the technical people in the company—those who are personally concerned with assessing the insurable risks inside it—to have the responsibility to provide that information, or to ensure that it gets to the insurance company. But, as I understand it, if you then have a sign-off from the senior management who have challenged it, they might block some of the information that the insurance professionals inside the company thought ought to go to the insurance company. Is that correct?

**Paul Hopkin:** I would not expect senior management in that role to feel that they needed to block information. Although I agree that is something senior management might seek to do, technically in my experience it would not happen. If there is an insurance manager who is the responsible person for collecting the information, that would jeopardise and challenge their professional position. I would not expect AIRMIC members to accept that sort of challenge.

**John Hurrell:** If that situation occurred, the senior manager who tried to block the information would be captured by the definition of “senior management”. They would therefore be in breach because it would be the knowledge of senior management that was flawed.

**Q38 The Chairman:** In paragraph 17 of your evidence, you implicitly support the reinstatement of the Law Commission’s draft clause preventing insurers from relying on breach of terms not relevant to the actual loss in excluding, limiting or discharging their liabilities under contract. You have heard some discussion of this by Lord Mance this morning. How big a problem is this phenomenon for your members?

**John Hurrell:** Lord Chairman, to answer your question specifically, I think it is a big problem. This is not because insurers seek to avoid liability under a policy where there has been a breach of an irrelevant warranty. The number of cases that go to trial on this basis would be close to zero. Our members certainly do not report that their insurers are using irrelevant warranties to avoid the policy in its entirety. However, there are two issues that we would like to draw to your attention. First, we think that our members, and perhaps any educated member of the commercial insurance-buying public, would say that the law as it currently stands, which supports the possibility of avoidance on the grounds of breach of an irrelevant warranty, potentially leads to a discredit of confidence in the insurance market. It cannot, therefore, be good for the commercial insurance-buying public’s feeling of security.

**The Chairman:** So it is not only in the insurer’s interest.

**John Hurrell:** No, because I think there is a credibility issue.

**The Chairman:** And a reputational one.

**John Hurrell:** The scope for an insurer, even at a relatively senior level, to ignore legal advice that they can avoid a policy is actually much more limited than it may have been 10 years ago when such things used to be done. More importantly, this gives the insurer an unassailable negotiating advantage on the grounds that it is not going to trial but that its opening gambit is, “You have breached a warranty. We accept that it is an irrelevant one, but if we chose to we could avoid the policy in its entirety. Now let us negotiate”. This is quite a challenging position for the policyholder to face.
As far as the Insurance Bill is concerned, let us look at Clause 10, on the suspension of warranties, and take an example of a warranty for the requirement to maintain a sprinkler system to protect against fire. If the sprinkler system fails for some reason, the policy is suspended and is reinstatable only once the sprinklers are working again. If, during this time, an aircraft drops on the building or it is subject to theft, there is no policy available to the policyholder. We therefore believe that you cannot have the proposed Clause 10 without the reinstatement in some form of Clause 11, which would restrict the suspension to a relevant risk which the underwriter designed the warranty to protect against when they imposed it. So we think that the Bill, as currently drafted, would act unfairly on the policy-holder in that regard.

The Chairman: So you would like to see something there to avoid that?

Q39 Lord Lea of Crondall: I would like to ask about late payment. Would you support the reinstatement of the draft clause from the Law Commission on late payment of claims? Is this a bigger problem for small businesses than it is for your members? If you do support it, could you also comment on the arguments put forward by those who take the contrary view?

Paul Hopkin: Yes, we are in favour of damages for late payment. Our position, and that of our members, is very simply that it is not reasonable for an insured, who has presented a claim and proved the evidence that the claim is covered, to be denied payment or for there to be an unreasonable delay in payment. It seems appropriate that if the claim is covered and the insured has done all they can to provide any additional information, if it is then unreasonably delayed some compensation and damages should be payable as a consequence of that unreasonable late payment.

Lord Lea of Crondall: My supplementary then would be to ask you to comment on the contentions of those who take the contrary view, such as London’s competitiveness, large firms versus small firms, et cetera.

Paul Hopkin: Yes.

John Hurrell: Perhaps I may pick up on that point. In terms of London’s competitiveness, the legal situation whereby an insurance payment is deemed to be damages against a hold harmless agreement is unique to the law in England and nowhere else in the world, including Scotland. Most of the insurers that our members use operate throughout the whole of the rest of the world, where the insurance payment is regarded as a contractual payment, against which failure to honour the contract could lead to a claim for damages. I do not believe that has brought the sky in anywhere else in the world.

Insurers operate very satisfactorily in jurisdictions where damages could be charged for failure to observe the contract.

Paul Hopkin: I would add to that and say that an insured would not actually want to end up having to seek damages for late payment. There is a good deal of onus on an insured to make a claim in a timely manner, to provide all information, to cooperate fully with the insurer and to answer all questions requiring further information. It is in the interests of all parties that claims are settled as quickly, as fairly and as reasonably as possible, but ultimately there will be consequences for large companies, particularly perhaps for small ones, if payment is delayed. If a facility or goods have been lost, they run the risk of alienating a major customer and large companies can suffer considerably if they cannot access adequate funds to make good the damage to their reputation that might result from failure to fulfil a customer order. This can be considerable for both large and small companies.

The Chairman: As Lord Mance has indicated, the reason for common law having this approach was because when common law was developing in this respect in the past it was not so hard to obtain loans as it can be in periods of difficult financial circumstances. It may mean that you have to focus on this.

Lord Ashton of Hyde: I understand your arguments and agree with many of them, but is there actually a problem in this area? I can understand the theoretical problems that could exist if an insurer did not pay, but is this actually a serious problem for your members?

Paul Hopkin: From time to time, yes, it is. Very large claims affecting AIRMIC members tend, fortunately, to be few and far between. However, when a very large claim does arise, especially since the financial crisis, cash is now king and the availability of cash has become much more important. The ability to borrow from banks is much more difficult and perhaps more expensive, banking covenants are more rigidly enforced, and the accountants also perhaps have greater influence than they used to.

Lord Ashton of Hyde: I can see all the potential circumstances where it would make a huge difference. Lord Mance talked about moving almost into business interruption. But I wanted to know whether it was generally a large problem, across the whole gamut of your members, or whether it relates only to very individual circumstances. Is there a general problem across the industry?

Paul Hopkin: It clearly relates to individual circumstances, but a feature of large insurance claims is that you do not know when you are going to occur.

Lord Ashton of Hyde: So you are saying that it is not a general problem across the industry.

Paul Hopkin: It is a potential problem when a large claim arises and could affect any policyholder.
The Chairman: There are no further questions. Thank you very much indeed. You do not need to depart, but you can depart.

Memorandum submitted by Airmic

AIMIC MEMBERSHIP

1. Airmic has a membership of nearly 1,200 and represents the insurance buyers and claims handlers for about 75% of the FTSE 100, as well as very substantial representation in the mid-250 and other smaller companies. Airmic members are responsible for insurance placements that represent about £5 billion of annual insurance premium spend. Also, Airmic members place insurances in their own insurance companies (referred to as captive insurance companies) with a total annual premium spend of a further £2 billion.

2. Airmic members are responsible for managing claims against insurance companies in respect of losses suffered by their employer, particularly in relation to large property damage / business interruption claims. Additionally, they have responsibility for handling and payment of third party insurance claims arising from the activities of their employers. Often these third party claims are paid in addition to external insurance premium spend and are estimated as having a value of at least £2 billion per year.

REFORM OF THE MARINE INSURANCE ACT (MIA) 1906

3. Airmic strongly supports the overall approach described in the July 2014 report of the Law Commission (Law Comm No 353 / Scot Law Com No 238) and believes that implementation of the recommendations set out in the Executive Summary of the report will substantially redress the balance between the parties to an insurance contract. Airmic has consulted its membership in regard to reform of the Marine Insurance Act (MIA) 1906 on several occasions and the results of these surveys are used as the basis of this evidence.

4. The results of the member surveys were evaluated by the Airmic Insurance Steering Group and were used as the basis of submissions to the Law Commission consultation papers. Although the exact circumstances of claims are confidential, Airmic members report that there have been a number of situations where claims have been challenged on the basis of non-disclosure and/or breach of warranty. Successfully contesting disputed claims has been difficult when there is the threat of avoidance of the policy ab initio.

AIRMIC MEMBER OPINIONS

Disclosure and the duty of fair presentation

5. Airmic members are strongly in favour of the concept of the duty of fair presentation of the risk, as described in Clause 3 of the draft Insurance Bill. In particular, Clause (4)(b) that places a duty on the underwriter to make further enquiries is welcome.

6. Airmic members are also in favour of the idea that legislation should specify that a material circumstance is a circumstance required to provide a fair representation of the risk. However, Airmic suggests that there should be an equal duty on the insurer to request a level of detail that is commensurate with the risk information. Airmic members are content that what is “material” will continue to be defined by reference to circumstances that would influence the judgment of a prudent insurer.

7. In simple terms, Airmic members have the view that the disclosure process required by law should encourage insurers and policyholders to work together to improve pre-contract disclosure and ensure that a fair presentation of the risk is provided.

Knowledge of insured and insurer

8. Airmic members are in favour of the suggestion that knowledge should include information known to the directing mind and/or the persons arranging insurance for the organisation. Airmic members believe that the concept of a “knowledgeable person(s)” is an issue of great practical importance, as they need to know how undertake the collection of information. Gathering information regarding all material circumstances can be an onerous task that may involve multiple sources of information and many months’ work.

9. Although the insured should carry out a reasonable search of available information, the inclusion in Clause 3(5) of reference to what the underwriter “knows or ought to know” for the purposes of a fair presentation is helpful. The helps define what the insured is required to disclose in order to ensure a fair presentation of the risk.

Remedies for breach of duty of fair presentation

10. Airmic suggests that the remedies available to insurers in the event of non-disclosure should be proportionate to the circumstances that gave rise to the non-disclosure. Airmic believes that the current remedy of avoidance ab initio available to insurers for non-disclosure is disproportionate in the vast majority of situations. In particular, Airmic is in
favour of the suggestion that an insurer should show that without the non-disclosure it would not have entered into the contract at all, or would have done so only on substantially different terms.

11. The insurer should have a more proportionate remedy based on what it would have done had the presentation been fair. Paragraph 2.34 of Law Comm No 353 provides an equitable basis on which to determine the remedies available to insurers for non-disclosure.

Warranties and representations

12. Airmic members are overwhelmingly in favour of the suggestion that in the event of a breach, the liability of the insurer should only be suspended in respect of that type of loss. Airmic is also in favour of the suggestion that in the event of a breach, the liability of the insurer should only be suspended in relation to losses at that time or at that location. In summary, it is the view of Airmic members that “the insurer liability should be suspended only as regards the effects of the non-compliance and should be restored on remedy”.

13. Airmic members are also in favour of the suggestion that warranty terms should be provided in writing, using unambiguous language specifically brought to the attention of the policyholder before the contract is formed.

Basis of contract clauses

14. Airmic members agree that the clauses in an insurance contract stating that the policyholder warrants the accuracy of the answers and/or the answers form the basis of the contract should be of no effect.

15. Airmic has published guidance for members on the need to avoid basis of the contract clauses and has produced a sample clause to neutralise these clauses. Therefore, the proposal that the Insurance Bill should contain a provision that basis of the contract clauses should be of no effect is welcomed by Airmic.

Breach of warranties

16. Airmic members have extensive experience of insurance warranties and are aware of the need to comply with the warranty terms and conditions. However, Airmic members have concerns regarding ‘conditions precedent’ in policies whereby cover does not attach until certain conditions have been met. In some cases, meeting the conditions after the inception date of the policy will not activate the policy coverage. Airmic has published a guide to members on ‘conditions precedent’ advising how the difficulties can be overcome.

17. Also, Airmic believes that breach of a warranty should only affect the liability of the insurer in respect of losses in the same category. For example, it does not seem appropriate that failure to fulfil an intruder alarm warranty should give the insurer the ability to refuse to pay an unrelated fire or flood claim.

Good Faith

18. Airmic members agree that the duty of good faith should continue as an interpretive principle, because it is currently enshrined in all insurance contracts. The principle should be equally applicable to policyholder, intermediary and insurer.

Contracting Out

19. Airmic members believe that the parties to business insurance should be entitled to contract out of the remedies for non-disclosure provisions of the legislation. There is some concern however, that opting out would become the insurance market norm and/or a standard opt-out clause would be devised this would not be to the benefit of policyholders. Airmic is very supportive of the suggested arrangement whereby parties should not be able to contract out of the prohibition on basis of the contract clauses.

20. Airmic is supportive of the position that wherever an insurer wishes to include a contractual term which puts the insured in a worse position than it would be in under the default regime, the insurer should have to satisfy two procedural requirements: (1) the insurer must take sufficient steps to draw the term to the insureds attention before the contract is entered into; and (2) the term must be clear and unambiguous as to its effect.

Benefits of Reform of the MIA 1906

21. Airmic believes that the existing insurance contract regime, as defined by the Marine Insurance Act 1906 places the UK out of line with an international marketplace. Therefore, Airmic believes that reform of the MIA offers a competitive opportunity for the UK insurance market. A more equitable legal framework that is in line with other insurance markets will encourage insurance buyers to place more business in the London market.

22. Airmic is in favour of the proposed package of reforms and believes that they represent an appropriate framework for insurance contracts. In summary, Airmic suggests that:

- ‘Fair presentation’ is a more collaborative means of disclosure to underwriters than the disclosure obligations of the MIA
- ‘Fair presentation’ also emphasises the fact that disclosure is a shared responsibility between insured and insurer
- Greater clarity is provided by the proposed description of who is considered to have the knowledge that needs to be disclosed
Q40 The Chairman: Mr Terrell and Mr Trudgill, thank you very much for coming to give evidence. We have, of course, read your submissions. You have heard the form of the process. Would you like to make an opening statement, either jointly or severally?

Graeme Trudgill: Thank you, Lord Chairman. Yes, we would like to make an opening statement. Thank you for inviting us to provide oral evidence. We strongly support the Bill and feel that there are four key areas that require modernising for the benefit of policyholders. The first is the basis of the contract clause: Clause 9, Warranties and representations. We are strongly in favour of the abolition of such clauses. Secondly, on automatic avoidance for material non-disclosure—Clause 8, Remedies for breach—we are strongly in favour of having a new regime of more proportionate remedies for failure to make a fair presentation of the risk, as the existing sole remedy of avoidance is too draconian and inflexible. Thirdly, on the consequences of breach of warranty—Clause 10—we are strongly in favour of the new remedy for breach of warranty being suspension of cover for the duration of the breach rather than automatic discharge of insurers’ liability. Fourthly, we did not include in our submissions to your Lordships points on revised Clause 11, on terms not relevant to the actual loss, but I can advise that BIBA members are strongly in favour of this redrafted clause.

If there were one change that we would ask for in this Bill, it would be to include revised Clause 11, as brokers believe that the insurers should pay the claim when the breach of a specific risk mitigation term is totally irrelevant to the loss that has taken place. Following further consideration of the Bill and the helpful new document provided by David Hertzell on 5 December, our mind has been put at rest in some areas, so we have decided to withdraw some paragraphs from our written submission. These are paragraph 9, on Clause 3(3)(b), relating to fair presentation; paragraphs 11 and 12, regarding our point on confidential information; and paragraph 13 on “ought to know”. Members have decided upon reflection and further discussion that they are now sufficiently comfortable with the Bill in these areas.

Finally, we congratulate David Hertzell on bringing forward this Bill. We support its implementation in full and do not want to impede its passage in any way. We think that it is vital to keep the UK at the forefront of the global insurance market.

The Chairman: Thank you. Is there anything you wish to add, Mr Terrell?

Graham Terrell: No, Lord Chairman. My thoughts are encompassed in my colleague’s opening statement.

Q41 The Chairman: In your written evidence, you state that there should be further clarity around the concept of “reasonable search”. Do you have any suggestions as to how we achieve the further clarity to which you refer?

Graham Terrell: That particular piece of written evidence pre-dated our perusal of David Hertzell’s oral evidence and the subsequent submission to you, dated 5 December. Having debated the issue a little further among ourselves, we have to say that we have considerable sympathy with David’s point that at some point it just becomes impossible to draft something that provides absolute clarity and still fits the range of circumstances that you are trying to match it to. The point that we have tried to make originated from a couple of our larger members feeling that there might have been some discrepancy between two of the paragraphs in the main report, on pages 108 and 109. The two paragraphs that I am thinking of, from memory, are paragraphs 9.34 and 9.39, relating to the scope of “reasonable search”. Paragraph 9.34, from memory—and I paraphrase—refers to reasonable search relating only to the knowledge of the insured person or entity.

The Chairman: Sorry, could you raise your voice slightly?

Graham Terrell: I do apologise. Paragraph 9.34 refers to the knowledge of the insured person or insured entity rather than the entire corporate
knowledge of the agent, whereas paragraph 9.39 goes on to say that a reasonable search could cover all information held by the agent. Now, BIBA is an extremely diverse organisation. Some of our larger members are very large, acquisitive multinationals. The example was given of what the position would be for a large international broker with perhaps as many as 70 branches across several countries with different IT systems that may just have completed a major acquisition of another significant player. Would they be conducting a reasonable search if they liaised purely with the controlling mind of the client, or would the expectation in those circumstances be for them to send searches for client data to all departments and all their other branches, and should those searches be purely on the corporate entity or should they extend the searches to the directors of the companies as well?

So I think our position is that we would welcome any further clarity that the Law Commission feels able to give on how paragraphs 9.34 and 9.39 are expected to run together, because some of our larger members feel that if the position is as is in 9.39, that a reasonable search should encompass potentially all the information held by the agents organisation, that requirement may be excessively onerous given the scope, size and structure of some of our members. Having said that, we have considerable sympathy with the Law Commission’s position that there is only so far you can go with providing clarity for these circumstances. If the Law Commission feels that it has gone as far as it can, I think that I am correct in saying, Graeme, that this is something that BIBA would be prepared to take offline, away from this Bill, and discuss with other shareholders and stakeholders in the insurance market.

The Chairman: I am conscious that the Law Commission is present and listening to what is being said. I am not inviting it to do anything, but you acknowledge the difficulties where you have a test that is meant to be flexible, but in a way, of course, that enables it to apply to the whole market—not only the small people, not only the big people, but all the market. It may be that that will be worked out in time. I would expect a court to take into account, so far as it can be ascertained, what the practice is within the industry. I am not giving you guidance, but I suppose that that is the advantage of a clause being a “reasonable” matter.

Graham Terrell: Indeed, Lord Chairman. As we said, we absolutely appreciate the considerable difficulty in setting down on paper what must essentially be a flexible system.

Q42 Baroness Goudie: In your evidence, you support the reinstatement of the draft clause on late payment of claims. Could you give us an idea of how often your clients suffer because of late payments, and how the proposed change in the law might improve the situation?

Graham Terrell: Yes, my Lady, if I could field that one again, it is fair to say that we regularly hear specific stories from members, but as far as I am aware BIBA has no formal documentation or a list of the quantity of these. Perhaps the most useful piece of information would be that which we understand was provided in your Lordships’ written report of Maetavish, where it referred to a survey of some 410 companies in the UK with an annual turnover in excess of £50 million. Of those surveyed, 40% said that they had made strategically significant claims: in other words, those that could impact directly on their commercial viability. Of those claims, 45%—nearly half—had been disputed by the insurers and those claims had taken an average of 35 months, or nearly three years, for resolution. In those circumstances, where you have a major claim, inevitably, no matter what the size of the company, that lack of cash flow must impact on your bottom line and can lead to the insured being unable, for example, to rebuild or replace a facility lost. As a result of that, they may lose a contract or go out of business. In those circumstances, a BI policy will not pay of course, because the loss is due the lack of finance. We feel that that position can be ameliorated by the introduction of damages rather than interest, which is the current practice. I believe that my colleague can give an actual example of where late payment led to a very serious consequence for the insured.

Graeme Trudgill: Yes, it is a typical example that we got in yesterday. A landlord had a buy-to-let property. The tenant had an illegal cannabis farm that caused £22,000 worth of damage to the property, but the insurer refused the claim saying that it was unauthorised DIY work by the tenant and not malicious damage. So this was argued for 12 months. Of course, during that time the landlord could not pay to reinstate the property or pay their mortgage and the property was sold at auction and a loss was made by the policyholder. Eventually, the insurer paid for the damage to the property and for 12 months’ rent, but that was too late: the landlord had gone out of business and a large loss had been made. It is the unassailable advantage that John Hurrell spoke of earlier. That is why we think that damages are more appropriate than interest in a circumstance such as this.

Graham Terrell: Perhaps I may pick up on another point that John made in reference to Clause 11. Equally, in respect of late payment claims, there is an issue of public perception or reputational damage for insurers. No one is suggesting that the example that my colleague has just given is an everyday event, but the fact that it can happen at all can only seek to harm the public’s perception of how the insurance industry generally is viewed.
The Chairman: Thank you very much. That is very clear.

Lord Carrington of Fulham: If I could just come back on that. As I understand what is being proposed on late payment, it would apply if there was not a dispute. In the example that you gave us, clearly the insurance company was in dispute and it was resolved after 12 months and then payment was made. But the late payment clause would not really have affected that because they were in dispute on the facts of the case as to whether it was insurable and applicable. So the clause as proposed here would not have ameliorated the insured’s position and would still have led to the property being sold and the loss being incurred. Is that correct, or have I misunderstood how the proposed clause would work?

Graham Terrell: No, my Lord, that is essentially our understanding as well. We were trying to give an example, a fairly extreme one admittedly, of what could happen in the current legal environment. We think that the clause, even as it was originally proposed, would still go several steps towards improving the situation and improving public perception of the insurance industry. In our view, the introduction of Clause 11 is the most important amendment that we would like to see made to this Bill. We are also very keen for it to go through and do not want to impede its passage. We are very well aware that late payment is a very complex and, dare I say it, contentious issue. The most important point for us is that, although in an ideal world we would like to see it back in the Bill, so long as it remains a live issue for discussion we would be perfectly prepared to see it dealt with by way of a further statutory instrument at a later date.

Lord McNally: I think that is very helpful, Lord Chairman, in that we are getting a great deal of evidence calling for this clause. Yet, as you have very helpfully and frankly admitted, it would be controversial for it to go in. That is something that we have to balance in taking the Bill through this procedure.

Lord Lea of Crondall: Did you say that you thought this could be dealt with by a statutory instrument?

Graham Terrell: It could be a different statute or perhaps an amendment to an existing one at a later date.

The Chairman: Or I suppose, in the Bill. There may be a power to bring in a statutory instrument if the Government thought it appropriate to do so.

Lord McNally: If the Government brought forward legislation covering this area early in the next Parliament but did not go through this process, it would then be a matter of political judgment whether they would put this into law despite the controversy.

Graham Terrell: As we stated, the overriding priority for BIBA is to see the Bill through the Lords as swiftly and in the most whole form possible, whichever way the Government eventually feel it is best to address it.

The Chairman: Of course, we have heard Lord Mance talking about compound interest and other matters of that sort, as an alternative. This adds to the complexity of what is the right step to take. Unless anybody else has any questions, I would like to thank you very much for your evidence. As we said to the previous witnesses, you can stay if you want to.

Memorandum submitted by the British Insurance Brokers’ Association

1. Thank you very much for your invitation to the British Insurance Brokers’ Association (BIBA) to submit written and oral evidence to the House of Lords Special Public Bill Committee on the Insurance Bill.

2. Our written evidence is below. The BIBA Liability & Accident Committee Deputy Chairman, Graham Terrell (JLT), will join me on 9th December to give oral evidence.

3. BIBA is the UK’s leading general insurance intermediary organisation, representing the interests of insurance brokers, intermediaries and their customers. BIBA’s membership includes just under 2,000 regulated firms, which employ more than 100,000 staff. General insurance brokers contribute 1% of GDP to the UK economy, and they arrange 53% of all general insurance and 81% of all commercial insurance business. Insurance brokers put the clients’ interests first, providing advice, access to suitable insurance protection and risk management.

4. BIBA feels that one of the benefits of the Bill is to bring balance to the level of responsibility, between Insured and Insurer, in the process of arranging insurance, and greater clarity.

5. The Bill has correctly identified three key areas of concern:

   — **Basis of Contract Clauses**
     We are strongly in favour of the abolition of such clauses.

   — **3.2 Automatic Avoidance for Material Non-Disclosure**
     We are strongly in favour of having a new regime of more proportionate remedies for failure to make a fair presentation of the risk, as the existing sole remedy of avoidance is too draconian and inflexible.
— 3.3 Consequence of Breach of Warranty

We are strongly in favour of the new remedy for breach of warranty being suspension of cover for the duration of the breach rather than automatic discharge of insurer’s liability as currently provided under the Marine Insurance Act 1906.

6. The Bill reflects the commercial world today and addresses the needs of the modern day renewal and placement process faced by insurers. It also addresses problems arising from provisions of the Marine Insurance Act 1906 which often cause confusion.

7. Clause 3 The Duty of Fair Presentation

We are pleased that new duty to make a fair presentation of the risk may be satisfied by the insured giving the insurer sufficient information to put a prudent insurer on notice that he should ask further questions.

8. We are pleased that the new law will provide insureds with greater clarity on how to satisfy the duty to make a fair presentation of the risk e.g. it will clarify who, on behalf of the insured, is deemed to have knowledge.

9. Clause 3(3) (b)

As regards the clause which states: “A fair presentation of the risk is one—which makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer”. We think this could be further clarified.

10. Clause 4—Knowledge of the insured 4 (4)

The question of whether there has been a reasonable search will vary widely between different sizes and types of insured, making this duty very uncertain. Further clarity on this term, either in the Bill or the Explanatory Notes, would be much appreciated. We also believe that the search should be limited in the same way as in Clause 4(3) i.e. the requirement to carry out a reasonable search should be limited to the senior management or those responsible for the insured’s insurance.

11. Clause 4(5)

We agree with the intention of this clause, i.e. that it can never be right for an agent (i.e. a broker) to be obliged to provide its client with confidential information that has been obtained from another client as a result of the broker’s business relationship with that other client. There is a concern that any such disclosure could breach data protection law.

12. We would therefore welcome an amendment to this clause so that it applies not only to ‘confidential’ information, but also to ‘any’ information that an agent has obtained as a result of its business relationship with another client.

13. We are concerned that clause 4 section 4 states what an Insured ‘Ought to know’ BIBA would therefore recommend a minor addition to clause 4 so that it specifically says instead: “where they reasonably ought to know,” to give insurance brokers a fair defence.

14. We do not agree with insurers being able to contract out of the new regime in all circumstances. For example, in subscription placements it could cause problems if some insurers contract out and others do not, e.g. by leaving the insured with a gap in cover in the event of a claim.

15. We were also in favour of draft clause 14 which has been omitted from the current Bill, regarding damages for unreasonably delayed payment of claims and we hope that this clause can be revived on another occasion.

16. We feel the reforms, if implemented, will bring important modernisation to the market which will result in better outcomes for customers. Although we have raised issues in our response that require consideration, and potential changes to the Bill, we do not in any way want to impede the progress of this important Bill which has the support of BIBA members.

We hope that you will give due consideration to our constructive suggestions and we very much look forward to giving oral evidence on the 9th December.

November 2014
Q43 The Chairman: Mr Mendelowitz, we are very grateful to you for coming, as we have been to the other witnesses who have given evidence before us. We have, of course, seen your written evidence and we are grateful for that as well. Do you want to make an opening statement?

Michael Mendelowitz: Thank you, Lord Chairman. I am obviously grateful for the opportunity to appear before this Committee on behalf of the British Insurance Law Association. I do not, by this opening statement, intend to enlarge on or summarise our written submissions, but I believe that I should explain where our evidence is coming from. BILA is not a representative body in the same way that others from whom you have heard in these sessions, such as ABI, AIRMIC, BIBA, IUA and LMA, are. Our constituency, if it can be called that, includes insurers, intermediaries, corporate policyholders and their employees, individual policyholders, insurance market bodies, lawyers in private practice who advise all of the foregoing, and academics.

The BILA law review sub-committee, which is responsible for the submissions made to the Law Commission and this Committee, draws its membership from each of those groups and does not necessarily seek to speak with one voice or even achieve a broad consensus on any issue which it discusses. Rather, we try to present a fair account of the sometimes diverse opinions expressed by our members. There is also a fair amount of cross-fertilisation across the bodies that see themselves as having a stake in insurance law and its proposed reform. To take one example, if I may name names, Mr van der Klugt, who gave evidence to you last week on behalf of the LMA, is a member of the BILA committee. Indeed, he sits on the law review sub-committee that drafted our submissions. My own name appears in the list of contributors to the submissions made on behalf of the City of London Law Society insurance committee, and I guess that counsel who are members of BILA, or who drafted submissions on behalf of others who have given evidence, would probably also be party to the COMBAR submission. So everybody is in this together. Although I understand that all these bodies, including BILA, are broadly in favour of the major, substantive planks of the proposed reforms, there are differences between their approaches to specific issues. I therefore conclude my opening statement and preface my answers to your specific questions by saying that, although I will obviously do my best to act as the BILA spokesman, I cannot pretend that my personal views will always coincide with a “BILA position”.

The Chairman: So you are giving your evidence, which is what you are invited to do.

Michael Mendelowitz: Thank you, Lord Chairman.

Q44 The Chairman: Your evidence calls for the Bill to state explicitly that it applies to reinsurance. As you have heard from previous points that we put, others have suggested that this is unnecessary or even undesirable. What is your response to that?

Michael Mendelowitz: Lord Chairman, to state explicitly that the Bill applies to reinsurance is probably not absolutely necessary, but the unanimous view of BILA is that it would be highly desirable. I think I can say no more than that I have read the transcripts of the evidence given to you last week and I am in full agreement with what Sir Andrew Longmore said then and what Lord Mance said earlier this morning. Rather than being harmful, I think there would be distinct advantages. Explicitly mentioning reinsurance would permit an exception to be made for reinsurance contracts in Clause 15 of the Bill. I gratefully adopt what the City of London Law Society said in its submissions, because attempting to impose a transparency requirement on insurers, reinsurers and retrocessionaires is, in my view, simply a recipe for unwanted satellite litigation. I do not accept the objection, which I understand comes from parliamentary counsel, that doubt might be cast on the interpretation of other statutes if the Bill included specific mention of reinsurance. Yes, I can see the argument, but I do not think that it should be allowed to trump other considerations. In our view, it is the very fact of the proposed amendment to the Marine Insurance Act 1906 that gives rise to some uncertainty, because the Bill introduces the concept of a non-consumer insurance contract. To me, that does not self-evidently include reinsurance and retrocession.

The Chairman: I have your point. Thank you.

Q45 Lord Carrington of Fulham: Coming on to the subject of fraudulent devices, in your written evidence you proposed that the Bill should provide the courts with discretion to relieve the insured from the full consequences of a fraudulent claim in a case where “the insured has supported or attempted to support an otherwise legitimate claim by the use of a fraudulent device”. We are slightly worried about that. Do you not think that there is a danger that this would send a message that it is acceptable to use fraudulent means to support
genuine claims—what the ABI called a concept of “fraud-lite”?  
Michael Mendelowitz: This is one of those instances where there was a fairly sharp divergence of opinion among the members of the BILA sub-committee, even if, as I now realise on re-reading our submissions, we appear to be unanimous on this point. Perhaps not surprisingly, the sub-committee divided along the lines of insurer representative and policyholder representative camps, with the brokers falling into the latter camp. I think the academics also supported the policyholder position, possibly because they have had experience of other jurisdictions such as Australia, where such a judicial discretion is allowed and the sky has not fallen in. My own view for what it is worth is to agree with the premise behind your question.

This Committee is very likely familiar with the fraud statistics published by the ABI. I had a look the other day at what I think is the latest update to the relevant page on the ABI website and it tells me that in 2013 insurers uncovered 119,000 dishonest claims worth nearly £1.3 billion across all lines of insurance. The effect of insurance fraud, which affects all of us, is to add an average amount of £50 annually to every UK policyholder’s insurance. I am not sure whether that £50 figure is based on the revealed frauds and therefore (presumably), unsuccessful attempts at fraud or is an estimate of the full extent of the problem, but on either view I support the proposition that the policy of the law should be to do whatever it reasonably takes to discourage insurance fraud, even at the risk of harsh outcomes in particular cases. After all, if one has a legitimate claim, it should not be necessary to lie to get that claim paid. Even if the lie can be characterised as stupid rather than malicious, I would prefer to see the law based on a clear statement of policy rather than a broad discretion.

Having said that, I want to make some subsidiary points in favour of the majority position of the BILA law review sub-committee. The first is that there are some indications that may suggest that the law will not in any event be as harsh in its application as it might appear in principle. The recent judgment of the Court of Appeal, which may be on the way to the Supreme Court, in the latest insurance fraud case—that is, Versloot Dredging v HDI (The DC Merwestone)—holds that, in order to have an effect, fraud, including a fraudulent device used in support of a legitimate claim, (because the DC Merwestone is a fraudulent device case), should not be, to quote Lord Justice Mance, as he then was, in the Agapitos case, “immaterial or insubstantial”. Secondly, there is the response of a group of commercial court judges to the Law Commission’s consultation on this point; it is referred to in the BILA submissions. Those judges suggest that where it is permissible, judges will tend to find that the use of a fraudulent device might be something that will not deprive the insured of a right to indemnity if the claim is otherwise legitimate. So there may still be an element of discretion creeping in.

Another point that I would like to make is that I believe that the BILA proposals should be given serious consideration as, if nothing else, a very imaginative solution to the problem of what one might call relatively minor insurance fraud, perhaps “fraud-lite”. It seems after all to be in keeping with the general policy of the insurance contract law reform project in relation to misrepresentation and non-disclosure that the all-or-nothing remedy of avoidance should be abandoned in favour of proportional remedies: in other words, what would the insurer have done had the disclosure been true? That might equally well apply to the claims process. Is it a little fraud? Is it a big fraud? A big fraud will vitiate everything. For a little fraud perhaps the insurer might have a lesser remedy, such as BILA has proposed in its written submissions.

Lord Carrington of Fulham: Does not the temptation then come to somebody who is making a claim to try their luck by doing a little fraud to see whether they can get away with it? They might get a slightly larger payout than they would have done otherwise.

Michael Mendelowitz: I cannot dispute that. Quite a lot has been written about the point at which claims negotiation, if one can call it that, shades into fraud. Some people may say that there is a dividing line. I do not believe that there is a clear dividing line but, as I said earlier in my evidence to this Committee, I think that ultimately the policy of the law should be to come down against fraud in any shape and form, or indeed regardless of quantum.

Q46 The Chairman: You have questioned whether the provisions on fair presentation and knowledge of the insured and insurer represent worthwhile improvements to the law. If the Committee decides to retain these provisions, what would be your suggestions to those responsible for tightening up and improving the drafting of the Bill?  
Michael Mendelowitz: Lord Chairman, let me say by way of opening that, although my inclination—and I suspect that of at least half of the law review sub-committee that drafted our written submissions—would simply be to support the original Law Commission proposals as drafted, I would make perhaps three related submissions for possible improvement. The first, which might incidentally go at least some way towards satisfying the objections to this part of the Bill that were raised by the IUA, the LMA and others in their written submissions and oral evidence—I think
that Catlin is in this camp—would be to specify that for the purposes of Clauses 4(2) and Clause 4(3) references to the knowledge of individuals include what such individuals may reasonably be deemed to know and that individuals are deemed to know what they ought in the ordinary course of their business to know. In other words, that would simply reintroduce part of the current language of Section 18 of the 1906 Act. Alternatively, this might be more broadly phrased as what individuals placed in their circumstances ought to know, rather than in the ordinary course of their business. That is one possible suggestion. The second would be to clarify that the reasonable search of information, which is referred to in Clause 4(4), is one way but not necessarily the only way to satisfy the test of what an insured ought to know for the purposes of disclosure. The third and I suppose the most practical element would be to add words, either to Clause 4(4) or perhaps in a new Clause 4(6)(c), to clarify that the search for information, including inquiries, should not necessarily be restricted to senior management or individuals responsible for the insurer’s—insurance—we have heard other evidence on that this morning. I refer particularly in this connection to the example of a reinsured’s claims manager, to which we drew attention in paragraph 17 of our written submissions. The claims manager may well have material information, but he would not normally be regarded as part of the insurer’s—management. The reinsurance manager, who is the person talking to the broker about placing the reinsurance, might not, although he ought to, think of talking to his claims manager about something that is in the pipeline but has not yet got into the statistics for the purposes of updating the renewal information.

The Chairman: I see. Thank you very much.

Michael Mendelowitz: Apologies, Lord Chairman, but might I say one other thing? This is very late, but I know that there was an IUA-LMA redraft of Clause 4, which was circulated yesterday evening. I think I would support that. I would have to qualify that response by saying that I have not had a lot of time to study it carefully, but it is an alternative way of getting there.

The Chairman: Thank you. Are there any other questions?

Q47 Baroness Goudie: Your evidence contains a large number of detailed drafting suggestions, for which we are very grateful. Could you please tell us which in your view are absolutely essential?

Michael Mendelowitz: Lord Chairman, I cannot honestly argue that any of them is absolutely necessary. I obviously believe that they are all good and worthwhile but I understand that parliamentary counsel operate under strict “less is more” guidelines, so that any words that are not absolutely necessary should be eliminated. I would however urge reconsideration of subsections (4) to (6) of new Section 19. They are probably not things that this Committee has been troubled with, as they relate to amendments to the Road Traffic Acts. We made a written submission on this, but on reflection I believe that the question posed in paragraph 34 of our written submissions stems from a misunderstanding. That is my misunderstanding, as I was the draftsman of that paragraph. However, I would say in BILA’s defence that the current drafting, which involves further amendments proceeding from the Insurance Bill to amendments to the road traffic legislation already made by the Consumer Insurance (Disclosure and Representations) Act, makes for a very tortuous and confusing passage. I would prefer to see the Insurance Bill, if enacted, simply repealing and replacing the whole of Section 152 of the Road Traffic Act 1988 and Article 98A of the Road Traffic (Northern Ireland) Order by provisions that consolidate the amendments which are already there because of CIDRA and those proposed by the Insurance Bill, putting them all in one convenient place.

The Chairman: Thank you very much for drawing attention to that. We are very grateful for your evidence and we need not trouble you further. I think that that brings the matters that the Committee is considering today to an end. We resume on Monday at 10 am in the Moses Room.
and, while a number of them are likely to give rise to disputes in the short to medium term, they potentially represent on the whole a significant improvement to insurance contract law in the longer term.

— The exception to this is the proposal relating to fraudulent claims. This remains sufficiently contentious that the Committee questions whether it is well suited to the fast track procedure for uncontroversial legislation.

— We also remain ambivalent about whether the proposed re-codification of the duty of fair presentation and the imputation of knowledge to insureds and insurers, does represent a worthwhile improvement to insurance contract law overall and whether it might not be preferable to have proposed suitable amendments to the relevant sections of the Marine Insurance Act 1906.

— On the assumption that the Committee will want to consider the Bill as presented we have also highlighted a number of detailed drafting issues in particular relating to the ambit of the legislation, knowledge and remedies for breach and for fraudulent claims.

**Policy issues**

1. For the most part, we expressly refrain from commenting further on the fundamental policy propositions underlying the clauses of the Bill in circumstances where the policy decisions in question were arrived at following various stages of a comprehensive and detailed consultation process that has been on-going since the beginning of 2006. BILA submitted formal responses at each stage of the consultation process and is pleased to note that the views it expressed on some key issues appear to have been taken into account. In what follows, therefore, we shall confine ourselves largely to comments on the extent to which the draft Bill either successfully implements, or fails to implement clearly, those policy decisions.

**Fraudulent claims and devices**

2. There is one partial exception to what we have just stated, which has to do with insurers’ remedies for fraudulent claims. We start from the assumption that—consistent with the approach adopted throughout the consultation process—the Law Commissions do not intend to attempt to define fraud in the context of insurance claims, or to circumscribe the boundaries of conduct that should, or should not, be held to amount to fraud in the making of a claim. We would also point out that during the drafting process there has been a shift in terminology in clause 11 from “fraudulent claim” to “fraudulent act”, without any indication whether a fraudulent act is to be equated with the making of a fraudulent claim, or whether it has a wider meaning. Of particular concern to us in this context is the question whether “fraudulent act” would include a fraudulent device employed to support a genuine claim—and, more widely, whether the draft Bill is intended to make provision for penalising fraudulent devices at all.

3. In our response to the Consultation Paper on this issue, we wrote:

   “An insured may stoop to doing something fraudulent to assist his claim that is fairly minor and has no significant effect on the claim (e.g. writing a false receipt for an item which he has genuinely lost). …. In such circumstances, it may be unfair that the insured should always lose the whole of its claim ....

   We recognise that the dividing line may be difficult to draw and that guidance may have to be set out in primary or secondary legislation. We would, nevertheless, seek to distinguish between this type of conduct and cases where the claimant never had a genuine claim or has made a significantly exaggerated claim; in the latter cases we would favour the whole claim being forfeit. Where, however, there has been a genuine claim in connection with which an insured has engaged in some fraudulent conduct to substantiate that claim to a minor degree, we would favour giving the courts some discretion to award him an appropriate amount of his claim but to penalise him in an appropriate way, such as by withholding a part of the claim and/or by an adverse award of costs, in recognition that such conduct was reprehensible.”

4. We note that similar reservations were expressed by a group of Commercial Court judges (see paragraph 2.13 of the Summary of Responses to Second Consultation Paper: Post Contract Duties and other Issues, December 2012).

5. The question of what should be the law’s correct response to the use of a fraudulent device in support of an otherwise legitimate claim under an insurance policy was recently considered before the Court of Appeal, in an appeal from the judgment of Mr Justice Popplewell in Versloot Dredging BV v HDI-Gerling Industrie Versicherung AG (“The DC Merwestone”) [2014] EWCA 1349. The Court of Appeal dismissed the idea that the court should consider whether, in all the circumstances, it was just and proportionate to deprive the insured of what was otherwise a valid claim. The court did not, however, disturb the view expressed by Mance LJ (as he then was) in Agapitos v Agnew [2003] QB 556 (CA) that the fraud should not be immaterial or insubstantial. Nevertheless, there remains a divergence of strongly-held views on this question by (on the one hand) representatives of the insurance industry and others who believe that for reasons of public policy, fraud must be deterred even where deterrent measures produce a harsh result in particular cases and (on the other) champions of consumer rights and others (including the Commercial Court judges referred to above) who question whether insurance law as it currently stands gives insurers a level of protection that is unique and unwarranted in relation to other defendants against whom exaggerated claims may be made. This may cause those now considering the Bill to question whether the Bill is suitable to be enacted using the “fast track” procedure for uncontroversial Law Commission measures. We appreciate of course that “uncontroversial” is intended to refer to party political issues rather than difficult legal questions, but we fear that the distinction will prove too subtle for some and that the Bill may not be passed simply because the debates which it generates in parliamentary committees will not be capable of resolution in the time available.
6. This issue could be rendered, if not entirely academic, then of diminished significance by insurers’ use of clear policy language providing for the consequences of the use of fraud, in whatsoever manner, in support of a claim. It may nevertheless be advisable, at least to clarify the Bill by stating whether or not fraudulent devices are meant to be caught by the expressions “fraudulent claim” and/or “fraudulent act” and to consider adding to the Bill a clause conferring an explicit discretion on the court to relieve the insured from the full consequences of a fraudulent claim in a case where the insured has supported or attempted to support an otherwise legitimate claim by the use of a fraudulent device. The court might, for example, in substitution for forfeiture of the entire claim, impose a penalty such as depriving the insured of his costs (of part thereof), or ordering the insured to pay the insurer’s costs (or part thereof), or reducing the amount of the claim by a sum approximating to the expense incurred by the insurer in investigating the fraud.

Fair presentation etc

7. So far as concerns the other main planks of reform (the remedies for breach of the duty of fair presentation; abolition of an insus of contractually-changed of the effect of a breach of warranty; and damages for breach of the insurer’s implied duty to pay claims within a reasonable time), we consider that the Law Commissions’ proposals strike the right balance and—even if, as will be seen, we cannot speak with complete unanimity on every aspect of the proposed reforms—potentially represent on the whole a significant improvement to insurance contract law in England, Wales and Scotland. BILA strives not to take the side either of the insurance market or of policyholders when controversies arise between these two groups; BILA’s aim is, rather, the achievement of good insurance law which operates, as far as possible, even-handedly between insureds and insurers.

8. We recognise of course that one of the immediate (and unintended) consequences of fundamental changes to insurance law such as are being proposed by the draft Insurance Bill could well be an upsurge in insurance coverage litigation to clarify matters such as what “an insurer offering insurance of the class of business in question to insureds in the field of activity in question would reasonably be expected to know in the ordinary course of business” (clause 5(iii)(b)), but if (as we believe) the proposed legislation results in an improvement in the law, such improvement will outweigh any adverse elements of the consequence just described. This statement must however be read subject to the observations that follow in the remaining paragraphs of this section and to the comments below relating to certain detailed aspects of the Bill, in relation to which the views of the majority of the BILA Law Review Sub-Committee are—as we shall point out—not shared by all of the members.

9. It is in this light that we would wish at this point to raise a fundamental question about the scope of the draft Bill. Our understanding is that the Law Commissions’ major objective in proposing reform of insurance contract law in England, Wales and Scotland was to re-balance the respective rights and obligations of insureds and insurers so as (for example) to remove perceived anomalies such as the insurer’s right to avoid a contract from inception in circumstances where the effect of avoidance was economically disproportionate, or to give insureds a remedy when an insurer unreasonably refused or delayed payment of a claim. BILA has been broadly in support of this objective, as well as supporting clarification of the common law in areas where judicial pronouncements have not always been consistent or readily understandable, such as in relation to the consequences of fraudulent claims. Beyond these areas, however, we have to question how far law reform should go.

10. Notwithstanding our previous support in the main for the “in principle” proposals set out in the Law Commissions’ consultation papers, we have to acknowledge some unease when we see certain of those proposals expressed in the language of the Bill now before the Committee. In summary, we support unreservedly reform of the law where we consider such reform to be necessary or to offer undisputable advantages over what went before; we caution, however, against legislative amendments which do no more than codify (or re-codify) existing law unless (a) such law is readily capable of codification and (b) the proposed codification makes the law more clear. More particularly, in relation to the clauses of the draft Bill which seek to clarify the duty of fair presentation and the imputation of knowledge to insureds and insurers, we have to question whether the proposed amendments in fact represent a worthwhile improvement to insurance contract law overall. It might have been preferable, instead of drafting new legislation (clauses 3 to 7 inclusive of the Insurance Contracts Bill) to have proposed suitable amendments to sections 18, 19 and 20 of the Marine Insurance Act 1906.

11. The discussion below of individual clauses of the Bill that follows should be read subject to this overriding concern, and where it seems to us that it might be possible to achieve the desired end by minor amendments to the 1906 Act, involving no more than the addition or deletion of a few words, we have suggested that such a course be followed.

12. We turn then to consider the detailed drafting of the Bill, on which we have the following comments.

Clause 1—Definitions

Application to reinsurance?

13. We presume that the category of “non-consumer insurance contracts” is intended to cover contracts of reinsurance (and retrocession), but we believe that the current draft of the Bill leaves room for uncertainty in this regard. It might be that as the Insurance Bill is intended to replace, in relevant respects, provisions of the Marine Insurance Act 1906 and the 1906 Act has been held to apply to reinsurance, it follows that the Insurance Contracts Bill must also apply to reinsurance. However, the new Bill (unlike the 1906 Act) is not a codifying statute; it expressly seeks to change the common law (and the 1906 Act) in relevant respects. In particular, the Bill provides for the “omission” of sections 18 to 20 of the 1906 Act, which are precisely the sections considered most often by the courts to have application to
contracts of reinsurance. It is at least arguable, therefore, that the Bill was not intended to apply to reinsurance at all.

We consider, accordingly, that clarification in this regard would be highly desirable and we suggest that the definitions of "non-consumer insurance contract", "insured", and "insurer" should be expanded to include, respectively, contracts of reinsurance or retrocession, reinsureds, and reinsurers where the context admits or requires such interpretation. Alternatively, a provision to this effect might be inserted into Part 6 of the Bill.

**Intended beneficiaries of an insurance contract who are not parties to the contract**

14. We question whether the definition of "insured" is sufficiently broad. We have in mind situations (other than where clause 12 applies, i.e. group insurance for consumers—although, as will be seen further below, we suggest that this clause should not be confined to consumers) where the beneficiaries of an insurance policy may not be contracting parties: for example, where the group holding company of a multinational business buys property and/or liability cover for all of its operating subsidiaries, or where a company buys a D&O liability policy for all of its directors and officers. (Further examples of policies covering composite interests will be given in our discussion of clause 12.) In such cases, we do not consider that the subsidiaries, or the directors and officers, will always necessarily be parties to the contract of insurance, but they ought to qualify as "insureds", at least in the sense of being persons (legal or natural) entitled to the benefit of the cover provided by the insurance. We acknowledge that an expanded definition of "insured" to include such persons would entail the (presumably unwanted) consequence that each of them would come under the proposer’s duty of fair presentation; it could also create inconsistency with the scheme of the Bill as regards imputation of knowledge in connection with this duty. Perhaps the solution is to create a new defined term, such as "beneficiary", meaning any person other than the insured who is intended, expressly or impliedly, to have the benefit of the cover provided by the contract of insurance. The introduction of the category of beneficiaries could also assist, we believe, in clarifying the duty of the insured to make "a reasonable search of information" (clause 4(4)) and also in targeting the insurer’s remedies for breach of the duty of fair presentation or in respect of fraudulent claims in appropriate circumstances; see further below.

**Clause 2(2) — Application and interpretation of the duty of fair presentation**

15. The legislative intent of this clause might be made clearer if it were amended to read (underlining added):

“This Part applies in relation to variations of non-consumer insurance contracts as it applies to the insurance contracts that are proposed to be varied, but—”

**Clause 4 — Knowledge of insured**

16. In sub-clauses (2)(b) and (3), would the word “any” not be simpler and more satisfactory than “one or more”? There is a potential inconsistency between sub-clauses (3) and (4); we presume that sub-clause (4) is meant to take precedence over (3) so that knowledge of what individuals who are part of an insured’s senior management or responsible for placing of the insurance would have found out (by a reasonable search of information available to the insured) will be imputed to an insured that is a corporate entity; but that such “reasonable search” is not to be understood as being confined to individuals within senior management or responsible for the insurance programme. Clarification of these issues in the drafting would be desirable.

17. As a separate but related point, does “a reasonable search of information” include an obligation to put relevant questions to other personnel within a corporate entity? An example considered by the BILA Law Review Sub-Committee was that of the reinsurance manager of a Lloyd’s syndicate who is asked by a prospective reinsurer of the syndicate whether the reinsured is aware of any claims affecting the account which is proposed to be reinsured. The reinsurance manager may not be personally aware of any such claims, but the syndicate’s claims manager (who is unlikely to be part of its senior management or responsible for placement of its reinsurance programme) may have received information in this regard which has not yet been logged in the syndicate’s claims system. Presumably, however, the reinsurance manager ought in such circumstances to confer with his claims colleague before responding to the reinsurer’s question? Further, should the obligation to make reasonable searches or enquiries not extend to our proposed category of beneficiaries (see above, clause 1)?

18. We would add here a general comment, in accordance with the caution expressed above about the appropriate circumstances for codification of law, relating to clause 5 (Knowledge of insurer) as well as to clause 4. Imputation of knowledge is an area of law which is fraught with difficulty, but the English legal system appears to have coped with that difficulty satisfactorily in the past. We therefore question whether there is really a need for—or even an advantage in—codification of the relevant rules in the context of an insured’s duty of fair presentation, where the application of those rules is fact-sensitive and the relevant facts are, by their very nature, often complex.

**Clause 4(5) — Knowledge and confidential information**

19. Insofar as clause 4(5) refers to knowledge of the insured, we consider that the revised draft achieves what was presumably its principal aim, namely to clarify the circumstances in which knowledge of a broker (or other “agent to insure” in the terminology of the Marine Insurance Act 1906) is to be attributed to the insured if and when section 19 of the 1906 Act has been omitted from the 1906 Act by the Bill now under consideration, so that the agent to insure no longer has a self-standing duty, additional to that of the insured, to disclose to the insurer all material facts which the agent knows. In these circumstances, provision would need to be made for attribution to the insured of relevant knowledge possessed by the agent. The practical problem which arises and to which the draftsman of the Bill has evidently attempted to provide a solution is that—particularly where the services of a major broker are engaged in the
placement process—some limitation on attribution of knowledge may be necessary or desirable because the broker may possess information which is (or could be) material to the risk which the insured proposes to insure, but which is not in the possession of the insured himself (or itself) and which the broker knows only because the information was given to the broker in confidence by a different client.

20. In line with the overriding concern expressed earlier in this letter, we wish to ask whether the desired reform of the law could not be achieved more simply by suitable amendments to section 19 of the Marine Insurance Act. Section 19(b) seems to be unnecessary (because—as pointed out in the Law Commissions’ June 2012 Joint Consultation Paper on the Business Insured’s Duty of Disclosure, at paragraph 7.15 (1)—if the insured is bound to disclose something and employs an agent for purposes of placing his or its insurance, the agent will be obliged in any event to make that disclosure on behalf of the principal); and section 19(a) could be qualified by an exception relating to knowledge concerning information possessed by the agent if such information was:

(a) acquired by the agent through a business relationship with someone other than the insured, and

(b) confidential to the person who imparted it to the agent.

21. In the further alternative, the best solution may be to do no more than repeal section 19(b) of the 1906 Act. The case law on section 19(a) restricts the agent’s duty of disclosure to knowledge acquired on behalf of the principal whose risk is proposed to be insured. If the proposed additional criterion of confidentiality (or rather, non-confidentiality) is introduced into the law, some unhappy consequences might follow. We offer as an example a situation where a broker has acquired knowledge that is material to a risk from someone other than the insured and where the communication to the broker of such knowledge was arguably confidential. Let us suppose that the broker considers his duty of confidentiality to the client who provided him with the information in question overrides the duty of his other client (i.e. the insured) to make a fair presentation of the risk to the insurer. Subsequently, however, the insurer discovers the non-disclosed information and asserts against the insured an entitlement to a remedy for breach of the duty of fair presentation, claiming that the non-disclosed information was not in fact confidential. In such circumstances, the issue of whether the information in question was actually confidential (as well as whether such confidentiality as might formerly have attached to it has been lost) could be argued in open court between the insured and the insurer, with the broker being no more than an embarrassed and reluctant witness, and the party who had originally asserted (and might want to continue to assert) the confidentiality of the information in question playing no part at all in the proceedings.

It seems to us, accordingly, that this particular proposed change to insurance contract law might be creating a new problem rather than resolving an old one (which may in any event not be sufficiently serious as to require legislative intervention).

CLAUSE 6(2)—FRAUD ON PRINCIPAL

22. Clause 6(2) is evidently intended to codify the principle in Re Hampshire Land [1896] 2 Ch 743, but some members of the BILA Law Review Sub-Committee question (in line with the general comment above) whether such codification is necessary (it does not appear to us that any other provisions of the Bill expressly or impliedly repeal the principle) or desirable.

CLAUSE 7—SUPPLEMENTARY

23. Would it be helpful, for the avoidance of doubt, to insert at the beginning of sub-clause 7(4), words such as (or having the effect of): “Without limiting the generality of sub-section (3), ...”? 

CLAUSE 8—REMEDIES FOR BREACH

24. Anticipating a proposal which we will make below when we come to comment on the Schedule, we suggest that where a qualifying breach affects a composite or group insurance contract, the insurer’s remedies ought to be exercisable only against the insured (or beneficiary) who should be held responsible for that breach. Recognising, however, that the practical consequences of this proposal could entail complex calculations in certain circumstances, we believe that any amendments to the Bill would sit more comfortably in the Schedule than in clause 8.

CLAUSE 10—BREACH OF WARRANTY

25. We suggest that sub-clause 10(1) should provide explicitly that section 10 applies both to consumer insurance contracts and non-consumer insurance contracts.

26. Given concerns that we have heard expressed (particularly in the marine insurance market) about warranties whose nature is such that any breach of them cannot possibly be remedied, we propose that sub-clause 10(2) should have inserted in it, after the words “has been breached but” the words “(if the breach is capable of being remedied)”. 

27. For the same reason, we suggest that in clause 10(5), after the words “is to be taken as remedied” there should be inserted “(provided that it is capable of being remedied)”.

CLAUSE 11—REMEDIES FOR FRAUDULENT CLAIMS

28. Subject to the concerns expressed above about the approach of English law to fraudulent devices used in support of legitimate claims and the intended scope of clause 11, we consider that the Bill (by and large) satisfactorily codifies the present state of English law, or proposes a robust but fair method of dealing with aspects of fraudulent claims on which the current law is not as clear as it might be. We do however still have two issues which we would urge the Committee to consider.
29. The first of these is whether the Bill could not be further improved by an expansion of clause 11(1)(c) (insurer giving notice to insured of termination of the contract) by providing explicitly that such notice should be written (in order, inter alia, to reduce potential disputes about whether or not such notice was given or received) and also to provide that such notice should be given within a set period—for example within 30 days of the insurer’s becoming aware of the fraudulent act. If a refinement of this sort is not added, satellite litigation might be encouraged over subsequent (non-fraudulent) claims where the insured argues that by not giving notice of termination within a reasonable period, the insurer has waived its right to terminate the contract—leaving it to the court to decide what is reasonable in all the circumstances. It is only fair to state that the members of the BILA Law Review Sub-Committee were divided on this proposal, with a minority expressing the view that the suggested approach might simply give right to satellite litigation of another sort, i.e. over determination of the precise date when the insurer became (or, possibly, should have become) aware of the fraud.

30. The second question is what is to happen if a fraudulent claim is followed by a legitimate claim and the latter claim is paid before the insurer becomes aware of the fraud. Presumably, the intention is that the insurer does not in such circumstances lose the right to treat the contract as terminated with retrospective effect, so that the insurer is entitled to recover from the insured not only whatever it may have paid in respect of the fraudulent claim, but also any payment in respect of the subsequent legitimate claim. If that is correct, we suggest that clause 11(1)(c) (or possibly clause 11(2)) should be augmented by a provision making it clear that if the insurer has exercised the right to treat the contract as terminated, the insurer is entitled to recover from the insured any sums paid under the policy in respect of (legitimate) claims made after the time of the fraudulent act, if such sums were paid before the right of termination was exercised.

Clause 12—Fraudulent Claims: Group Insurance

31. We question why the effect of this clause is limited to consumer insurance contracts. It seems to us that the principle underlying clause 12 is equally of potential application to commercial policies insuring composite interests, such as professional indemnity, Directors’ and Officers’ liability, all risks property insurance taken out by a group holding company on behalf of itself and all of its operating subsidiaries, project insurance (CAR or EAR) covering the interests of the employer, the principal contractor and all sub-contractors, etc. In this context, the proposal which we have made above concerning the definition of a “beneficiary” as another potentially relevant person in the context of insurance contracts might be of value, i.e. the insurer’s rights would be exercisable only in relation to the cover provided for the fraudulent beneficiary (rather than the “CF”). We acknowledge that some detailed redrafting of clause 12 would be necessary, not only to remove sub-clause (1)(c) (limitation to consumer contracts) but also quite possibly to amend sub-clause (1)(b)—is it necessary that none of the “Cs” (or beneficiaries) should be a party to the contract? It seems to us that the suggested clarification of the law would work satisfactorily in circumstances both where such persons were parties to the contract and where they were not.

Clauses 14 and 15—Contracting Out

32. It seems to us that the words “or of any other contract” which appear a number of times in these clauses are unduly wide. In order to enhance the clarity of clause 14(1), we suggest that additional words should be inserted so that it commences as follows (underlining added):

“(1) A term of a consumer insurance contract, or (subject to sub-section (3)) of any other contract affecting or relating to a consumer insurance contract, which would put the consumer in a worse position ... [etc]”

33. We suggest that similar amendments be made (mutatis mutandis) to clauses 15(1), 15(2) and 15(4), with the “subject to” words in parentheses referring to section 15(7).

Clause 19—Provision consequential on Part 2

34. We question whether the reference in clause 19(6) of the Bill to section 11 of the Consumer Insurance Act 2012 should not provide for the omission of sub-section 11(3) of that Act in addition to sub-sections 11(1) and (2). It appears to us that section 11(3) of the Consumer Insurance Act is effectively replaced by clauses 19(4) to 19(5) of the Bill.

Schedule—Insurers’ remedies for qualifying breaches

35. We suggest that the provisions immediately following the “General” sub-headings in Part 1 and 2 (i.e. paragraphs 1 and 7) be augmented to provide that where a qualifying breach potentially affects a composite or group insurance contract, the insurer’s remedies are to be exercised only in relation to the insured (or beneficiary) who has committed such breach or whose interest in the contract is vitiated by it.

36. We recognise that such a regime could be difficult to apply in practice. For one thing, identification of the relevant insured or beneficiary may not be straightforward. For another, if the insurer would have charged an increased premium, it may not be readily apparent what part of the premium paid for the composite or group contract relates to the cover provided in respect of the insured or beneficiary potentially affected by the qualifying breach. It is conceivable that the overall premium will not have been calculated on a simple per capita basis; there may (for example) have been in effect some element of cross-subsidy by members of the insured group considered less likely to make claims in favour of higher risk members, with the average premium rate for all members of the group being reduced simply because the cover is bought on a composite or group basis, thus benefiting even those members who are subsidising others. In such cases, however, there is (or so it seems to us) an available solution: either the insurer will be called upon to provide evidence of its premium rating, or it may be left to the courts to make a fair apportionment.
37. Further, we suggest that sub-paragraph (3)(b) be expanded to provide explicitly that if the insurer has already returned to the insured an amount representing the premium reduction, such amount may be reclaimed by the insurer from the insured.

**Terms relevant to particular description of loss / Damages for late payment**

38. The draft clauses relating to these items do not form part of the current Bill, and we make the comments below solely in the eventuality that it is suggested, during the committee stage, that they be revived.

**Terms relevant to particular description of loss:**

39. We ought to record that a significant section of the BILA Law Review Sub-Committee (possibly as many as half of its members) did not support what was previously clause 11, expressing the view that this is a proposed reform too far, particularly as its scope extends beyond warranties, and because it could be conducive to satellite litigation concerning the meaning of expressions such as “a particular kind” (and possibly even “a particular location or time”) and over whether the term of the contract in question would indeed tend to reduce the risk of loss of a particular kind or at a particular location or time. We note that the Bill reflects that concern by removing this section. If there is any suggestion that it be revived we would repeat our advice that those members view that such a provision is likely to give rise to more difficulties than it resolves.

**Damages for late payment of claims:**

40. This was one of the more controversial parts of the insurance contract law reform project. The consequent division of opinion in the insurance market and those who represent it was reflected in the BILA Law Review Sub-Committee. The majority of the Sub-Committee members were and are of the view that Sprung v Royal Insurance (and the cases concerning the juridical nature of a claim for indemnity under an insurance policy which preceded Sprung and led to the conclusion expressed in that case) should be overruled by statute; however the minority considered that the reform proposed would lead to an explosion of litigation without necessarily providing an effectual remedy for people in the position of Mr Sprung.

**Third Parties (Rights against Insurers) Act 2010**

41. We note—and welcome—the fact that the Bill also includes amendments of the Third Parties (Rights against Insurers) Act 2010, which will enable this important statute to be brought into force.

**General and concluding observations**

42. We trust the submissions above are found to be of assistance. Members of the BILA Law Review Sub-Committee would be happy to assist the Committee if such evidence is considered helpful.

*November 2014*
Written Evidence

Memorandum submitted by Aon Risk Solutions

Thank you for your email. My only substantive comment is that the provisions removed in order to fast-track the passage of the Bill into law were actually really good. I thought that the provision that provided for damages for late payment was both a welcome and necessary development to redress an imbalance in the current law.

I appreciate that these provisions would have only been taken out following proper debate and consideration, so I certainly do not mean to criticise. I understand that something is better than nothing and that sometimes you need to make trades. I also understand that there may be further efforts from the Law Societies in the future to reintroduce these back in. However, I am not sure that there will still be the same momentum once the Bill is passed into law and following personnel changes within the Law Societies etc. I believe that these omissions are somewhat of a shame and an opportunity missed.

November 2014

Memorandum submitted by Aon UK Limited

1. Aon has taken a keen interest in the Bill and has already provided a number of responses to previous versions of it. We are grateful to the Special Public Bill Committee for providing us with a further opportunity to comment.

2. Aon continues to support the objective of bringing greater clarity and certainty to this important area of the law. We see this as being in the common interest of our clients, as well as insurers, and brokers. With that in mind, we set out below a few areas where we believe the Bill could be enhanced and clarified to ensure that it meets the Law Commission’s intention to provide a balanced relationship between the insured and insurers.

Knowledge of the insured (Clauses 4):

3. Clause 4(4)—The question of whether there has been a ‘reasonable search’ will vary widely between different sizes and types of insured, thereby making this duty very uncertain. Further clarity in either the Bill or the Explanatory Notes would be very helpful to Aon and its clients. We also believe that this search should be limited in the same terms as Clause 4(3) i.e. only the information held by senior management and those responsible for the insured’s insurance would fall within the scope of a reasonable search.

4. Clause 4(5)—In our view, it could never be right for an agent to be obliged to provide Client A with information it has obtained as a result of its business relationship with Client B. We would therefore welcome an amendment to this clause so that it applies not only to ‘confidential’ information, but rather to any information an agent has obtained as a result of its business relationship with another client. It would also be useful to have further guidance on who at the agent (when it is a large organisation) would have the relevant knowledge i.e. the actual broker, a team group of people expressly assigned to a client account, or the whole organisation? In our opinion it is not realistic to impute knowledge based on the latter.

Knowledge of insurer (Clause 5):

5. Clause 5 (2)(a)—The Explanatory Notes expressly state that this will include information held by the claims team, which “ought reasonably” to have been passed to the underwriter. However, it is unclear when such circumstances would arise i.e. should the claims team always pass the information to the underwriter, only when the underwriter asks for it, or when the claims team thinks the losses might be relevant to the risk? We believe that such information should be provided to the underwriter as a matter of course.

Remedies for Breaching the duty of fair presentation (Clause 8 and Schedule 1):

6. Clause 8—Unlike the Consumer Insurance (Disclosure and Representations) Act 2012 (“CIDRA”), there is no specific reference to how the remedies will work for group insurance. We suggest that the Bill is amended to insert wording along the same lines as Part 3 of Schedule 1 of CIDRA, but for non-consumer contracts.

7. Schedule 1—We note that the Explanatory Notes refer to there being an inducement test which reflects the current law as developed following the decision in Pan Atlantic (i.e. a subjective test). However, as you will be aware, the current law always considers this in conjunction with the objective materiality test under the current Marine Insurance Act. If the Bill is intended to follow the current law, we would ask that the relevant remedies are only available to insurers where they were induced, and the ‘prudent’ insurer would have been induced, to write the risk on the terms they did as a result of the insured’s unfair presentation.

Remedies for fraudulent claims: Group insurance (Clause 12):

8. We note that this section only applies to consumer insurance contracts. We believe that the law needs to be clarified in relation to non-consumer insurance as well given that we are aware of a large number of group insurance contracts which cover non-consumers. For example, company car insurance and company travel insurance (given that these contracts are wholly or mainly related to the employees’ trade, business or profession and would not therefore be consumer insurance contracts).


**Contracting out: non-consumer contracts (Clause 14):**

9. The only time we can see insurers contracting out of their new duties is when the insured: (1) does not understand the impact; or (2) is in a weak bargaining position. We believe this would mean that the most financially vulnerable insureds (i.e. the ones who need this protection the most) will be the ones who are left exposed where contracting out is allowed. We therefore remain strongly opposed to insurers being given the option to contract out of the proposed new regime under any circumstances.

**Clause 11 (Terms relevant to particular descriptions of loss) and Clause 14 (Implied term about payment)**

10. We appreciate the above clauses have been deleted from the current draft. However, Aon would wholeheartedly support their re-introduction at a later stage and would be more than happy to provide further comment on any new proposed wording.

*November 2014*

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**Memorandum submitted by Aviva**

**Aviva view of proposed changes:**

**Duty of Disclosure & Fair Presentation of Risk**

- Aviva encourages far greater disclosure and transparency at proposal stage between customer/intermediary and Aviva. Signposting to eradicate reduce/ data dumping is to be encouraged, particularly for corporate and large SME customers.

- Clarifying attribution of knowledge and obligations on insurer to make further enquiries is a positive step in reducing ambiguity of material insurance risk information.

- Aviva has some reservations around the ability of online customers and their brokers to consider their exposures in sufficient detail to satisfy the intent of the forthcoming legislation. Insurers, brokers, customers and regulators will need to work through the process to ensure that they meet the requirements. Aviva are working through how we would look to implement the law’s requirements into the online environment and do see some challenges in accommodating within the current model.

**Remedies for Breach of duty of fair presentation**

- Aviva broadly supports the remedies for breach of fair presentation.

- Proportionate remedies will encourage greater disclosure and insurer enquiries to ensure that full indemnity is provided. However, this will challenge insurer’s clarity and underwriting guideline recording as a number of such cases turn on their individual merits.

- Aviva supports the avoidance remedy due to deliberate/reckless qualifying breach. The onus is on the insurer to prove and envisaged this will be a considerable challenge in a number of cases. Aviva suggests that the insurer, upon proving a breach of the duty of fair presentation, the burden should then move to the insured to prove the breach wasn’t deliberate or reckless.

- Case law will further develop guidelines but there are risks that this will introduce significant additional investigation costs, in addition to those created by the widening and clarity of policy wordings. However, allowing insurers to keep premiums in such scenarios is another incentive for customers to carefully consider their disclosure obligations.

- Aviva is developing high level and more detailed material on what constitutes a fair presentation of risk and is working with brokers and other parties to gauge receptiveness of approach.

**Insurance Warranties**

- Aviva supports the warranty proposals.

- Our own Claims philosophies and standards adopt standards aligned with treating customers fairly and a causal link approach between policy breach and resultant claim so we do not envisage significant changes following the implementation of the new legislation.

**Fraudulent Claims**

- Aviva broadly supports the changes incorporated in the Bill and it is encouraging to see clear guidance on the protocols to be adopted in various scenarios.

- Fraud claims are difficult to prove and ‘genuine’ losses before the fraudulent event where there is a suspicion may be difficult to prove as non-genuine.

- There will still be difficulties around where the loss arises as a result of an incident which occurred after a breach, but is not actually suffered until after the breach has been remedied.
**Good Faith**

The retention of good faith as an interpretive principle is supported by Aviva. However, there is a concern that the effect of this and the potential for conflict with the revised duty of fair presentation may result in a watered down version of the current position.

**Contracting Out**

Transparency requirements are onerous and Aviva will consider its use where appropriate.

**Those clauses omitted in the current Bill**

**Late Payment of Insurance Claims**

- Aviva broadly supports the proposals
- Reasonable time’ guidance needs to be clear but flexible.
- There is concern that because such claims will be allocated to the fast track, legal costs will be recoverable and this could spawn a new industry in claims management companies offering to pursue insurers for additional payment in cases where it is not justified, in order to create a new potential revenue stream.
- FOS involvement where damages are awarded for distress and inconvenience are also a concern.
- Factors outside the insurers control could also include the availability of resource to repair and reinstate ongoing suspected fraud investigations and difficulties with access etc. and there needs to be clear provision in the bill to allow for this.

**Warranty specific changes**

Although some terms are intended to cover all aspects of a policy, that isn’t always the case. We perceive that an issue with warranties is that such terms have the effect of excluding all losses, and aren’t restricted to limiting the specific loss which it was intended to cover. A move towards introducing an approach which is closer to a causal link approach would align with our current claims philosophies and standards.

**Other issues/concerns raised by Aviva:**

- Current FOS involvement on broker involved cases. Whilst understandable on direct cases, there should be minimal involvement when the customer is represented by a professional intermediary.
- Definition of when broker represents us or the customer, i.e. If a managing general agent or a delegated authority, they represent the insurer.
- Fair presentation of risk needs to be as clear as possible what is expected from customer/broker.
- Broker knowledge requirement to be as clear as possible what is expected from broker.

**Insurance Contract Bill—Clause 11—Aviva comments**

Aviva welcomes that the Law Commissions are seeking a greater degree of clarity around warranties and conditions precedent. Broadly speaking, Aviva was generally supportive of the spirit of the original Clause 11 because it aligned generally with the Aviva GI Claims Philosophies and Guidelines. That said, Aviva shares some concerns over several ambiguities, in particular the scope of the type of losses which could legitimately be declined following breach of a condition. Some of those concerns are ongoing and our reservations are set out below:

Clause 11 (1) refers to ‘term(s) (express or implied)’, however, the accompanying Stakeholder Notes refers to ‘terms’, ‘risk mitigation terms’, ‘clauses’, ‘risk mitigation clauses’ and ‘warranties’. These inconsistencies introduce ambiguity. Although Aviva would normally consider ‘terms’ as meaning conditions (or warranties previously), in the widest sense ‘terms’ can be interpreted to relate to exclusions/exceptions and conditions written into the contract either at policy or at section level. Looking at the wider interpretation, would the Law Commissions classify an ‘exclusion’ as a term’ for the purposes of Clause 11? If so, would it be a ‘term defining the risk as a whole’, in that it contributes to the delineation of the scope of coverage? We also consider that there is uncertainty regarding the intent of the words: ‘other than a term defining the risk as a whole’. Will the Law Commissions please clarify if this is a reference to a term or condition applying at policy level?

**Examples**

The Motor example given in paragraph 1.19 (2) of the Stakeholder Notes is clear with regard to roadworthiness of a vehicle and although Aviva would not treat this as ‘warranty’, the example reflects what we would require typically under a reasonable precautions condition. In practical terms, we advise that Aviva claims handlers would take a lenient view on the first example in the given circumstances.

Within our motor policy, the ‘keys exclusion’ means that Aviva will not cover theft of a vehicle while the ignition keys have been left in/on such vehicle. Different insurers may address this issue differently, e.g. via a condition precedent to liability that for any theft claim the insured must lock their vehicle and remove the keys when it is unattended. [In the given scenario, does the Law Commissions have a preferred approach?]

The words in sub-clause (1) only refer to compliance with terms which ‘would tend to reduce the risk of’.... loss. We consider that this could be set out in more robust terms, such as: ‘terms which would reduce and/or prevent the risk
of...’ on the basis that some policy conditions are intended to stand alone whilst others work in conjunction with other conditions (such as the unoccupancy or alarm conditions within a property policy wording).

Conversely, may we suggest modifying sub-clause (3) to, say, ‘could not have increased the risk of loss or allowed the loss to occur’ (or similar sentiment). The wording refers to ‘increased the risk of loss’, however, several of our conditions are designed to prevent or reduce the risk of a loss occurring and, accordingly, we consider that a fuller statement would clarify this position. An example would be where an insured breaches our unoccupancy condition by failing to inspect the property every 7 days and remove combustible items from the premises. Following several minor attempts to break in to the property, an arsonist returns, gains entry and fires the entire premises, using the combustibles left in the building. Had it not been for the breaches, inspections would have picked up the initial attempted break-ins and identified the fuel source, giving us/them the opportunity to remove the source and improve security, and thus prevent the loss.

If we leave the wording as just referring to ‘reducing the loss’ said breaches could be said to fall outside the scope of the clause, hence suggesting we expand the wording to say ‘terms which would reduce and/or prevent the risk of’. We also have questions about underwriting terms specific to the risk. If, for example, we apply a coinsurance clause, minimum excess or sub-limit etc. to make the risk acceptable to us, our view is that such terms would not be caught by the scope of this sub-section. For example, we may apply a 20% coinsurance clause with a minimum excess because the claims experience and/or standard of protections are not as good as we would ideally require. If the insured is in breach of the alarm condition, but this breach did not increase the ‘risk of loss’, are we in danger of losing our right to apply our bespoke underwriting terms?

Similarly, if a risk advisor/underwriter requires the insured to carry out work/changes to the risk (such as mandatory risk improvements following survey), we presume they would be caught by the term, ‘term’? So, again, for instance, if we require the rectification of all priority 1 and 2 electrical faults found in a premises within 30 days, failing which no or limited cover applies, there is a fire involving a breach of a condition, would those terms apply or not?

In all the circumstances, the Aviva starting point will be to approach claims settlement from a causal link perspective. Not only do we consider this to be more beneficial to a claimant but also this practice is closely aligned with Aviva’s implementation of the FCA Principle of ‘Treating Customers Fairly’.

November 2014

Memorandum submitted by BLM

INTRODUCTION: BLM

1. This firm is one of the UK’s leading insurance practices working for the country’s largest composite insurers, Lloyd’s Syndicates and other London Market insurers. We also represent not only many of the UK’s largest but also its smallest corporate entities and their brokers advising on issues of insurance coverage and the liability issues that arise where coverage is confirmed.

2. The firm has 12 offices, 1800 staff of whom approximately half are lawyers. We have offices in England and Wales, Scotland, Ireland and, with effect from 1 December, Northern Ireland and thus advise clients in all of the United Kingdom’s legal jurisdictions. We have responded to many of the consultations of the Law Commission’s programme of reform of Insurance Law.

OVERVIEW

2. We are aware that it is the view of most of our insurer and policyholder clients that the reforms proposed will benefit UK business by improving the availability of contingent capital at the point of greatest need. We are aware that there are some concerns around aspects of the drafting and welcome the careful consultation process undertaken by the Law Commission to date and the opportunity afforded by the appointment of the Committee to complete that process. We comment specifically below on aspects of the Bill.

4. We are also aware from our own informal conversations with insurers who have a substantial presence in the domestic market that they have or will be adopting the changes set out within the Bill prior to commencement.

DEFAULT REGIME

5. The reforms will enable insurers to offer a more attractive insurance “product” whilst retaining the flexibility to offer the policies underpinned by the 1906 legislation for those who prefer it. We are aware that there are sections of the UK Insurance Market and certain types of coverage, such as marine insurance, where the preference is to continue to write business on the traditional basis. The possibility to opt out subject to the “transparency” defined at clause 16 of the Bill is the right solution.

FAIR PRESENTATION

6. The reforms adjust the balance of risk in both the pre- and post-inception stages and create a process for dialogue between insurer and insured that imposes obligations on both.
7. The duty of fair presentation that includes the obligation to provide sufficient information also in turn creates an obligation on the insurer to consider the information provided critically and make enquiries of the insured in appropriate circumstances.

8. The present remedy of avoidance where misrepresentation at the pre-inception stage is inadvertent mitigates against such dialogue whereas the possibility of a remedy that reflects an adjustment of terms and attenuated claims payment (as opposed to no payment) will encourage exchange of information.

9. We anticipate that where there is new legislation that there will be new case law. This is inevitable as the judiciary are empowered to apply a new and more proportionate remedy that is to be made available. We consider that the opportunities afforded to steer a “middle course” will in the longer term provide better coverage for the policy holder and a better “product” for the insurer to provide to the market and encourage market professionalism.

WARRANTY

10. We support the prohibition of “basis of the contract” clauses as set out in clause 9. We agree with the clear intention behind the changes set out in the Bill as drafted (clause 10).

11. The present law allows for forfeiture of a claim for breach of warranty even when the insured has remedied the breach before the loss has occurred. In our experience, this harsh sanction is only rarely invoked, but its continuing existence spells out serious consequences for insureds and may possibly encourage “technical” repudiations of claims and so-called ‘underwriting at the claims stage’, neither of which is desirable. We support the view of the Treasury, as set out in the Bill’s impact assessment, that the reforms should ensure a “balanced outcome for parties where insurance warranties are breached.” We would suggest that the new approach is likely to encourage a more open dialogue between parties precisely because the harsh sanction above has been removed.

12. It is our view that providing (a) for the suspension of policy coverage while a warranty is breached and (b) allowing for its resumption after the breach has been rectified in full—as required by clause 10(5)—is broadly fair and just as between both parties to the contract.

13. We note that insurers will be able to contract out of clause 10 should they wish to do so (subject to the transparency requirements in Part 5 of the Bill. We believe this flexibility will be welcomed in specialist sections of the market.

FRAUDULENT CLAIMS AND THIRD PARTY INJURY CLAIMS

14. The current Bill applies only to the relationship between the insurer and insured and does not deal with claims (such as those in tort, which may be covered by liability insurance policies) made against the insured by third parties. We draw this point to the Committee’s attention in order to point out that clause 56 of the Criminal Justice and Courts Bill will require courts to dismiss “fundamentally dishonest” personal injury claims. For these claims at least, therefore, there will be a sanction for fraud—ie complete forfeiture of the claims—identical to that which has applied in first party insurance and which is now clarified at clause 11 of the Insurance Bill.

15. In our view, fraud must be discouraged and effectively sanctioned by the law and we see no reason to draw a distinction between whether it is perpetrated by an insured or by a third party claimant. We say that the word “insured” might easily be replaced by “claimant” in the passage below from the recent Court of Appeal case of Versloot Dredging (at paragraph 155):

(a) Once it is accepted that deterrence is itself a legitimate aim, the fact that forfeiture is a harsh, in some circumstances very harsh, sanction does not mean that it is disproportionate to that aim. The rule is only applicable in the case of fraud, from which no insured should have any difficulty in abstaining: The careless or forgetful insured is not affected, nor is the insured who tells some irrelevant lie or whose lie is not told in order to induce payment. These limitations on the scope of the rule render it a proportionate response to the aim of deterrence of fraud, which crosses a moral red line ....

FRAUDULENT GROUP CLAIMS

16. We consider it appropriate to protect the non-fraudulent members of a Group Insurance Scheme.

THIRD PARTY (RIGHTS AGAINST INSURERS) ACT 2010

17. We support the implementation of this Act and its revisions as set out at Part 6 of the Bill. These seek to reduce the complexity and cost of bringing proceedings and establishing the policy coverage afforded to the insolvent insured. Virtually all of our insurer and policyholder clients support this change. We note that the early commencement of Part 6 and the 2010 Act will support the objectives of Parliament to ameliorate the overall process for claims brought by victims of mesothelioma. BLM Partner Nick Purgater expressed our support for these changes in giving oral evidence earlier in the year to the Justice Select Committee’s enquiry into mesothelioma claims.

AMENDMENTS

18. We note that two aspects of earlier law commission drafts of the bill have been omitted from the bill before your Lordships. We are aware from the Second Reading debate that the Government offered encouragement to those endeavouring to reach an agreement as to clauses that could be taken forward and offer observations in respect of those two omitted clauses.
19. The first relates to “late payments” where there are contrasting outcomes that arise between claims in the Scottish and English and Welsh jurisdictions. In the latter the concept underpinning a contract of insurance is that the agreement between insured and insurer is that the insurer will “hold harmless” the former. The event that triggers the claim is in theory a breach of the contractual terms and thus the obligation to pay the claim that arises is, in legal theory, an award of damages. English legal principle provides that damages may not be paid on damages. The Law Commission had proposed a clause to bring the outcomes in respect of “late payment” into line in the two UK legal jurisdictions.

20. The position in England and Wales contrasts with that in Scotland where the insurers’ obligation is characterised as a contractual duty to pay a sum of money equivalent to the insured’s loss. However, the insurer is not obliged to pay the insured until a claim is made and the insurer is allowed a reasonable time to investigate a claim to determine if it is valid and should be accepted. An insurer is in breach of its contractual obligations where it pays only after unjustifiable delay, or where it wrongly repudiates a claim. If there is no term in the policy regarding the time period in which payment should be made Scottish courts are likely to imply a term that the claim should be dealt with reasonably and without delay.

21. Our experience within that jurisdiction is that claims for consequential loss suffered as a result of the late payment of money, in addition to interest may be made. A claim for such consequential loss was deemed, by the Court of Session, to be a relevant head of claim which could proceed to be tested at proof in the case of Strachan v The Scottish Boat Owners Mutual Insurance Association 2010 SC 367. If wider damages, aside from interest on the sum from the date it became due, are sought by way of redress for late payment the courts will use the test for foreseeable loss set out in Hadley v Baxendale 1854 9 Exch 341. In our experience, the test is interpreted restrictively. Often the claim for damages will be made in conjunction with the claim for breach of contract where an insurer maintains a repudiation. In practice, the damages claim may be compromised, along with the claim for the basic insured loss to reflect the risk to both parties in proceeding with the case.

22. The second of the Law Commission’s omitted clauses relates to “irrelevant warranties”: we understand that draft clauses are to be submitted to establish that a breach of warranty should only give rise to a remedy for the insurer where the warranty relates to the nature of the risk. We fully recognise the difficulties of drafting such a clause although it is a practice that is adopted in respect of many commercial policies. We do consider that it is essential that any amendment reflects those concerns and does not provide a remedy that would establish a causal link between event, warranty and claim.

MICRO BUSINESSES

23. In our view, the Committee should be aware that “micro businesses” seeking commercial insurance will be covered by the Bill and that in addition, they also fall within the jurisdiction of the Financial Ombudsman Service (FOS) in respect of disputes. The FOS defines “micro businesses as those “with a turnover of less than £2 million and fewer than 10 employees.” Ombudsmen within the FOS are tasked with determining complaints and disputes by reference to what is, in their opinion, is fair and reasonable in all the circumstances. Thus they are not formally bound by the law but they will it take into account, along with the following: regulations, rules, guidance, standards, and (where appropriate) what is considered to have been good industry practice at the relevant time.

Footnote—related reform in Ireland

We thought it worth making the Committee aware that the Irish Law Reform Commission is undertaking a programme of insurance law reform which closely reflects the changes already made to insurance law in the United Kingdom. The Irish project is however, more closely linked to consumer insurance business (the subject of UK legislation in 2012) and details may be found here: http://www.lawreform.ie/welcome/commercial-law-and-the-law-of-obligations.382.html.

November 2014

Memorandum submitted by Catlin Underwriting Agencies Ltd and Catlin Insurance Company (UK) Ltd

1. Catlin is an insurer in the London Market, which has two London legal entities, the Catlin Syndicate at Lloyd’s and Catlin Insurance Company (UK) Ltd. Catlin’s business consists of a wide variety of business insurance and reinsurance sourced from around the world, including the UK. The London platforms wrote nearly US$2.5bn of premium income in 2013.

2. We believe strongly that reinsurance and business insurance should be characterised by cost- effective contracting, certainty of outcome and timely claim payment. Indeed, at Catlin we are proud of our leading reputation for excellent claims service. In our view this is driven by the culture within an insurer (which might be encouraged by regulation). Claims excellence is not created by changes to primary insurance contract law. On the contrary, changes to the law may drive up the cost at the contracting stage and reduce the certainty of outcome—particularly if bright-line tests are replaced with factually intensive enquiries. These will serve to drive up premium. English law, including English insurance law, is used in international transactions precisely because “it does what it says on the tin.”

63 See Fiona Woolf, the Lord Mayor of the City of London, in an article in the Law Gazette 27 January 2014.
3. In a similar vein, Lord Falconer in a speech on 18 October 2005 to The Commercial Bar Association pointed out the merits of certainty of outcome and predictability:

"... The English law of contract is the international law of choice over a wide range of areas, particularly in finance, shipping and insurance. ... You could say that the English common law of contract is now a world-wide commodity. It has become so because it is a system that people like. In ever more complex, sophisticated and inter-related markets, English commercial law provides predictability of outcome, legal certainty and fairness. ... It would be a huge error for the UK and the EU to lose this distinctiveness in the name of harmonisation. An error not just for the UK but for the EU as a whole." (emphasis added)

4. The reason that we, and others, value certainty in commercial insurance and reinsurance law is that certain and predictable legal outcomes enable us to contract efficiently (without teams of lawyers) on terms that we and our counterparties know will be enforced as written. This enables us to concentrate on the commercially important terms. Should we have a disagreement with a policyholder or reinsurer as to the scope of the coverage under a policy, certain law significantly increases the prospect of settlement as both we and our counterparties will obtain legal advice that is likely to be similar as to the parties’ prospects of succeeding on the disputed coverage point. This narrows the dispute and makes settlement more likely. If the law is less certain or contains more factual tests, then the parties’ legal advice is more likely to be divergent, and the range of the dispute becomes wider which makes settlement less likely.

5. A policyholders’ lobby group in the US summarised the effect of replacing certain legal principles with factual tests as follows:

The natural result of transforming a question of law into a question of fact is that discovery expands exponentially, litigation costs vastly increase, the time required to reach a resolution expands exponentially, and additional burdens are placed on ... courts. The resultant increase in litigation costs, protracted discovery, and expansion of time to resolve these coverage disputes naturally favors the party to the transaction ... that is in the financially superior position ... "

6. The certainty of English commercial insurance law is undoubtedly one of a number of factors that has helped the UK to remain the 3rd largest insurance market in the world, the largest in Europe and the most international, despite the UK economy being only 7th largest in the world. The London Market is particularly significant in large, complex, new and difficult to place insurance and reinsurance—areas where pre-contract disclosure is particularly important. For instance, the London Market underwrites 62% of offshore energy insurance premium and 33% of marine premium. UK insurance is a great international success story, yet the Law Commission asserts that UK law is "out of line" internationally leading to loss of reputation. There is simply no evidence for this assertion; indeed, since it was first made in 2006 the Gross Written Premium Income of Lloyd’s of London has increased by over 60% from £16.4bn to £26.1bn.

7. We remain keen to ensure that commercial insurance law retains the advantage of certainty. Although changes to the law necessarily introduce an element of uncertainty, we believe that the benefits of the following changes outweigh that cost. Therefore, we support the following aspects of the Bill:

7.1. Disclosure—applicable to business insurance only.

7.1.1. Remedies for Breach—Substantively amending the law to provide proportionate remedies,

7.2. Warranties—applicable to business insurance only.

7.2.1. Remedies for Breach—Amending the law to provide for suspension rather than discharge of liability,

7.2.2. Abolishing Basis of Contract Clauses,

7.3. Fraud—applicable to business and consumer insurance.

7.3.1. A restatement of the law on insurance fraud.

8. We are concerned that the recasting of the duty of disclosure in Part 2 of the Insurance Bill needlessly imperils the certainty of the law for little or no real benefit. We have advised the Law Commission of these concerns and submitted as well as reported on them in an article at the BILA 50th Anniversary Colloquium in May 2014.

9. We support the Joint Submission of the LMA and the IUA (LMA/IUA) to this Committee. We note that the LMA/IUA have particular concerns about the Bill’s proposed recast duty of disclosure which will introduce new language, a number of new factual tests, and resultant significant legal uncertainty for little change in the law. Any change should be introduced in a more surgical manner to reduce such uncertainty.

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65 See "London Matters" joint study by the London Market Group and Boston Consulting Group, November 2014

66 Id at p. 15

67 LC Summary Report of July 2014 (Law Com No 353) (“Summary Report”) at 1.14

68 See our Catlin submissions to the Law Commission of 2 October 2012 and 24 February 2014.


10. The “problems” identified by the Law Commission with the existing duty of disclosure for business insureds are that:

10.1. The duty is poorly understood,

10.2. Medium to large companies do not know how to judge what the company “knows or ought to know”,

10.3. Although there are exceptions in section 18(3), these are written in archaic language and not well known, and

10.4. The Marine Insurance Act appears to allow the insurers to play a passive role, without asking questions about relevant issues.

11. The Bill will repeal sections 18-20 of the Marine Insurance Act and recasts the duty in Part 2, sections 2-7 of the Insurance Bill. The main difficult provisions in Part 2 are:

11.1. Clause 3—sets out the duty of fair presentation. The key provision is s. 3(4) which provides that the disclosure required is

11.1.1. disclosure of every material circumstance which the insured knows or ought to know,

or

11.1.2. failing that, disclosure which 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.

11.2. Clause 4—knowledge of insured. This sets out that an insured only knows what its senior management or those responsible for its insurance know. It also sets out that an insured ought to know what should have been revealed by a reasonable search of information available to it. There is also a controversial provision (which the Law Commission may seek to amend) that absolves the insured’s agent from the duty to disclose confidential information acquired through a business relationship with someone other than the insured. The effect of this section is to abolish much of the existing law (including the concept of the agent to know) and replace it with new concepts.

12. The Bill has recast the duty of disclosure in different and arguably more modern language. In doing so, it introduces a host of new terms, concepts and tests that will require interpretation and clarification by the courts. This will likely take decades—at significant cost. This appears to be out of proportion to the problems that the Law Commission is seeking to remedy.

13. A couple of examples of provisions that will reduce the clarity of the current law are:

13.1. Clause 3(4) appears to give the insured / broker an alternative to a disclosure of all material circumstances. This alternative is to provide the insurer with sufficient information to put the prudent insurer on notice to make further enquiries. Yet, this new concept will likely produce the same result as waiver does under the current law. Yet the signal in the Bill is that full disclosure may not be required.

13.2. Clause 4 completely recasts what the insured knows or ought to know, removing the concept of the agent to know and restricting the information to that known by the senior management.

14. Looking back at the problems identified, we believe that the real solutions are those underlined below:

14.1. The duty is poorly understood—this is a training / broking issue.

14.2. Medium to large companies do not know how to judge what the company “knows or ought to know”—this is a training / broking issue, and if the law is genuinely unclear on this point, then a surgical addition of, say, a Section 18(6) would likely be a less problematic way of dealing with this.

14.3. Although there are exceptions in section 18(3), these are written in archaic language and not well known—this is a training / broking issue.

14.4. The Marine Insurance Act appears to allow the insurers to play a passive role, without asking questions about relevant issues—that may be the appearance but is not the reality.

15. The reforms are said to primarily benefit larger businesses, yet they are most likely to have their insurance broker. The Law Commission and HM Treasury do not acknowledge the role of the broker and thereby ignore the reality of how business is conducted. For instance:

71 Summary Report at para. 2.8
72 This is said to have given rise to a high number of disputes about non-disclosure and warranties (Summary Report at 1.20). Some of these are result from the current remedies, but in any event the Law Commission only points to 26 High Court disclosure cases in a decade. While the Law Commission also says that this is the tip of the pyramid and indicates far more “disputes”, in the Impact Assessment these legal costs are estimated at £75m to £95m each year which equates to between 0.25% and 0.31% of claims paid each year. This seems like a low level of frictional cost and likely to be significantly exceeded by the case law required to interpret a series of new provisions.
73 In May 2014, we estimated that there were at least 17 new tests of which 14 were factual. See BILA Colloquium—the Insurance Bill—a Review of the Panel Discussion on the Law Commission’s Draft Insurance Bill, by Harry Wright, at 127 BILA Journal 244 et seq. (October 2014) at p. 249.
74 The Government’s Impact Assessment says the Act will result in a saving to business of nearly £100m over a 10-year period. That cannot be true. The extent of litigation is seriously under-estimated; the huge amount of training and drafting is grossly underestimated, and the saving in time taken in producing disclosure is over-estimated.
75 See para. 7.36 of Law Comm No 353 of July 2014 (the full report).
76 See for example WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA [2004] EWCA Civ 962
77 See para. 2.15 of Summary Report
15.1. The Summary Report states that the current duty “effectively requires the policyholder to look into the mind of the hypothetical prudent insurer and to work out what would influence it, with little additional guidance”

This is one of the key roles that the broker has always performed, and the broker, by virtue of his interaction with the whole market, is better placed than even an underwriter to know what the prudent underwriter needs or wants.

15.2. The Impact Assessment produced by the Government states (1.53-1.61) that the business insurance market suffers from “quality uncertainty”—in other words that the insured cannot distinguish between an underwriter that will pay claims and one that will not pay claims—or as they say the insured cannot distinguish between plums and lemons. Yet brokers spend a great deal of time and effort informing their insureds about insurers’ attitudes to paying claims and conduct surveys of the market for the benefit of their clients.

We use our positive approach to paying claims as a competitive differentiator and look for recognition of that in the brokers’ rankings. It simply is not true that the client cannot distinguish between plums and lemons.

16. While some reduction in legal certainty is an inevitable result of any change in the law, such reduction should, in our view, be kept to a minimum in international business law. The changes to the law do not justify the wholesale introduction of new terms, concepts and tests. Indeed, we believe that the problems identified by the Law Commission are not suitable for primary legislation but rather should be dealt with by training and education.

17. A final word should be said about Contracting Out. The Bill permits insurers to contract out of most of its provisions for business insurance provided that the contracting out term is brought to the attention of the insured and that term is clear and unambiguous as to its effect. While contracting out as a concept is unobjectionable, it is not a substitute for restricting new uncertainty to an absolute minimum. This is particularly because the contracting out regime in itself introduces new tests.

18. We support the changes to the Bill proposed by the LMA/IUA (including those not addressed herein) but recognise that time is short. The substantive changes that are supported by both insured and insurer groups could be achieved by enacting the Bill without Part 2, the recast duty of disclosure.

November 2014

Memorandum submitted by The City of London Law Society

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of the House of Lords Special Public Bill Committee’s call for evidence on the Insurance Bill has been prepared by the CLLS Insurance Law Committee (the “Committee”).

1. The House of Lords Special Public Bill Committee has published a call for evidence on the Insurance Bill (the “Bill”). It is seeking views on “the provisions contained within the Bill, and any other matters that would be considered to be relevant to the subject matter”.

2. In response to this call for evidence, the Committee’s views on certain provisions of the Bill are set out below.

3. The Committee provided regular comments and feedback to the Law Commissions on the provisions of the Bill during the consultation and drafting process. In general, the Committee supports the Bill and agrees that reform is required. The comments below address areas in which the Committee considers that further work is required, and are not an exhaustive statement of the Committee’s views on the Bill.

Clause 4(2): Knowledge of the insured

4. Clause 4(2) of the Bill makes the knowledge of “individuals who are responsible for the insured’s insurance” knowledge of the insured. Section 19 of the Marine Insurance Act 1906 (the “MIA”) requires disclosure “by the agent effecting the insurance”. We consider that clause 4(2), which replaces section 19 of the MIA, is considerably wider than section 19 of the MIA. It covers a wider group of individuals, including people who manage the insurance, whether they are responsible for effecting the insurance or not.

5. The effect, in a Bill which in philosophy seems to be directed towards helping the insured, will be to assist the insurer in attaching the knowledge of others to the insured.

Clause 16: The transparency requirements

6. During discussions with clients, one point which has stood out is the reaction to the transparency requirements for contracting out. It has been suggested that the transparency requirements should be removed from the Bill for the following reasons:

98 See para. 2.5 of Summary Report

99 See e.g. Willis Quality Index http://www.willis.com/About_Willis/Willis_Quality_Index/
a. the transparency requirements are more appropriate for consumer insurance than business insurance. We would expect a business to be able to take an informed view as to the wording of a policy, with advice from brokers as necessary (although a business may not always use a broker). It is unnecessary to have a statutory requirement that contracting out wording should be clear and unambiguous and should be drawn to the insured’s attention; and

b. the transparency requirements might well lead to unnecessary disputes as there is no authority providing guidance on how they should be interpreted and applied.

7. However, it has also been noted that in many cases the broker is responsible for slip or policy provisions which reduce or remove the protection that the Bill seeks to give to the insurer, as the slip or policy is the broker’s standard document. On this basis, if the transparency requirements are retained, they should apply to both the insurer and the insured.

The application of the Bill to reinsurance

8. We have previously suggested to the Law Commissions that the Bill should expressly state that it intends to cover reinsurance contracts. The response of the Law Commissions was that:

a. the Bill is intended to replace certain provisions of the MIA, and must apply to the same contracts; and

b. contracts of reinsurance are treated by the common law as contracts of insurance.

9. In relation to each of these responses, we consider that (respectively):

a. the argument regarding the MIA is circular. Clause 19 of the Bill (which “omits” sections 18, 19 and 20 of the MIA) states that it is consequential on Part 2 of the Bill. If Part 2 does not apply to reinsurance, clause 19 of the Bill does not affect the MIA’s application to reinsurance.

b. as to the point about the common law treating insurance and reinsurance as the same, we do not consider that the Bill is about “insurance”. The Bill is about consumer insurance and non-consumer insurance. Although the Bill does apply to “consumer insurance contracts”81 it mainly applies to “non-consumer insurance contracts”: Part 2 applies to “non-consumer insurance contracts only” (see clause 2(1)) and Part 3 applies to representations made for a non-consumer insurance contract (see clause 9(1)).

On this basis, the Bill is primarily about “a contract of insurance that is not a consumer insurance contract” (the definition of a “non-consumer insurance contract”), i.e. a contract of insurance in connection with an insured’s trade, business, or profession.

Where there is an express dichotomy of a “consumer insurance contract”, which is plainly only a reference to an insurance contract, not a reinsurance contract, and a “non-consumer insurance contract”, the less strained construction is that such wording is also a reference to insurance contracts, not reinsurance contracts.

Under the common law, which governed insurance and reinsurance contracts, the MIA, which codified the common law, could apply to both insurance and reinsurance. This Bill changes the common law for the contracts which it governs.

10. Given the explanatory notes to the Bill, that the Law Commission has stated its view that the Bill applies to reinsurance and the decision in  Agnew v Länsförsäkringsbolagens A.B. [2000] UKHL 7,82 we recognise that future courts would probably say that the Bill does apply to reinsurance, should the point ever arise. However, we consider that it is preferable:

c. to make the position completely clear to avoid a risk of the sort of litigation that occurred in Agnew; and

d. to make the position clear on the face of the legislation itself to avoid having to look at explanatory notes or extraneous material.

11. In addition, we consider that sections 15 and 16 are inappropriate for reinsurance, as the parties will in principle be of equal commercial strength.

November 2014

Memorandum submitted by the Commercial Bar, Members

1. This submission is made on behalf of the members of the Commercial Bar whose names are listed at the foot of the document.

2. In a short paper such as this, it is not possible to set out a detailed analysis of the Law Commissions’ Report on Insurance Contract Law1 (the “Report”) or the Insurance Bill 20142 (the “Bill”). It attempts instead to highlight some important features of the Bill to illustrate the substantial change that will be ushered in if the proposed new law is enacted. That change will bring with it a considerable degree of uncertainty, in place of a largely settled body of principles. A proliferation of disputes seems an inevitable consequence. It is that concern that motivates this paper.

81 The Bill defines a “consumer insurance contract” with reference to the Consumer Insurance (Disclosure and Representations) Act 2012, which defines a “consumer insurance contract” as a contract of insurance between an individual contracting otherwise than for his trade, business or profession and a person who carries on the business of insurance.

82 In  Agnew, the House of Lords found that the insurance provisions of the Brussels Convention did not apply to reinsurance contracts.
3. From the point of view of developing the law, as opposed to law reform which is a matter of policy, a compelling case would need to be made for the necessity or desirability of the proposed new law before accepting the risk of such a consequence. As regards the law of non-disclosure, misrepresentation and warranties, as it applies to non-consumer insurance (only), the Report does not contain such a case.

THE PROPOSALS

Disclosure and misrepresentation

4. The Bill proposes new tests for (i) what the insured actually knows; (ii) what the insurer ought to know; (iii) what the insurer is presumed to know; (iv) what the insurer ought to know; (v) what the insured is presumed to know; and (vi) how the duty of disclosure is to be complied with. It also introduces completely new regimes for contracting out and proportionate remedies. Each new test and new concept brings with it considerable uncertainty; uncertainty breeds disputes. The stated aim in the Report of reducing disputes does not seem likely to be met.

5. The package set out in the Bill is not incremental change; it is a major departure from the existing law. Two important examples follow.

6. Example 1: Clause 3(4)(a) essentially replicates the existing law as regards what must be disclosed. Clause 3(4)(b) introduces a lesser test that the disclosure obligation may be satisfied if sufficient information is disclosed as to put the insurer on notice that it needs to make further enquiries to reveal material circumstances. It seems inevitable that the clause 3(4)(b) test will become the default option taken by insureds and, as drafted, that test could be satisfied even if the insurer deliberately suppressed material circumstances.

7. The Report says that the insured will only be able to rely on clause 3(4)(b) if it is has tried but failed to comply with clause 3(4)(a). The difficulty is that the Bill does not say that. To achieve what the Report apparently intends, it would be necessary for Courts to use the duty of good faith to read extra words into clause 3(4)(b). The Report also suggests that the duty of good faith could be used by the Courts to find that, if material circumstances are deliberately suppressed, the information provided was not sufficient to put the insurer on notice or that it was not sufficiently clear and accessible. That is, the Report’s alternative suggestion is that, where information does satisfy the test as set out in clause 3(4)(b), the Courts could use the duty of good faith to find that it did not. How that could be achieved, consistent with the wording of the Bill, is unexplained.

8. Example 2: Under the current law, broadly speaking the risk that material information does not find its way from within the insured’s organisation to the insurer rests on the insured. That is because, as between the insured and the insurer, the insured is the better informed as to its own business. Under the Bill, it appears that that risk will shift to the insurer. The new scheme for the attribution of knowledge to the insured in clause 4. It appears to mean, in short, that if an employee of the insured arranging its insurance makes enquiries of other employees (or agents), and those other employees, whether through negligence or design, do not answer those enquiries, truthfully or at all, the insurer will not be taken to have their knowledge. This amounts to the statutory abolition of the concept of proportionate remedies. Each new test and new concept brings with it considerable uncertainty; uncertainty breeds disputes. The stated aim in the Report of reducing disputes does not seem likely to be met.

9. Taken together, those two examples amount to a significant reduction in the scope of the insured’s duty of disclosure. Whether that is an appropriate reform (in the true sense of the word) is for policy makers to decide.

Proportionate remedies

10. Whether to reform remedies by replacing the existing remedy of avoidance with a system of proportionate remedies is likewise a policy decision. Policy makers will no doubt be aware that whilst, in theory, the remedy of avoidance is capable of operating harshly, the reported cases do not support the proposition that it frequently does so in practice. There have not been any obvious reported cases of it doing so for over thirty years and the last obvious case to which the principle has been applied was overruled at the first available opportunity. As regards the law of non-disclosure, misrepresentation and warranties, as it applies to non-consumer insurance (only), the Report does not contain such a case.

11. The primary remedy for misrepresentation is rescission. Under the Bill, rescission will not be available to insurers and the system of proportionate remedies will apply instead. There is no obvious justification for making contracts of insurance a unique class, incapable of rescission for misrepresentation by the insured.

WARRANTIES

12. The law relating to warranties is simple and settled. Clause 10 of the Bill represents a major departure from the existing law. Many standard terms, such as the important Institute Clauses which are widely used in marine policies, will need to be reviewed and perhaps rewritten. Automatic termination clauses may no longer be possible. The main changes will be: (i) warranties will be converted into suspensive conditions; (ii) insurers will have no liability in respect of loss occurring or “attributable to” something happening after a breach of warranty; and (iii) cover will revive when (a) a breach of warranty is remedied or (b) if “the risk to which the warranty relates later becomes essentially the same as that originally contemplated by the parties”. Disputes as to the application of those new concepts are inevitable.

13. As is the case with avoidance, so too the common law controls the serious consequence of breach of warranty, i.e. discharge of cover, by interpreting warranties strictly. The reported cases this century and during the last two do not
reveal repeated examples where a warranty has worked injustice. The only example given in the Report where a breach of warranty defence could be seen to cause injustice was decided in 1786.

14. It is not automatically unfair that cover is discharged if a warranty is not complied with. Without a particular warranty, the insurer may decline the risk altogether, impose different terms or charge a higher premium. It is not obviously unfair that an insured should be denied cover if, absent a particular warranty, it would not have had any cover, or would have been obliged to pay more for it.

15. Warranties play an important role. In the case of marine, aviation and transport risks in particular warranties assist in maintaining important safety standards, such as the classification of ships; watering down their policing function could have serious consequences for safety in those important industries (or render them uninsurable under English law).

The evidence relied on in the Report

16. The case law: The number of reported cases concerning disputes about disclosure/misrepresentation or warranties is few, compared to what must be hundreds if not thousands of non-consumer insurance claims per year. Disputes concerning issues of major principle, as opposed to the application of established principle to unique facts, are rare. The case law does not suggest major problems with the existing law. (It is recognised that the case law is not the whole story.)

17. The consultation responses: The Report gives each response to the LCs’ consultations equal weight. That is, the response of a private individual is afforded equal weight to the response of a major trade organisation, such as the ABI or the LMA.

18. Lack of understanding on the part of insurers: Insurance law is by no means unique in being an area of law that businesses are required to comply with but which falls outside of their core area of commerce and expertise. Businesses also have to comply with employment law, health and safety law, competition law and revenue law. Depending on their business they may also need to have regard to at least the following areas of law: planning, media (including advertising and defamation), intellectual property, landlord and tenant and banking (including guarantees). All businesses also need to understand the law of contract and their potential exposure in tort. That businesses may need professional advisers to help them to understand and comply with their obligations in those respects is to be expected. So too in the case of sophisticated businesses placing complex insurance programmes.

19. It is unclear how proposed reforms might result in increased understanding of what the law is. As matters stand, insureds can avail themselves of the services of professional brokers and, if necessary, lawyers. Whereas, under the new law, giving firm advice will be difficult in many cases.

20. AIRMIC research: AIRMIC has over 1,100 members8. AIRMIC had 111 responses to its survey in 2010 and 156 in 20121. The experience of 85% to 90% of AIRMIC members is unreported. Those members who have experienced a problem with an insurance claim may be more motivated to respond to the survey than those who have not. The incidence of such problems may be over reported in the survey results.

21. BIBA research: BIBA has just under 2,000 members1. BIBA had 206 responses to its survey in 2013. The experience of roughly 90% of BIBA members is unreported. The incidence of problems with claims again may be over reported in the survey results.

22. Mactavish: The Report draws heavily on work by Mactavish14. Mactavish does not publish its research or any detail as to how it is carried out. It publishes its analysis of the same, with selective examples. Mactavish is not an independent research body, carrying out research from a neutral perspective. Mactavish is a services supplier which is in the business of selling its “insurance governance” services, describing itself as “the UK’s leading expert on insurance governance”. It has a vested interest in convincing its customers that they need its services.15

23. In its 2011 report, Mactavish made errors of law. It said that Pan Atlantic v Pine Top17 “sets out the conditions that have to be met for an insurer to avoid an insurance policy” and goes on to refer to the requirement to disclose all material facts and the prudent underwriter test. In fact, those requirements have their origins in 18th and 19th century case law and are enshrined in s18 of the MIA. Mactavish continue that Assicurazioni General Spa v ARIG19 “sets an additional requirement that the underwriter proves non-disclosure of the material fact induced the particular underwriter to write the risk on the terms that he did”. It did not. That was the point decided in Pan Atlantic v Pine Top, which restored the law to where it had been in Berger v Pollock, overruling the intervening Court of Appeal decision in CTI v Oceanus to the contrary in the process. Research based on a flawed understanding of the existing law should not be assumed to be reliable.

24. Research overall: The above is not to dismiss the research relied on. Rather, it is to highlight what may be its limitations. The weight to be afforded to it is for policy makers.

25. Legal analysis: The legal analysis in the Report contains errors. For example, with respect to s19 of the MIA which sets out the duty of disclosure of the agent to insure, the Report says (the cases cited in the footnotes appear in brackets):

... it has sometimes been held that only the final placing broker falls within section 19 [PCW Syndicates v PCW Reinsurers]. However, the better view seems to be that it also applies to intermediate agents [Blackburn v Haslam, Baker v Lombard, GMA v Unistorebrand].
26. s19 does not apply to intermediate agents. The Court of Appeal so decided in *PCW Syndicates v PCW Reinsurers* in 1996, explaining that in *Blackburn v Haslam* was to be understood as a case in which an intermediate agent had failed to pass on information to the agent to insure (s19 extends to information that ought to be communicated to the agent to insure). *GMA v Unistore* is a first instance decision which predates *PCW*. *Baker v Lombard*, the judgment in which is available only in summary form but assumed to be accurate, is a decision of the Court of Appeal granting leave to appeal against a costs order and declining leave to appeal from a decision about amendments to a pleading.26

27. In addition, it is a theme of the Report that, in order to avoid unfairness and injustice, Judges routinely do not apply the law as it in fact is.27 However, it is important to understand how the MIA was intended to be understood. It was never the case that the duty of disclosure as set out in s18 was intended to be read as unlimited or that insurers were entitled to be entirely passive.30 The MIA was intended to be understood as being informed by the 150 years (or so) of case law which preceded it, a principle which is enshrined in s91(2) of the MIA. Thus, in *Asfar v Blundell* in 1896 it was held that the insured had made sufficient disclosure of the material facts and that if the underwriter wanted to know more, it was incumbent on him to ask questions. Because the remedy of avoidance is severe, the law has always prevented its indiscriminate use. In that way, the common law, in combination with the MIA, is in balance. What the Report says are instances of a failure to apply the law are in fact illustrations of that balance in operation.

28. The proposals in the Bill are said to build on the legal analysis contained in it. That is an unsatisfactory foundation for major change to a highly significant area of the law.

**CONCLUSION**

29. The insurance law principles of disclosure, misrepresentation and warranties have been under development for over 250 years, against the backdrop of partial codification in the Marine Insurance Act 1906 (MIA) for over a century. That is a strength, not a weakness. The result is a sophisticated canon of principles, informed by a rich body of case law and a high degree of certainty, attained, in many cases, decades ago. At the same time, the common law continues to prove itself capable of meeting the challenges of the modern age.32 Enacting clauses 3 to 8 and 10 of the Bill appears to mean starting again. It could be decades before the law is returned to an equivalent state of certainty to that which exists today. That state of certainty is not perfect. It never will be, given the divergent constituency served by the law of insurance of England and Wales. The compelling case that would be needed to justify replacing it, in terms of the development of the law, is absent.

**REFERENCES:**

1. Law Com No. 353 / Scots Law Com No. 238.
2. As introduced in the House of Lords on 08.07.14.
3. 5.6(4).
4. 5.67.
5. (1866-67) LR 2 QB 511.
8. 12.2.
9. AIRMIC website. The names of members are only available to other members.
11. AIRMIC website.
12. BIBA website.
13. BIBA website.
14. E.g. 5.9, 5.12, 5.19, 5.32, 5.35, 5.39, p58 FN 21,
15. Such as e.g. its “Insurance Governance Programme”.
23. (1888) 21 QBD 144.
I have a very brief comment on Part 4 of the Bill dealing with fraudulent claims and in particular Section 11(1)(c) which provides the insurer with the right to serve notice that it treats the insurance contract as having been terminated with effect from the time of the fraudulent act.

I note that Section 11(1)(c) places no time limit on the insurer's ability to exercise the option contained in that section. It is open ended and seemingly available indefinitely. The effect is uncertainty for the insured. The possibility exists that valid (non-fraudulent) claims could arise under the policy sometime after the fraudulent claim is made by the insured and discovered by the insurer. With no parameters set for the period in which the option can be exercised the insured is left in limbo since a subsequent valid claim could simply be met by a notice of termination from the insurer which, because of its retrospective effect, defeats an otherwise valid claim. There is something to be said for the insured being provided with some certainty as to whether it is going to have to make alternative insurance arrangements. A time limit on the notice from the insurer would provide that certainty (and provide the insurer with guidance about exercise of the option). My suggestion would be that the notice must be served within a reasonable time of the insurer becoming aware that the fraudulent claim in question was fraudulent.

This comment is made in a personal capacity only.

November 2014

Memorandum submitted by the Federation of Small Businesses

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the above named call for evidence. The FSB is the UK’s leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. The FSB is non-party political, and with approximately 200,000 members, it is also the largest organisation representing small and medium-sized businesses in the UK. Small businesses make up 99.8 per cent of all businesses in the UK. They contribute 50 per cent of GDP and employ 59 per cent of the private sector workforce.

The FSB recognises that insurers need information on which to assess risk and in some cases, the insured is best placed to provide information for example, that is a fair presentation of a new risk the business wants insurance cover for. However, the burden of knowing what information is required and being able to search and then provide the information needs to be reasonable. Crucially, the provision of the correct information must be within the capability of the insured.

The requirements set out in the Insurance Bill under sections (3) and (4):

— Put the insured at risk of having a claim declined or cover withdrawn due to not providing information the insurer needed but did not explicitly ask for from the insured.

— Place a burden on the insured that is disproportionately higher than the burden on consumers under the Consumer Insurance (Disclosure and Representations) Act 2012, who are required to take reasonable care with the information they provide to the insurer.

The FSB recommends the requirements on making a fair representation, under the Insurance Bill, should be more closely aligned with the requirements on consumers, under the Consumer Insurance Act. It is only the insurer who will know the risk appetite of the insurance firm and what type and level of information is required to assess the risk.

Requirements on the insured should not be subjective but should be clear and within the capability of the insured.

The FSB makes the following comments regarding Part 2 in the Insurance Bill:
1. Under (3) (c) for the insured to be deemed to have made a fair presentation of the risk, every material representation as to a matter of fact must be substantially correct. There is no clarity on what substantially means or how the insured can assess whether this requirement is met.

2. Under (4) (a) the insured must disclose every material circumstance which the insured knows or ought to know, or (b) failing that, disclosure which 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. It is highly unlikely that the insured will know either what level of information the insurer will deem sufficient or what will put a prudent insurer on notice.

3. Under (5), the insured cannot rely with certainty on the exceptions to these onerous requirements for protection, because they are difficult if not impossible for the insured to assess. In particular, few insured business owners would be qualified to assess whether the particular circumstances of their business would diminish the insurance risk because the insured would not know the different risk appetites of insurers. Further, the requirements are subjective and the burden of proof would fall on the business to show, for example at (d) that the insurer could be presumed to know the information already.

4. The FSB supports the premise in section (8) that it is for the insurer to show that a qualifying breach was deliberate or reckless, before a remedy can be sought against the insured.

November 2014

Memorandum submitted by the Financial Ombudsman Service

We would like to thank you for your offer to present written evidence to the committee on the Insurance Bill. Please find our evidence below.

About the Financial Ombudsman Service

The ombudsman service was set up by Parliament to sort out individual complaints that consumers and financial businesses are not able to resolve themselves. It is an independent service for settling complaints fairly, reasonably, quickly and informally, which is free to consumers. The business must be given the chance to look into a problem first-and they have eight weeks to consider it. If the business does not respond within eight weeks, or does not respond to the consumer’s satisfaction, the consumer can go to the ombudsman service.

Our Evidence

Our duty is to come to a fair and reasonable decision, taking into account relevant law and regulations, codes of practice, regulators rules and guidance, and good industry practice. It follows that relevant law is only one factor we consider when coming to a determination that we believe is fair and reasonable.

Our approach to insurance disputes has been developed over years, taking account of regulatory developments and best practice whilst working with both businesses and consumers to understand their needs. The ombudsman service therefore worked with the Law Commission and Scottish Law Commission on their Insurance Law project with the aim of promoting understanding of the approaches we have developed. The recommendations of the Commissions reflected our approach, and so we have supported them.

We articulated that support in our response to the Treasury consultation on the Insurance Bill when it was in draft form, believing that terms relevant to particular descriptions of loss (clause 11) and implied term about payment (clause 14) were appropriate for inclusion in this bill.

We believed those provisions would move the law in a fairer and more reasonable direction, in line with the changes in Consumer Insurance (Disclosure and Representations) Act (CIDRA) and other areas of common law. We explained in our response that they would also support the best practice of the industry. Although these provisions would be largely aimed at policyholders other than consumers, we explained how we would expect some to apply equally to consumers and could provide clarity and protection for businesses and their customers.

For similar reasons, we also agreed with the recommendations that led to the CIDRA. We felt that the Act replaced the outdated legal position, ensuring consumer protection and clarity for businesses, again in line with the ombudsman service approach.

I hope our views are helpful in this issue and would be happy to answer any questions that may arise.

November 2014

Memorandum submitted by the Financial Services Consumer Panel

This letter constitutes the submission of the Financial Services Consumer Panel to the call for evidence launched by the Special Public Bill Committee on the Insurance Bill on 20 November. We welcome this opportunity to outline our concerns about the lack of consumer protection afforded by the Bill, in particular as regards redress for consumers who face unreasonable delays or unfair refusals of their claims.
It will come as a surprise to most if not all consumers that, under English law, holders of indemnity insurance policies are not entitled to damages for an insurer’s failure to pay an insurance claim or for an unreasonable delay in the processing of the claim.

In fact, in the case of indemnity insurance (such as property and liability insurance), the Court of Appeal held in Sprung v Royal Insurance Ltd that an insurer’s obligation is not to pay claims, but to prevent a loss occurring in the first place. By contrast, Scots law provides that the insurer’s primary obligation is to pay valid claims after the opportunity for a reasonable investigation.

As a consequence of this legal technicality, in England and Wales the insured is not entitled damages where an insurer delays payment or wrongly refuses to pay a claim.

Throughout the development of the draft Insurance Bill, the Law Commission and Scottish Law Commission have been very clear that the lack of entitlement to damages for late payment of valid insurance claims or an unreasonable refusal to pay such claims in England and Wales should be addressed in the Bill.

We recognise that the Financial Ombudsman Service, which makes decisions on fairness rather than strict application of the law, applies a remedy of damages for late payment or unreasonably refused claims, and says there is broad acceptance within the industry about its approach. However, this is inconsistent with the legal framework currently in place in England and Wales.

Therefore, we agree with the Law Commission that the current position is “hard to justify legally, commercially and intuitively, and statutory intervention is required”. The British Insurance Law Association has described the current situation as “the principal defect in this part of English insurance law, requiring remediation as soon as possible”.

The law as it currently stands is unfair and unexpected. In our view, the Insurance Bill was the obvious opportunity to put English and Welsh consumers on a level field with Scottish consumers. It is astonishing that the “principal defect” in the law is not mentioned in the current version of the Bill.

We understand that clauses relating to late payment of claims were excluded from the Bill very late in the process, because the insurance market was unable to achieve consensus with the Law Commission about how best to address this matter.

However, it would seem they successfully resolved issues to include clauses that provided their firms with increased protection. In fact, the majority of the Bill is devoted to increasing protection for insurers, for example as regards insurer’s remedies for fraudulent claims.

The lack of willingness on the part of the insurance industry to resolve this matter in the interest of consumers is disappointing.

We would therefore urge you to introduce into the Bill clauses that give consumers in England and Wales the same legal entitlement as consumers in Scotland, and in many other jurisdictions. This would entitle English and Welsh consumers to remedy in the event of insurers refusing to honour valid claims, or failing to pay out claims within a reasonable time.

November 2014

Memorandum submitted by the Insurance Law Research Group, University of Southampton

We congratulate all those involved on getting the Bill thus far and hope for successful enactment. At the same time, we wish to take this opportunity to express our summary criticisms in the briefest possible terms, in the hopes that they may be of assistance.

The Duty of Fair Presentation

1. We understood the policy objective as being a general clarification of and, if any change is intended, a reduction in the scope of the proposer’s duty of disclosure, to harmonise with the trend in (if not the terms of) consumer insurance. We did not think that the proposal fully met these ambitions and thought that it would be useful to set out a few of our question marks for your consideration.

2. The Bill provides for a very high standard of disclosure for two reasons. First, the expression “prudent insurer” represents an objective standard and is therefore understood to mean an ideal insurer with consistent and high standards, not affected by the vicissitudes of human nature. In fact, the judicial dicta on the concept are to the effect that it is open to interpretation, for example: “[T]his is an objective test, and the characteristics to be imputed to a prudent insurer are in substance a matter for the courts to decide”.\(^{82}\) Second, since the duty of fair presentation is on the insured, the burden of proof will be on the insured to prove that it has lived up to that high standard, if that fact is questioned by the insurer. The insured must do so by providing market evidence, that is, evidence by other underwriters. The insured must thus find an unrelated but sufficiently initiated underwriter who is willing, in effect, to testify against its own interests in the market. We felt that for these two reasons, the burden of proof was too demanding on the insured to fulfill and that the effect was too high a standard of disclosure.

\(^{82}\) Norwich Union Insurance Ltd v Meisels [2006] EWHC 2811 (Tugendhat J).
3. By virtue of section 8 of the Bill and the Schedule attached thereto, ‘deliberate or reckless’ breaches of the duty of presentation lead to the remedy of avoidance, and other breaches lead to a proportionate remedy. It is assumed that the language of ‘deliberate or reckless’ is employed in place of ‘fraudulent’ as a means of avoiding any enhanced standard of proof. While we do not approve of any enhanced standard of proof in this context, we also noted that this again works to the advantage of the insurer who can now more easily demonstrate relevant facts on the balance of probabilities than if the standard of proof were to remain that for fraud.

4. Overall, the proposals shift the duty to disclose considerably in the favour of the insurer (eg the prevention of ‘over disclosure’ aka data dumping) for technical reasons not readily apparent from the statute itself and we thought such factors worth looking at before finalising the legislation. This is in contrast to the changes to the remedial scale, which is now proportionate by design.

**Warranties**

5. Our overall impression is that these sections seek to deal with the immediate rather than the root causes of the problems with ‘insurance warranties’. We see little in sections 9 and 10 that would prevent an insurer from recasting a promise currently made as a warranty as a ‘condition precedent’ to liability. If that is meant to ensure understanding by the insured as to the nature of the promise, then we have doubts as to the likely efficacy of these provisions.

6. We also have difficulty seeing that the commercial market justified wholesale reform of this type. We would have preferred targeted reforms intended to improve the clarity of remedies for breach, but retaining commercial freedom as to the ultimate remedy.

7. Section 10 of the Bill reads as a mandatory reclassification of the ‘insurance warranty’. The rule in section 33 of the Marine Insurance Act 1906 and *The Good Luck* is replaced by a complex form of combined temporal and causative exception. Cover is suspended during periods of non-compliance and for losses that occur later which are attributable to such non-compliance. In effect, this is broadly equivalent to the standard ‘navigation warranties’ in force in the marine market. What this shows is that some insurers were able to define their risk management terms in line with section 10 in the past (and indeed go further and allow for ‘held covered’ extensions), but others have preferred to insist on the stricter warranty.

8. It is not clear from section 10 that insurers could not simply state that compliance was a ‘condition precedent’ to continuing cover. Unless more was stated, this would weaken the insurer’s position as technically it would now be for the insured to prove compliance and not the insurer’s responsibility to prove breach (as is the current position under warranties).

9. We have been highly critical of the default remedy in section 33 of the Marine Insurance Act. There are two criticisms that are not dealt with by the new statutory formulation (despite its substantial interference in the market): long-standing, trivial breach; and the provision of a single ‘one size fits all’ default.

10. The remedy for breach remains the simple ‘on/off’ switch. The circumstances in which liability is removed are constrained, but there is no proportionality. So, an ongoing trivial breach of a warranty would discharge liability. This approach to insurance contract promises is the result of historical accident rather than clear choice. Insurance law cannot, apparently, create a common law ‘innominate term’ but ought to consider a statutory version (at least as one option).

11. It may be that ‘waiver’ is meant to assist insureds here, but that depends on the insurer being aware of the breach and communicating permission sufficiently clearly to found an estoppel. In any event, we thought that clarification as to the triggering of the remedy would be useful for the purpose of understanding ‘waiver’. Section 9(1) abolishes the current remedy. That remedy is triggered automatically by the breach. As a result of the lack of opportunity to elect, waiver is by equitable estoppel. If the existing remedy is “abolished”, will the remedy that replaces it also be automatic or will there be an element of election? Given that the form of waiver available to the insurer and the elements to be proven depend on this question, it should perhaps have an explicit answer.

12. We would prefer to see consideration of a tailored series of defaults, with at least some having a reduction in the level of cover awarded, rather than a simple on-off remedy. We would then leave it to the market to decide which it favoured in each situation. We think it is beyond the ability of lawmakers to shape a single default which works efficiently given the breadth of commercial insurance contracts. We would, at least like to see some explanation of what this default is meant to achieve: is it to be routinely followed, or is to force underwriters to make explicit what is currently implicit in risk management terms? The development of more than one statutory form would require us to identify labels for these varying provisions, but would enable parties to be clear as to the intended effect of non-compliance. Law could recognise for example a ‘section 33’-style strict clause, and a whole range of less strict clauses. This, after all, is the basis of much of commercial contract law outside of insurance. Provisions with statutory force acquire (quite naturally) greater judicial attention and outcome certainty; and this (with other factors) will focus attention on them whatever the merits of the clause in the contractual situation under negotiation.

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13. We took the policy objective against which the proposals should be assessed to be the reduction in fraudulent claims and encouraging honesty in the claims process.

14. We felt that the proposals were good in their minimalism, but that they represented an excessive swing of the pendulum in favour of the insurer and might benefit from tempering.

15. The proposals leave intact the meaning of ‘fraudulent claim’ by not providing a definition. We believe that the definition of fraudulent claims is not currently unclear or problematic, at least not to an extent where it cannot be handled by the courts, and that therefore this is a good solution. Nonetheless it is worth noting that the assumption that the courts will continue to develop the definition of ‘fraudulent claim’ to fit the remedy as drafted relies on the courts recognising that section 11 is not establishing a statutory codification of the appropriate default for minor exaggerated claims and fraudulent devices. Also, codifying the remedy but not defining the circumstances to which it attaches risks the courts having to ‘reverse engineer’ a rule to fit. The difficulties that this can cause are evident from the ‘avoidance’ rule found in section 17 of the Marine Insurance Act 1906 and elsewhere.

16. Furthermore, there is a problem of overall imbalance. The scope of the definition of fraudulent claims has in recent years been increased to encompass also entirely honest claims promoted by fraudulent means and devices. This was described by Lord Mance as “deliberately designed to operate in a draconian and deterrent fashion.” The recent judicial discussion of subjective intent is unlikely to represent a major shift. Even though the judgment of Popplewell J in the DC Merwestone expressed considerable concern that the forfeiture rule overly favoured underwriters, even to the extent that it may breach the Human Rights Act, the Court of Appeal disagreed. It would be unfortunate to codify the rule just as it is under critical consideration by the highest court in the land.

17. It was already the case that an exaggeration made for the purpose of negotiation was not a fraudulent claim. The law has therefore for some years been subtly shifting in favour of the insurer—this is consistent with the policy aims, but care must be taken that the shift does not go too far when statutory form is considered, and the equilibrium needs to be considered in the context of the global reforms.

18. We noted that the termination remedy under section 11 of the bill represented the option harshest on the insured. Termination by notice with retrospective effect from the date of the fraudulent act is a more onerous remedy for the insured than other potential termination remedies, such as notice of prospective termination following a stipulated notice period or termination with immediate effect from receipt of notice. The remedy is in reality an election to terminate with retrospective effect and would affect subsequent honest claims made in reliance upon notice not being given and the insurance remaining in place. This would affect the position of a generally honest insured who had lapsed into a fraudulent claim but had made several honest claims before and afterwards, and who would have had the opportunity to take out a policy elsewhere but relied on the policy to remain in place.

19. It should be noted that the forfeiture rule is already designed to be punitive. If it is now accepted that avoidance is not an available remedy for fraudulent claims, out of the potential termination options, the one opted for by the Law Commissions is the harshest one. We therefore felt that from a more global overview perspective, it would be good to temper the proposals slightly in favour of the honest or not-so-dishonest insured.

20. We thought that the judicial discretion rule embraced by section 56 of the Australian Insurance Contracts Act 1984 would be appropriate also in our jurisdiction, especially in relation to entirely honest claims following a mostly genuine claim tainted by “slight” fraud and taking into account the exaggeration or other dishonesty in proportion to the total claim. This was considered especially appropriate in view of the relative harshness of the retroactive effect of termination in section 11(2)(a). Section 56 created a statutory discretion in the event of a fraudulent claim. Should the Supreme Court in the DC Merwestone find that the ‘draconian’ forfeiture rule is bad law, section 56 could provide a useful model for statutory reform. It seems much more likely that a statutory discretion would be created than a judicial one (as the case law in common mistake etc, makes clear). Judicial remodelling of the law is much more likely to impose familiar common law restrictions such as ‘materiality’ and ‘inducement’.

GOOD FAITH

21. Part 5 is designed to remove the remedy of avoidance for breaches of the duty of utmost good faith. It addresses solely the remedy and does not purport to affect the contents of any doctrine of good faith. We consider this a minimalistic incision with potential for a successful outcome for insurance law, in particular in view of dicta in The Star Sea and Goshawk vs Tyser.

87 Both Astra Insurance Ltd v Brown [2012] Lloyd’s Rep IR 211 and Versloot Dredging BV v HDI-Gerling Industrie Versicherung AG (The “DC Merwestone”) [2013] Lloyd’s Rep IR 582, [2014] EWCA Civ 1349 (subject to the appeal to the Supreme Court) were decided in favour of the insurer.
90 “The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing”; Lord Hobhouse in Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea) [2001] UKHL 1; [2001] 1 Lloyd’s Rep. 389 at [62].
22. However, we have considered the implications on the amendments on the Marine Insurance Act 1906. Following the amendments, section 17 of the MIA 1906 will be situated directly underneath the header “Disclosure and representations” and immediately followed by section 21, “When contract is deemed to be concluded”. This new geography may influence its interpretation and cause an unintended construction in the context of marine insurance so that any application of the provision in a post-contractual context is put in question.

23. Finally, it appears clear from the consultation process preceding the introduction of the Bill that the Law Commission would like good faith (or utmost good faith, which we do not consider to be anything different) to remain as a guiding principle. That being the case, we would recommend including a provision to that effect in the new Act. The principle currently only appears in section 17 of the Marine Insurance Act 1906 and in its wording makes direct reference to marine insurance, so that it could feasibly be inferred in the interpretation of new legislation applicable to insurance in general that it did not apply to other forms of insurance.

LATE PAYMENT

We would like to express our regret that the issue of remedies available to the assured in the event of late payment of the claim by the insurer has not been addressed in the Bill.

November 2014

Memorandum submitted by London & International Insurance Brokers’ Association

The London & International Insurance Brokers’ Association (“LIIBA”) is a trade body representing the interests of Lloyd’s brokers operating in the London and worldwide insurance and reinsurance markets. Lloyd’s Brokers handle in excess of £60bn insurance premiums and claims annually. London Market brokers introduce virtually all of Lloyd’s business and a significant proportion of London companies business, placing considerable volumes of business in international Markets. It is estimated that the direct GDP contribution of the London Insurance Market to be £12.0bn which represents 10% of UK financial services. The London market is viewed by most as the world’s leading and most important insurance market particularly for complex or international risks.

You kindly asked for any comments we might wish to submit to the SPBC on the Insurance Bill, which are set out below. We have made written submissions and comments to the Law Commission at each state of its consultation process.

1. Overall, we are in favour of the proposed reforms, as we consider the current law to be overly biased towards insurers, and believe it to be too vague and uncertain for insureds to understand comprehensively.

2. We welcome the proposals set out in the Bill as they seek to redress some of the current problems arising from provisions of the Marine Insurance Act 1906 which are outdated and which often cause confusion with regard to interpretation. For example, the sheer amount of data available to insureds, causes practical and interpretation difficulties and considerable confusion when the insured has to decide what needs to be disclosed.

3. We believe that the Bill should specifically cover reinsurance, and although this is referred to in the notes it would save any future uncertainty if it appeared within the body of the Bill itself.

4. We strongly support the abolition of basis of contract clauses, which can have the effect of converting certain representations by the insured into warranties and are pleased that insurers will not be able to contract out of this going forward.

5. We are pleased that the new duty to make a fair presentation of the risk may be satisfied by the insured giving the insurer sufficient information to put a prudent insurer on notice that he should ask further questions.

6. We are pleased that the new law will provide insureds with greater clarity on how to satisfy the duty to make a fair presentation of the risk e.g. it will clarify who, on behalf of the insured, is deemed to have knowledge.

7. We strongly support a new regime of more proportionate remedies for failure to make a fair presentation of the risk and misrepresentation, as the existing sole remedy of avoidance is too draconian and inflexible.

8. We are strongly in favour of the new remedy for breach of warranty being suspension of cover for the duration of the breach rather than automatic discharge/termination of cover.

9. We do not agree with insurers being able to contract out of the new regime in all circumstances. For example in subscription placements it could cause problems if some insurers contract out and others do not, e.g. by leaving the insured with a gap in cover in the event of a claim.

10. On some general issues we have concerns that references in the Bill to the term “agent” might lead to additional liabilities being imposed on insurance brokers.

11. We believe that the clause about the insured’s new duty to present information in a manner that is “reasonably clear and accessible” to the insurer should be further clarified.

12. We support the revised draft clause 11, as it is in unjust for insurers to rely on breaches that are not relevant to the loss.
13. We would also like to see the reinstatement of draft clause 14 which has been omitted from the current Bill, regarding damages for unreasonably delayed payment of claims and we hope that this clause can be revived on another occasion if there is no possibility of dealing with it now.

14. A report, by the Boston Consulting Group, on the competitiveness of the London Market was recently commissioned by the London Market Group. It found that for London to continue to be the central hub for insurance then, among other factors, the ease of doing business needed to be enhanced, in particular for brokers.

15. The UK is still noticeably behind other countries in terms of addressing its insurance contract law and the smooth passage of this Bill is essential, with perhaps a further review by the Law Commission on some of those areas which remain outstanding, in the not too distant future.

We would welcome the opportunity of discussing this response or any other aspects of the Insurance Bill, with you, if you think it would be helpful to do so.

November 2014

Memorandum submitted by Laura Macgregor, Professor of Commercial Contract Law at the Law School, University of Edinburgh

BACKGROUND

My name is Laura Macgregor, and I am Professor of Commercial Contract Law at the Law School, University of Edinburgh. I teach commercial law subjects at all levels, from ordinary to Masters, including agency law, partnership law, contract law and insurance law.

I am currently researching the law of insurance, specifically the role of agents/brokers in insurance law. I have written a draft book chapter on imputation of knowledge from agent to principal in pre-contractual disclosure in business insurance. The book, Agency Law in Commercial Practice, is being edited by me with two other academics, Danny Busch (Nijmegen) and Peter Watts (Auckland). It will be published in early 2016 by Oxford University Press.

In this document I comment only on the parts of the Insurance Bill that correspond with my research interests, i.e. the role of agents in the process of pre-contractual disclosure.

SUMMARY OF COMMENTS

Legislative change in this area is very welcome and indeed overdue. I would summarise my comments as follows:

— The changes to remedies are extremely welcome. The current “all or nothing” nature is the most serious defect in the current law and is overdue for change.

— The law in this area currently favours the insurer at the expense of the insured. Clearly, what is required is a re-balancing of these obligations. I question whether this has been achieved by the Bill. In the new scheme, stringent obligations are placed on the insured which appear to go further than is necessary in relation to disclosure.

— In relation to actual knowledge, clauses 4(2) and 4(3) appear narrower than the existing law, and are in this respect a welcome limitation of the insured’s duties.

— Through a combination of clauses 3(4) and 4(4) the insured can be deemed to know certain material circumstances where he does not in fact know them. He is nevertheless required to disclose these circumstances to the insurer. This information is defined by what its agent knows. This seems to go further than the existing law, which at least limits the deeming provision to the activities of an agent who effects the insurance (under s. 19 Marine Insurance Act 1906). As a provision which extends the insured’s duties, this is unwelcome and fails to achieve an appropriate balance between the obligations of the insured and the insurer. The older case law on the concept of an “agent to know” should not continue to be relevant. This case law is confusing, and it is difficult to see how it could be relevant given the new definition of fair representation of the risk.

— The proposed scheme seems to suggest that all knowledge of the agent, howsoever acquired, must be disclosed (apart from confidential information, as provided in clause 4(5)). This seems to conflict with the current position in agency law, where, as a general rule, only knowledge acquired in the course of a business for the agent’s principal is imputed to the principal. I do not favour any expansion of the current law on this point—only information acquired by the agent whilst acting in the course of a business for his principal should be imputed to the principal.

REMEDIES

The most serious defect of the current law is the nature of the remedy applicable for breach of the duty of disclosure, i.e. it renders the insurance contract void. This remedy has a draconian impact on the insured party. The new provisions contained in Clause 8 and Schedule 1 of the Bill provide a more nuanced response to a relevant breach. Crucially, the remedy will depend upon what the insurer would have done had he known the true position. The remedy is thus tailored to the circumstances. This will bring welcome change to this area. The new provisions will be a more proportionate and appropriate response to a breach of the duty of disclosure.
DUTY OF DISCLOSURE: STRIKING A BALANCE BETWEEN INSURER AND INSURED

The Explanatory Notes to the Bill state (in para 6) that the existing rules on disclosure “...were designed to protect a fledgling insurance industry against exploitation by the insured.” This explains why the rules operate in such a severe way against the insured, and are weighed so significantly in favour of the insurer. Lord Hoffmann memorably stated that the rules on disclosure “go a good deal further” than the basic principal of utmost good faith. Certainly, what is required is a rebalancing of the obligations between insurer and insured. I question whether the Bill rebalances those obligations in the correct way. In my opinion, the duty of disclosure will still operate onerously on the business insured, particularly as regards the class of persons caught by the duty and the information which those persons are obliged to divulge. I expand upon this statement below. I think it is important to begin by recognising how unusual these provisions are in requiring so much disclosure in the performance of the obligation of (according to Lord Hoffmann, more than) utmost good faith. This is, of course, highly unusual in Scots (and English) commercial law.

OVERALL CONTEXT OF IMPUTATION OF KNOWLEDGE FROM AGENT TO PRINCIPAL.

The rules relating to disclosure should be considered against the backdrop of imputation of knowledge from agent to principal in the law of agency generally. The relevant provisions in the Marine Insurance Act 1906 (ss 18 and 19) and the provisions which will replace them (Clause 4) treat the insured as knowing something that the insured does not actually know. Because this is a legal fiction, the justification for imputation must be clear. Imputation plays a relatively small role in agency law generally—this particular context of pre-contractual disclosure is perhaps the most obvious example of it. There is no clear rationale for imputation of knowledge in agency generally. Although historically the idea of the agent as alter ego of the principal was persuasive, modern commentators question the utility of this particular rationale. Not all information known by the agent is imputed to the principal in agency law generally, nor is information imputed from principal to agent, and so the idea of the agent as the alter ego of the principal is not a convincing justification. A different rationale is the “communication” rationale. Information which ought to be passed to the principal in the performance of the agent’s duty, so the argument goes, is presumed to have been communicated to him. As a presumption, this does not in itself provide a rationale as such, but rather an explanation for the rules. The presumption is irrebuttable—the principal cannot defeat it by showing that communication did not take place.

Given the lack of clarity in the reasons for imputation in the law of agency generally, it is not surprising that a similar lack of clarity affects the rationale in this specific insurance context. As a result, there is an even more pressing need to ensure that the law strikes the correct balance between insurer and insured.

INSURANCE BILL, CLAUSE 4(4)

Actual knowledge

The current law, specifically s. 18(1) of the Marine Insurance Act 1906, imputes actual knowledge from agent to insured/principal. The authors of the leading modern textbook, MacGillivray, suggest that actual knowledge can be imputed under s.18(1) where the agent is one of three types:96

1. Agents employed to manage a property or activity which is the subject-matter of the insurance and on whom the assured relies for information about it;
2. An agent employed to effect the insurance;97 and
3. An agent in such a predominant position towards the assured that his knowledge is regarded as that of the assured.98

Case law has established the idea of an “agent to know” as a party whose knowledge can be imputed to the principal (which may correspond with class (1) above).

In the Bill, the equivalent provisions on actual knowledge are contained in clauses 4(2) (applicable where the insured is an individual) and 4(3) (applicable where the insured is not an individual). The actual knowledge of an individual who is responsible for the insured’s insurance is treated as actual knowledge of the insured (in both cases of individual and non-individual insureds). Where the insured is a non-individual, the knowledge of an individual who is responsible for the insured’s insurance is treated as actual knowledge of the insured (in both cases of individual and non-individual insureds). Where the insured is a non-individual, the knowledge of an individual who is in the insured’s senior management is included. Arguably, this latter provision is a reflection of the rules of attribution in corporate law generally, and therefore unsurprising. The idea of a person responsible for the insured’s insurance roughly reflects the existing law in class (2) above. Classes (1) and (3) of the existing law appear to have no equivalent in the Bill.

95 See, for example, the language used by Lord Watson in the leading case on pre-contractual disclosure involving agents, Blackburn, Low & Co v Vigors (1887) 12 App Cas 531 at 540: “...the insurer...is entitled to assume that every circumstance material to the risk insured has been communicated to him, which ought in due course to have been made known to the shipowner before the insurance was effected.” See also Story, Commentary on the Law of Agency, (1839), §141: “...for, upon general principles of public policy, it is presumed, that the agent has communicated the facts to the principal; and if he has not, still the principal, having entrusted the agent with the particular business, the other party has a right to deem his acts obligatory upon the principal...”
97 Blackburn, Low & Co v Vigors (1887) 12 App Cas 531 at 539; PCF Syndicates v PCF Reassurers [1996] 1 WLR 1136 at 1150.
This being the case, this seems to be a narrowing of the duty on the insured,\textsuperscript{99} which is welcome, bearing in mind the comments about the need to strike a fairer balance in the obligations of insured and insurer made at the beginning of this document.

**DEEMED KNOWLEDGE—KNOWLEDGE CAN BE IMPEUTED FROM AGENT TO PRINCIPAL, BUT OF WHICH AGENTS?**

To charge someone with knowledge that he or she does not have is to apply a legal fiction and, as such, requires explicit and pressing justification.

The authors of one of the leading textbooks on insurance law, MacGillivray, indicate that where an agent is to effect insurance, the insured can be deemed to know information material to the risk which either the agent or the insured ought to have known.\textsuperscript{100} They explain that this is as a result of three separate rules which were derived from s.19 of the Marine Insurance Act 1906:

\begin{quote}
“(1) the agent is bound to disclose what the assured knows, unless it comes to the assured’s notice too late for communication to the agent;

(2) The agent must disclose material facts known to him, whether or not also known to the assured;

(3) The agent must also disclose facts which in the ordinary course of business he should have known or been told, whether or not the assured should have known of them or told him about them.”\textsuperscript{101}
\end{quote}

Additionally, the knowledge of an “agent to know” (discussed above) can be deemed to be the knowledge of the insured under s.18(1) of the Marine Insurance Act 1906.

In the proposed legislative scheme, deemed knowledge is covered in Clause 4(4) of the Bill. The test is expressed by reference to “what should reasonably have been revealed by a reasonable search of information available to the insured (whether within its own organisation or held by others, for example its agent, and whether the search is conducted by making enquiries or by any other means).” This seems to be a much wider test than the existing law. The previous legislative scheme at least limited the information to that known to an agent effecting the insurance. Clause 4(4) uses the word “agent” without qualifying it. Thus any agent of the insured could be caught. To widen the class of persons whose knowledge could potentially be imputed to the principal seems to run counter to the rebalancing exercise that is being carried out. This provision seems to favour the insurer rather than the insured.

Sections 18 and 19 of the Marine Insurance Act 1906 (the sections which imputed knowledge from agent to insured) are being repealed.\textsuperscript{102} I note, however, that the Explanatory Notes state both that Clause 4(4) “codifies principles derived from some case law,”\textsuperscript{103} and that the clause “is to be interpreted in light of existing case law.”\textsuperscript{104} The Explanatory Notes state that the knowledge of an agent to know “may well be included.”\textsuperscript{105} This is unfortunate. The case law establishing the category of an “agent to know” is very difficult to understand. It seems therefore that in applying the new provisions the courts will continue to discuss the “agent to know.” This will inevitably add ambiguity. We should as far as possible remove difficult and anachronistic terminology.

In summary on this point, clause 4(4) is wider than the existing law in the types of agents whose knowledge can be imputed to the principal. This seems surprising given that the overall aim of the legislation is to redress the balance between insurer and insured, reversing the historical preference that the insurer has enjoyed. A better way forward would be to describe in this section the types of agents whose knowledge can be imputed. The three types of agents identified in MacGillivray would be a good starting point. If these three types were spelled out in this clause, possibly using the language from MacGillivray, then this would be an improvement both on the existing law and on clause 4(4) as drafted. Crucially, the types of agents whose knowledge is caught by this section would be appropriately limited. I cannot see any reason potentially to impute the knowledge of all agents, contrary to the more limited rule in agency law generally.

**KNOWLEDGE CAN BE IMPEUTED FROM AGENT TO PRINCIPAL, BUT WHAT KNOWLEDGE? ALL KNOWLEDGE HELD BY THAT AGENT?**

In terms of clause 4(2) an insured knows what is known to the individuals responsible for the insured’s insurance. Clause 6(a) tells us that this would include individuals who participate on behalf of the insured in the process of procuring the insured’s insurance (whether the individual does so as the insured’s employee or agent, or as an employee of the insured’s agent, or in any other capacity.) This clause has to be read in conjunction with clause 4(4), already commented on.

Clauses 4(2) and 4(4) are qualified by clause 4(5). The insured’s knowledge does not include confidential information acquired by the insured’s agent (or an employee of the insured’s agent) through a business relationship with someone other than the assured. This qualification is appropriate and welcome. The agent concerned may be acting for a number of principals. He may also be subject to professional rules of conduct which require him to respect client confidentiality. As such, the exclusion of confidential information is required.

\textsuperscript{99} Blanchard also identifies this as a possible narrowing of the existing law, ‘Reform of the pre-contractual duty of disclosure of the agent to insure: evolution or revolution?’ (2013) LMCLQ 325 at 329.

\textsuperscript{100} They explain that this is as a result of three separate rules which were derived from s.19 of the Marine Insurance Act 1906.

\textsuperscript{101} This runs counter to Blanchard’s conclusion, presumably reached before the Explanatory Notes were issued, that the Law Commission Report amounted to a “statutory abolition of the concept of an agent to know as it presently exists,” in ‘Reform of the pre-contractual duty of disclosure of the agent to insure: evolution or revolution?’ (2013) LMCLQ 325 at 326.


\textsuperscript{103} Clause 19(2), Insurance Bill [HL].

\textsuperscript{104} Para 55.

\textsuperscript{105} Para 56.
Even with this exclusion, clauses 4(2) and 4(4) cast the net very wide. Knowledge, howsoever acquired, (provided it is not confidential information) is within the ambit of these provisions. Generally in the law of agency, only knowledge acquired by an agent while acting for the principal is imputed to that principal.\textsuperscript{106} There are strong policy reasons in favour of limiting the knowledge imputed to the principal to only the knowledge that the agent acquires in the course of his agency work for that principal. Agents work for many different principals, sometimes in different areas of commerce. Why should knowledge acquired at a time when the agent was not working for a particular principal be imputed to that principal? The principal will not in any sense have “paid” for that knowledge. Should knowledge discovered by an agent at, for example, a social event be imputed to his principal? When the agent is not working, he may not identify the importance of the knowledge nor indeed remember it. And yet, these provisions catch all knowledge of the agent, provided it is not confidential. I think a fairer balance could have been reached if the knowledge imputed from agent to principal were limited to the knowledge the agent acquires in the course of a business for that principal. Clauses 4(2) and 4(4) in their existing form go too far, placing a heavy burden on agent and principal alike.

\textbf{The Fraud Exception (The Rule in Hampshire Land)}

The Bill recognises an existing rule of English law known as the fraud exception or “Hampshire Land” principle.\textsuperscript{107} This is expressed in clause 6(2):

> “Nothing in this Part affects the operation of any rule of law according to which knowledge of a fraud perpetrated by an individual (“F”) either on the insured or on the insurer is not to be attributed to the insured or to the insurer (respectively), where –

\begin{enumerate}[\item]
    \item if the fraud is on the insured, \(F\) is any of the individuals mentioned in section 4(2)(b), or (3), or
    \item if the fraud is on the insurer, \(F\) is any of the individuals mentioned in section 5(1)."
\end{enumerate}

In other words, a principal cannot be charged with his agent’s knowledge where that agent was defrauding him. The rationale of this rule is that, in such circumstances, one cannot expect the agent to have kept the principal informed. Although this would be appropriate were the agent acting properly in the normal course of business, it is not appropriate where fraud is taking place. The fraud exception is highly controversial. Peter Watts, one of the most highly respected agency lawyers in the common law world, has very persuasively argued against it.\textsuperscript{108} He has expertly illustrated the dubious history of the concept.

The fraud exception tends to encourage the principal not to question his agent or at least not to find out information which might be material to the risk. Thus clause 6(1) of the Bill is very important: this provides that knowledge includes “…matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining from confirming them or enquiring about them.” Thus clause 6(1) ensures that the insured has a duty to disclose this “blind eye knowledge.” As such, if the Hampshire Land principle is enshrined in the Bill, clause 6(1) is a necessary corollary.

It is unfortunate that the Law Commissions did not question whether the Hampshire Land principle ought to be enshrined in the Bill, particularly given the controversy surrounding it in published academic work. Clause 6(2) is phrased: “... any rule of law according to which...” In other words clause 6(2) does not confirm that the Hampshire Land rule exists, or assert that it is part of the law. I have been unable to find any Scottish case which applies the Hampshire Land principle. I should emphasise that I have not conducted a thorough search of all databases. Nevertheless, a search of the Scottish Court Judgments website does not reveal any Scottish case which has relied on Hampshire Land. Scottish case law from the late eighteenth century pre-dating Hampshire Land, including a Scottish appeal to the House of Lords,\textsuperscript{109} reaches a different result. Although one might argue that Hampshire Land has impliedly over-ruled these earlier Scottish cases, there is at least an argument that the law of Scotland differs from Hampshire Land. Given the manner in which clause 6(1) is drafted (“any rule of law according to which...”), there may be an argument that this clause has no effect in Scotland, there being no rule of Scots law equivalent to Hampshire Land.

In summary on this point, it is unfortunate that the opportunity was not taken by the Law Commissions to look more deeply into the Hampshire Land rule, particularly given the controversy it has caused in English law. I question whether such a rule is part of Scots law, and therefore whether clause 6(2) will have any effect in Scotland.

November 2014

\begin{center}
Memorandum submitted by Mactavish
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1. Mactavish is a specialist research and advisory firm that has been working in the insurance industry for over 15 years. We publish widely acclaimed research and work for buyers of corporate insurance, helping them to improve the reliability of their insurance. We also provide support for insurers and brokers who are looking to tackle the same issues.

\textsuperscript{106} See P. Watts ‘Imputed knowledge in Agency—Excising the Fraud Exception’ (2001) LQR 300 at 304.

\textsuperscript{107} \textit{In Re Hampshire Land Company} [1896] 2 Ch 743.


\textsuperscript{109} See Thompson v Buchanan, 13 March 1782, IV Brown, 329; and Stewart et al v Dunlop et al, 8 April 1785, IV Brown 330.
2. Reform of the law appears to us to be long overdue. The duties prescribed under the 1906 Marine Insurance Law seem outdated and inappropriate for the complexities of 21st Century business, and the case law that has evolved alongside it to compensate for these inadequacies leaves insureds unsure of their legal position.

3. Mactavish research over the last decade suggests that the current regime has fostered an environment where disputes over coverage for large / strategically significant claims are commonplace.

4. In its most recent study, Mactavish found that 40% of UK companies had suffered at least one large and/or strategically significant insurance loss in the past 3-4 years, and of those 45% were disputed by insurers on various grounds. The most common cause of dispute was whether the loss was covered by the policy at all, and how the value of the loss should be calculated. The average resolution time was 35 months for the disputed claims.

5. Disputes and delays in payment clearly have a significant impact on the businesses that have been relying on the insurance. Very few even amongst the largest FTSE 100 have ready cash to fund a disputed major claim without significant strategic disruption, while access to debt that could act as a stopgap until the claim is paid has been severely impaired by the recession and financial crisis. Customers do not have the confidence that such support would be forthcoming today.

6. While Mactavish’s analysis of the materiality of insurance to the companies it works for suggests that it is often a very cost-efficient way (when compared to other forms of capital) of financing infrequent loss events, if that finance is fundamentally unreliable then businesses are at significant risk. Critically, this risk is often not apparent to the policyholder until the policy fails and it is too late.

7. In light of the above, it is therefore disappointing that the Law Commission’s recommendations on damages for late payment had to be removed from the bill put before Parliament. In our view this should be reinstated to bring insurance law into line with other commercial law.

8. Mactavish evidence has been provided to the Law Commission to help quantify the extent to which these problems affect current UK policyholders. This is summarised in the summary evidence pack provided to the Law Commission and HM Treasury and appended to this paper110, but importantly this work considers both:
   a. The unacceptably high frequency with which large or important claims are actually disputed on grounds relating to the matters dealt within the proposed legislation, and beyond its scope; and
   b. The far greater frequency (in some cases near universal) with which the issues flagged affect UK policyholders’ current policies (and which would thus come to light if and when tested by a large claim event). Core data on the prevalence of issues is included in the following summary, but it is important to note that the cases discussed in the evidence pack suffered from a variety of problems with their existing insurance contracts—i.e. the same contract was likely to suffer from a basis of contract clause, a surfeit of obligations and an obligatory arbitration clause that meant that disputes would have to be resolved in private outside of the courts.

DUTY OF DISCLOSURE

9. In Mactavish’s experience, the duty of disclosure is not well understood by UK businesses—including those who have a professional adviser in the form of a broker. Trying to understand what a “prudent underwriter” would deem “material” is not feasible for most insureds, who often are guided to provide the (limited) information requested by the market as a pre-requisite for pricing the insurance, and nothing more.

10. Mactavish feels that the concept of a “duty of fair presentation”, as set out in the Insurance Bill, is far more accessible to insureds—particularly as the role of placing insurance only rarely sits with a specialist ‘insurance manager’ but is often the responsibility of a CFO, Company Secretary or even the CEO in smaller businesses. The analogues with EU and UK accounting rules (where the need to make a fair presentation acts as a general override that takes precedence over specific checklists or approaches) mean that this is more accessible to customers without extensive insurance knowledge.

11. The remedies proposed for breach of the duty of fair presentation are much more reflective of the commercial realities of insurance contracts: Mactavish is told on a regular basis by insurers that avoidance of policies is a rare event and that they already act more in line with what is being proposed.

12. However, Mactavish has seen larger companies (FTSE 100 or equivalent) negotiate terms that go much further than the standard proposed in the bill—for example, clauses which allow the company to only pay the additional premium that it would have been liable for if the information had been disclosed at renewal, rather than a proportional reduction in a claims payment as is proposed in the bill. It is also fairly common for companies of all sizes to be able to achieve more than is set out in the bill in certain types of liability insurance, e.g. cover for directors and officers.

13. The point we are making is that larger companies are more likely to be able to negotiate to some extent around the inadequacies in the law (although there is significant variation depending on sector, type of insurance, premium spend and the insurers in question) but that small and medium sized business are not provided with such contractual improvements due to a lack of buying power. In essence, we today have a far from level playing field where small and medium sized businesses require legislation to force the industry to offer at least some of the improvements which can be achieved by their larger competitors.

Warranties

14. Mactavish strongly supports the abolition of basis of the contract clauses, which it has found to be extremely common: 100% of cases reviewed had at least one basis of contract clause on a material class of business in its programme, although it was more typical for these to be found in multiple policies. These are present in proposal forms (present in 62% of those reviewed), policy wordings (in just over half of the documentation seen—56%) and even in some cases in the broker/insurer contract documentation (market reform contracts) that insureds do not usually receive.

15. Basis of contract clauses are an oddity of the law, not referred to in the 1906 Marine Insurance Act despite having been in use in the 19th Century, and are grossly unfair to policyholders, who are not aware of the impact that the apparently innocuous words have on the nature of their insurance contracts. They are also commonly mis-explained by insurers and brokers to policyholders. There can be no justification for retaining the right to use these clauses.

16. Any provision that can automatically terminate a contract if breached, whether or not that breach was material or relevant to a loss, seems to be an overly harsh one and Mactavish therefore supports the change in law proposed in the bill with respect to warranties. However, we do see policyholders achieve more than this in individual negotiation with insurers—for example, also restricting the impact of breach of conditions precedent and establishing a direct requirement for the breach to have caused the loss or caused the insurer prejudice. So again we believe the proposed legislation is in fact doing the minimum necessary and less than the market is prepared to do under contract for large companies.

17. It is also worth noting that policyholders are often extremely unsure of the importance of obligations in their policies—with conditions precedent and warranties not always labelled as such (and such labels have not been held to be definitive as to status by the courts in any case). Policies can often have several pages of obligations spanning multiple sections and categories, and this is a particular problem where combined policies covering several different types of insurance are purchased—usually at the smaller end of the corporate space. The insureds we have worked with often had over 10,000 words of obligations to comply with across their entire insurance programme: uncertainty about the impact of breach only exacerbated the problem of knowing where to focus efforts to comply for these companies.

18. In light of this, simplifying the impact of breach of all the different types of conditions would be extremely helpful to policyholders—currently there are warranties (of various types), conditions precedent, conditions, innominate terms, mere terms and descriptive of the risk terms. This variability (amplified further by the wide variety of language which can be used to achieve each within a policy wording) is unhelpful for insureds trying to comply with the terms of their contracts and for those policyholders engaged in disputes with their insurers over a claim, as they cannot be sure whether their policies are valid.

Need for statutory change

19. The insurance market has not changed its own standards and practices to reflect the changing nature of business risks, making statutory change a necessity in Mactavish’s opinion.

20. Mactavish has extensive experience of assisting insureds with the attempted negotiation of changes to their individual contracts and struggling as these go against the trends of the wider market.

21. Crest Nicholson and Middlesex University have both worked with Mactavish to improve the reliability of their policy wordings, and have experienced significant difficulties in their negotiation with the market.

22. Both Crest Nicholson and Middlesex University tried to change their policies first with their incumbent insurer(s) and then as part of marketing exercises where theoretically their commercial bargaining position should have been strongest. They encountered a very mixed response—and had to expend significant time, energy and resource in achieving the progress that they have; which, while taking their contracts far beyond the standard experienced by the majority of their peers, requires a level of expertise and resource which would not be available to small and medium size businesses and has an additional cost. The market is very competitive on price but uncompetitive on contractual standards.

23. The case for statutory reform is greatly strengthened by the difficulty of policyholders negotiating changes on a case by case basis. This experience, shared by not only Crest Nicholson and Middlesex University but also the vast majority of Mactavish policyholder clients, is driven by a number of factors:

   a. The current insurance renewal process is simply not geared up to negotiate individual policy terms in advance of renewal, with full policy documents typically not provided (or even required by FCA rules) until weeks after the contract is concluded.

   b. Sales, underwriting and placing teams at insurers and brokers are equally not currently geared up for technical discussions on coverage and wordings at negotiation stage on a large scale. This means that policyholders that do attempt to negotiate often encounter inconsistent responses and referral of any changes to central departments (e.g. head office legal) which adds significant delay and cost to the process over many months and multiple rounds of negotiation.

November 2014
We feel bound to respond to the Combar signatories’ incorrect description of the role, function and alleged “vested interest” of Mactavish, the company of which I am founder and Chief Executive Officer. I respond to the Committee for two reasons:

1) The Combar signatories’ comment on our work implies that our evidence provided to the Law Commission and to the Committee should somehow be disregarded. I explain below how their criticism is incorrect but also irrelevant, dealing solely with historical context which has no bearing on a report that documents the current practical problems faced by commercial policyholders as a result of today’s insurance industry practices and law.

2) Our work sets out a great deal of direct policyholder intelligence on these problems faced by a very broad cross-section of corporate Britain both large and small—a view which is otherwise in short supply in the current debate.

At paragraph 22 of their written submission to the Committee, the Combar signatories state “The [LawCommission] Report draws heavily on work by Mactavish”.

The Combar signatories go on to assert with regard to Mactavish:

“Mactavish is not an independent research body, carrying out research from a neutral perspective. Mactavish is a services supplier which is in the business of selling its “insurance governance” services, describing itself as “the UK’s leading expert on insurance governance”. It has a vested interest in convincing its customers that they need its services”.

Whilst it could, by way of riposte, be observed that anyone involved in the field of insurance, including the Combar signatories, will have a vested interest in some respect or manner, the implicit suggestion being made here seems to be that, because the “vested interest” of Mactavish is purportedly in “convincing its customers that they need its services”, that Mactavish must have some unidentified interest in the enactment of the Bill, presumably on the basis that this would help it in “convincing its customers that they need its services”.

First, I take umbrage at the inference that because Mactavish has taken the view (as also have most other contributors to the Law Commission’s consultation process) that the contents of the Bill are likely, on the whole, to be of beneficial effect to those not immersed in the minutiae of insurance law, such as small and medium sized businesses, and that its enactment is therefore to be encouraged and welcomed, that Mactavish’s position must therefore have been rendered illegitimate by virtue of its alleged “vested interest”. This implicit assertion, with due respect to the signatories to the Combar submission, is unattractive.

Our involvement, with our many clients, in the many areas and aspects of insurance which affect them has given us a perspective with regard to the practicalities and application of the current law relating to the placement of insurance risks. It is this, and not some narrow, self-interest which has informed and led us to adopt the position that we have.

Moreover, the Combar assertion is both illogical and incorrect. Indeed, advice received from specialist leading counsel whom we have instructed on various insurance issues and with whom we work day to day, is that the enactment of the Bill, by effectively providing a new or newly stated minimum standard for the placement of non-consumer insurance, is likely to impact negatively on insurers’ preparedness to entertain and agree the various measures and provisions proffered by Mactavish on behalf of its clients, which the current, unsatisfactory state of the law makes many underwriters feel obliged to do. This, we have been advised, might in turn potentially serve to reduce our volume of current work.

For the sake of completeness, it is the view of leading counsel referred to above, that the new dynamism that Mactavish has provoked amongst corporate insureds with regard to the active negotiation of the detailed wording of their insurance contracts, militates against legislative intervention, on the basis that the many individual, negotiated outcomes produced across the market will, in time, emerge as new or revised elements of custom and practice, thus forming market conventions which, if sustained over time, will in due course be recognised and endorsed by ruling of a court. Such a process, he counsels, is however likely to take many years as it will be dependent on which issues come before the court (as opposed to arbitral tribunal), when they do so, the relevant party’s willingness and financial ability to elevate the dispute to appellate level at which binding precedent is set, and the many other factors which, haphazardly, affect the development and progression of the common law.

The Combar signatories, at paragraph 23 of their submission, make reference to two supposed errors of law in Mactavish’s report and then, on the basis of these two supposed errors, seek to dismiss the Mactavish submissions with the disparaging comment that:

“Research based on a flawed understanding of the existing law should not be assumed to be reliable”

The discussion of law in the Mactavish report does not purport to constitute legal advice and could not be read or understood by any fair-minded reader, whether possessed of a legal or other background, as seeking to do so. The legal discussion is relevant only as an overview in order better to understand the practical problems faced by insureds in understanding and meeting their disclosure obligations—which difficulties are fairly stated—and the consequences of failing to comply with the duty of disclosure which, again, are accurately discussed. To suggest that the quality of the research is compromised by any such matters is obviously also unattractive.
The section of the report under attack concludes by stating “Mactavish is not a law firm and only aims to warn insurance buyers that risk disclosure and other tenets of insurance law are important and require their attention. However, there are clear grounds for concern. The vast majority of buyers (87%) are unaware of how onerous the duty of disclosure really is. Key legal terms such as warranties and their implications when it comes to policy coverage are not understood.”

Thus in the clearly stated context of the report and the purpose of the section it is, as I say, an unattractive criticism from the Combar signatories and I wonder whether it is really helpful to descend to the detail highlighted below.

As regards the Combar signatories’ case-specific criticisms of the Mactavish report, the criticism in relation to Pan Atlantic v Pine Top is surprising, to say the least. Of course Pan Atlantic was not the legal source of either the requirement to disclose all material facts or the “prudent underwriter” test, each having its origin in common law, as codified in s.18 of the MIA. The statement in the Mactavish report that the House of Lords’ decision in Pan Atlantic “...sets out the conditions that have to be met for an insurer to avoid an insurance policy” is thus correct, other than to those who choose to understand the words, “sets out”, as having the same meaning as, “sets out for the first time”, or similar.

Moreover, the report very clearly states “In the UK the duty of disclosure (i.e. the requirement to inform insurers of all facts material to assessing risk) sits firmly with the insured. This is established by over two centuries of common law and enshrined in the Marine Insurance Act 1906”, This is clearly stated in our report prior to the reference to Pan Atlantic v Pine Top.

Finally, it is a surprising suggestion that the House of Lords’ rejection of the decisive influence test for materiality in that case is not part and parcel of the test viewed broadly.

As to the discussion of Generali v Arab Bank, following Pan Atlantic there followed a period of uncertainty as to whether it was sufficient for the underwriter’s inducement to be presumed following a material non-disclosure or misrepresentation; see paras 56 et seq of Ward LJ’s judgment in the CA [2002] EWCA Civ 1642. Generali v Arab Bank emphasised/restated the need for proof of actual inducement either through evidence from the actual underwriter or other facts, see para 62. Combar’s criticism is therefore unfair; to suggest that it undermines the Mactavish report displays a lack of balance.

The dismissive tone of the Combar submission, as it relates the submissions made by Mactavish, is perhaps borne of the fact that none of us at Mactavish are lawyers. This may have led the Combar signatories mistakenly to assume that, despite this lack of legal qualification, we had nevertheless ventured to make our own submissions on the law. Thus, so the argument seems to go, we knowing nothing of the law, our submissions are denigrated as necessarily being unreliable. This hinted suggestion to the Committee that the submissions of Mactavish be disregarded, once again, seems to be misguided.

I do not make any comments on the Combar piece more generally save to say that we have a number of reservations about its tenor, substance and motivation.

The Mactavish report which has been attacked by Combar is attached so that members of the Special Public Bill Committee on the Insurance Bill can form their own view.

The report was co-branded with and endorsed by PwC. It was further publicly endorsed in written statements at the time of publication by Airmic, Aviva, Axa Corporate Solutions, Berrymans Lace Mawer, Herbert Smith, Willis, and Zurich Global Corporate (see attached statements). Papers written on the exact same Mactavish report include those attached from Berrymans Lace Mayer, Herbert Smith and PwC. It seems extraordinary that a report peer reviewed and endorsed by such a body of experts and practice leaders should be so illogically dismissed and in such bad faith.

For clarity, I am not asserting that any of the above mentioned organisations either support or reject the proposed bill, merely that they publicly endorsed the Mactavish report attacked by Combar.

Mactavish generates such extraordinary levels of interest and support across the policyholder, broker and insurer world that the attempt to discredit our right to contribute rather than challenge any single assertion we have made about the poor functioning of the placement process for commercial insurance seems to suggest a recognition for the accuracy of our research, analysis and reporting and its widespread acknowledgement and acceptance by experts.

Our reports are critical of the placement practices followed by commercial policyholders, brokers and insurers in equal measure. These are the most balanced reports that have been published on the subjects at hand in making clear that all parties need to enhance their performance at placement and that the law should be framed to encourage and reward good practice across the board. The current law fails utterly to achieve that.

I also attach a short document on Mactavish which highlights many endorsements from policyholders regarding the quality of our work in this area.

I understand some may choose to attack Mactavish because our evidence is compelling, it supports the enactment of the bill, and they have no legitimate or evidential basis to disagree with our research, analysis, conclusions and recommendations.

Mactavish’s research is widely available and well circulated and read at no cost to recipients. The details of how the research is carried out are made clear and further details can be provided to anyone who asks. One of the signatories, Sara Cockerill QC, wrote to me asking for a copy of one of our reports on 5th November 2014 and it was provided on 6th November 2014. That doesn’t seem to suggest any difficulty in accessing details of our work.
Please could you add this letter to the publicly available evidence pack available to the general public.

December 2014

Memorandum submitted by Marsh Limited

I write on behalf of Marsh Limited ("Marsh"), insurance brokers and risk advisers, to let you have our general comments on the Insurance Bill.

1. Overall, we are very much in favour of the proposed reforms, not least because:
   1.1 the current law is too Insurer-friendly, and is too vague and uncertain for insureds;
   1.2 the Marine Insurance Act 1906 is outdated and often causes confusion for insureds. For example, the information revolution, and the sheer amount of data now available to insureds, causes practical difficulties when the insured must decide what needs to be disclosed;
   1.3 We believe the Bill will help to promote the London insurance market, and that if it is not passed insureds will increasingly choose jurisdictions where insurance law is more insured-friendly than it currently is in the UK.

2. We are pleased that the new duty to make a fair presentation of the risk may be satisfied by the Insured giving the insurer sufficient information to put a prudent insurer on notice that he should ask further questions.

3. We are pleased that the new law will provide insureds with greater clarity on how to satisfy the duty to make a fair presentation of the risk e.g. it will clarify who, on behalf of the insured, is deemed to have knowledge.

4. We are strongly in favour of having a new regime of more proportionate remedies for failure to make a fair presentation of the risk and misrepresentation, as the existing sole remedy of avoidance is too draconian and inflexible.

5. We are strongly in favour of the abolition of "basis of contract" clauses, and we are pleased that insurers will not be able to contract out of this.

6. We are strongly in favour of the new remedy for breach of warranty being suspension of cover for the duration of the breach rather than automatic discharge/termination of cover.

7. We are in favour of the revised draft clause 11, as we think that insurers should not be able to rely on breaches that are not relevant to the loss. However, if the new draft clause 11 still generates concerns across the market we would not want that to put the rest of the Bill at risk, as we are very keen that the Bill should be passed.

8. We were also in favour of draft clause 14 which has been omitted from the current Bill, regarding damages for unreasonably delayed payment of claims and we hope that this clause can be revived on another occasion.

Our reservations about the Bill as drafted are

9. For the avoidance of doubt, we think the Bill should expressly state that it applies to reinsurance as well as insurance.

10. We do not agree with insurers being able to contract out of the new regime in all circumstances. For example, in subscription placements involving more than one insurer, it could cause problems if some insurers contract out and others do not, e.g. by leaving the insured with a gap in cover in the event of a claim.

11. We are concerned that references in the Bill to the term "agent" should not lead to additional liabilities being imposed on insurance brokers.

12. We think that the clause about the insured’s new duty to present information to the insurer in a manner that is "reasonably clear and accessible" could be further clarified.

I trust this is helpful.

November 2014

Memorandum submitted by Chris McGloin

1. The proposed Insurance Bill is very important as it provides a necessary up-to-date framework to allow increased certainty to the buyer when effecting insurance contracts.

2. The current law is heavily biased against the buyer and this can make it very difficult for the buyer to pursue valid claims to the detriment of all parties involved.

3. Fair presentation is an improved approach and provides an effective basis for buyer, insurer and broker to work together. This reflects the practice already prevalent for many buyers and will underpin this current practice with the appropriate legal framework. The remedies for breach are more proportionate and reflects the practice sometimes adopted already by insurers. Importantly the new law addresses the threat that the insurance policy can be cancelled ab initio—a tactic sometimes used inappropriately in negotiation by certain insurers.
4. I have recent personal experience of warranties and basis clauses being used inappropriately by major insurers. I firmly believe the approach outlined in the Bill is essential to restore credibility to insurance as a risk mitigation measure for commercial buyers of insurance.

5. A major driver for the proposed changes is to enhance the credibility and reputation of the UK insurance market. This may be undermined if there is inappropriate use of the opt-out clause. The Bill should have robust language to ensure that the use of the opt-out clause is clear and the implications fully explained. The obligations for the insurer and broker to explain this to the client should be clearly outlined in the Bill.

The above comments are based on my 40 years’ experience working in the insurance industry in the UK first with Royal Insurance (1973-1983), then brokers Sedgwick and Aon (1983-2005) and more recently as Risk Manager for Invensys plc (2006-2014). In addition I currently serve on the Board of Airmic and chair the Insurance Steering Group for the association. Airmic has submitted a more detailed response which I fully support.

November 2014

Memorandum submitted by RGA International Reinsurance Company Limited

1. This submission is made on behalf of RGA International Reinsurance Company Limited, UK Branch Office (“RGA”).

2. Within the UK RGA is one of the largest writers of new individual reinsurance business and we have contracts with a number of the major UK Life Offices.

ABOUT RGA

3. Reinsurance Group of America, Incorporated (NYSE: RGA) is a leader in the global life reinsurance industry with approximately $2.9 trillion of life reinsurance in force and assets of $39.7 billion. We are one of the largest life reinsurance companies in the world.

4. We are the only global reinsurance company to focus primarily on life and health-related reinsurance solutions.

5. Our core products and services include individual life reinsurance, individual living benefits reinsurance, group reinsurance, health reinsurance, financial solutions, facultative underwriting and product development.

6. Our world headquarters is located in St. Louis, Missouri and we have operations in 26 countries.

RGA’S VIEWS ON THE PROPOSED INSURANCE BILL

7. Following on from the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA), which came into force in April 2013 the Law Commission sought to review a number of additional elements of insurance contract law with a view to creating this Bill.

RGA HAVE BEEN ESPECIALLY INTERESTED IN THE FOLLOWING PARTS OF THE BILL.

(1) The duty of fair presentation

8. Essentially the Law Commission is looking to create proportional remedies for misrepresentation replacing the current single remedy of avoidance of the contract for a breach of duty on the part of the insured or their agent. The principle of putting the customer back in the position they would have been had they told the truth in the first place has been widely welcomed in the business to consumer world and the Law Commission aims to adopt these principles here thereby avoiding claims stage underwriting.

(2) Warranties

9. At present the effect of the law is that if a policy holder breaches a warranty, the insurer may refuse claims for any subsequent losses. This is true even if the breach was minor, had no relevance to either the risk or the loss, or had already been remedied before the loss took place. The Law Commission is seeking to prohibit the use of “Basis of Contract clauses” (which can turn minor representations into warranties); make warranties into suspensive conditions (i.e. restoring an insurers liability once a breach of warranty is remedied) and ensure that insurers can only avoid liability in cases where the breach relates to the losses caused by that type of risk.

(3) Insurers’ remedies for fraudulent claims

10. Current provision is for insurers to have a limited set of options in the event of a fraudulent claim, requiring cancellation of the policy and no liability for any legitimate claims occurring prior to the fraudulent act. This situation is unsatisfactory and there may well be cases where legitimate claims are being avoided as a result. The changes proposed seek to allow valid claims to be paid if they occurred before the fraud took place.

WHY IS IT IMPORTANT TO MAKE THESE CHANGES NOW?

11. The insurance industry trades on its reputation and the trust of the insured that the promises made will be fulfilled. In all three areas there is the possibility for real reputational damage occurring at the present time and case law is
littered with examples that the buying population would now consider to be ‘sharp practice’. The success of CIDRA is that it has kept the law up to date with current consumer expectation and failure to apply these reforms weakens the basis upon which the reviving reputation of the industry is founded.

WHAT IS THE RISK FOR THE INDUSTRY OF NOT DOING THESE THINGS?

12. Trust in the financial services industry is fragile due to banking scandals and PPI miss-selling and while the insurance industry has largely not created these issues its reputation has been badly damaged by association. The industry will face increasing reputational pressures in the future, and the flooding that has occurred through the winter of 2014 will add to this. Law reform will help to set the minimum acceptable standards and will eradicate clearly identifiable areas of poor industry practice.

13. At present the industry relies on companies interpreting best practice for themselves while keeping a watchful eye on the reputation of their own individual company. A significantly more satisfactory position is to have a clearly defined legal position which recognises the modern situation of many contracts and the information being supplied to form these contracts. The reforms being proposed will lead to consistent and enhanced customer outcomes which, we believe, is in the public and industry’s best interest.

Of particular note is

14. The option to avoid contracts for warranty breaches and for innocent non-disclosures or non-disclosures that are not relevant to the matter at hand and which in no way corresponds to the modern customers’ expectations.

15. This is a clearly unacceptable outcome from a modern industry.

CONCLUSIONS

16. RGA are supportive of the proposed Bill and believe it will significantly benefit the reputation of the industry.

17. RGA also note the following areas which were dropped from the Bill by the Law Commission:

(1) Insurable Interest
(2) Damages for late payment of claims

18. RGA feel strongly that both of these elements require close examination and we will endeavour to support the Law Commission in their efforts to reach consensus for reform in these areas.

November 2014

Memorandum submitted by RSA Insurance Group plc

1. RSA welcomes the opportunity to respond to the Committee’s call for evidence in relation to the Insurance Bill. As you may be aware, RSA, together with its direct brand MORE THAN, is a leading provider of home and car insurance. Headquartered in London, but with offices in 28 countries, RSA exports UK expertise to insure domestic and commercial policies and large-scale construction and infrastructure projects in over 140 countries. In the UK, RSA employs 7,000 people—part of a global workforce of 21,000.

2. RSA has responded (both directly and, where appropriate, via our trade association, the Association of British Insurers) to all previous Insurance Bill-related consultations issued by both the English and Scottish Law Commissions and HM Treasury and has had and continues to have a keen and direct interest in the progress, content and ultimate impact of the Insurance Bill.

3. In summary, RSA is supportive of the Insurance Bill overall, but laments the missed opportunity for comprehensive reform through the omission of the Law Commissions’ original clauses (Clauses 11 and 14), relating to breach of a policy term unrelated to a loss, and addressing late payment of a claim respectively. We outline our views further below.

GENERAL SUBMISSIONS ON THE INSURANCE BILL

4. RSA strongly supports the Insurance Bill and original recommendations of the Law Commissions.

5. RSA believes that the changes to the law relating to insurance that the Insurance Bill is designed to bring about are long overdue and that the relevant sections of the current Marine Insurance Act 1906, no longer reflect and are out of step with modern commercial insurance practice. In particular, they are not designed for and do not operate in a commercially rational way in cases:

(a) where a customer is a large organisation, often operating in many locations and countries. In many cases the majority of the employees and agents of a customer are not aware of the existence or terms of the insurance cover arranged by their employer, let alone what duties of disclosure they, or the organisation itself, may have in respect of those insurances; or

(b) where an insurer, with its risk assessment and monitoring systems and experience in insuring many risks and organisations of a similar type, scale and location to that of a given customer, may, in certain cases, have a level of knowledge equal to, if not greater than, that customer in respect of the risks to be insured.
6. The effect of the current legal position under the Marine Insurance Act is that, not only are customers risking being in breach of their duty of disclosure, insurers are also often either not being provided with the necessary information in order to properly assess and price the risks they are being asked to insure, or are being provided with information that is not relevant as part of that underwriting process.

7. Furthermore, in RSA’s experience, many in the commercial insurance market (be they customers, brokers or, indeed, insurers themselves) do not properly understand the operation of these sections of the Act and the disclosure-related legal duties and rights that flow from them. This lack of understanding has:
   (a) contributed to problems in the commercial insurance market in relation to what a customer and their insurer considers to constitute certainty of cover; and
   (b) often served to undermine the insurance industry’s own and ongoing push to promote itself and its products as an integral part of a prudent business’s risk management programme.

8. It is of no commercial benefit for either an insurer or their policyholders for there to be uncertainty as to whether a customer has or has not complied with their duty of disclosure. Such lack of certainty inevitably leads to inaccurate insurance pricing, increases in coverage disputes and a resultant deterioration of the commercial relationship between insurers and their policyholders.

9. Certainty of compliance leads to certainty of underwriting/pricing which leads to certainty of coverage—and both insurers and their customers have a vested interest in each of those steps.

10. We also consider that the current legal position in relation to insurance-related warranties, in particular ‘basis of contract’-type warranties, is anachronistic, potentially confusing (both within the insurance market and amongst policyholders) and does not reflect what RSA considers to be prudent commercial practice with respect to the commercial arrangements with our customers.

11. We believe that the current legal position whereby a breach of warranty, regardless of rectification, materiality or the absence of any prejudice suffered by an insurer, automatically discharges an insurer from all future liability under a policy, regardless of whether that breach relates to a particular loss or claim event, is overly harsh on policyholders and does not reflect what our commercial customers expect from RSA when they insure with us.

12. RSA believes that the Insurance Bill goes a long way toward addressing these significant deficiencies in the current legal position with respect to commercial insurance.

**Submissions relating to the removal of Clauses 11 and 14 from the Insurance Bill**

13. Notwithstanding RSA’s overall support of the Insurance Bill, we are concerned by the removal of Clauses 11 and 14, two clauses which were contained in the Law Commissions’ original draft of the Insurance Bill which was submitted to HM Treasury in June 2014. These two clauses relate to:
   (a) the effect of a breach of a policy term that is unrelated to a loss (Clause 11); and
   (b) the effect (and the rights of the policyholder) in the event of the late payment by an insurer of a valid insurance claim (Clause 14).

14. RSA believes that not only would the omission of these two clauses be likely to have an adverse effect on our commercial insurance customers here in the UK but will also reflect poorly on the UK insurance industry as a whole and could undermine trust in the sector.

15. In our view the Law Commissions’ proposals in respect of Clauses 11 and 14 are both fair and commercially reasonable. Indeed, they reflect RSA’s existing approach to assessing the validity of claims and ensuring timely payment, and we would like to ensure such good practice is replicated across the insurance industry.

16. RSA believes that the removal from the Insurance Bill of Clause 11 (terms not relevant to the actual loss) will have the effect of continuing to promote a commercially irrational legal position and one that is divorced from general contractual principles.

17. We have reviewed the revised draft of **Clause 11** prepared by the Law Commissions in early November 2014 and fully support the amendments that have been proposed. We believe that the Law Commissions’ revised draft of Clause 11:
   (a) supports the stated (and, we understand, agreed by all insurers) policy objective of ensuring that insurers should not be entitled to refuse liability for a loss which is of a completely different nature from that contemplated by the breached term; and
   (b) provides sufficient certainty and protection to both the insurer and the customer.

18. The removal from the Insurance Bill of **Clause 14** (addressing late payment of claims) is likely to have a particularly adverse impact on RSA’s small business customers, who are more likely to be negatively affected by any restrictions or delays in their cash flow.

19. We believe that an obligation should be placed on insurers to pay valid insurance claims within a reasonable time. We believe that this obligation:
   (a) is reasonable from a legal point of view (and brings the law relating to insurance into line with general contractual principles);
   (b) reflects good commercial practice in the modern insurance market; and
(c) is something that our customers would expect when making their decision to take out insurance with RSA.

20. We believe that, if reintroduced/enacted, Clause 14 will:

(a) strike an appropriate balance between, on the one hand, the obligation placed on insurers to pay a claim within a reasonable time and, on the other, recognising that what constitutes a “reasonable time” may, in many cases, be dependent on factors outside the control of insurers, as well as needing to take into account the complexity of the relevant claim; and

(b) provide insurers with an appropriate defence to a claim for breach of the implied term in cases where an insurer has reasonable grounds for disputing the validity and/or quantum of the customer’s claim.

21. We note that HM Treasury has indicated that if these two clauses are not reintroduced into the wording of the Insurance Bill (and, as a result, the wording of any subsequent Act) it may be able to be revisited and incorporated into such legislation at a later date. We appreciate that this is technically possible, however, given that this area of law was last amended over 100 years ago and it has taken over 30 years for the Law Commissions (and their predecessors) to get us to a point where progress on reform can finally be made, we question whether any such legislative revisiting is realistic. As a result, we are keen to ensure we do not miss the opportunity that currently presents itself to strengthen protection for UK insurance customers and reform this outdated law in its fullest sense.

22. RSA is grateful to the members of the Committee for providing us with the opportunity to give our views in relation to the proposed changes to this important area of law, changes which, if made properly, will be in the best interests of insurers and customers alike. RSA would welcome the opportunity to make oral representations to the Committee.

November 2014

Memorandum submitted by Willis Limited

1. I am writing to you in my capacity as General Counsel, UK to Willis Limited, the chief UK trading entity of Willis Group, to emphasise the importance to the ongoing competitiveness of the United Kingdom insurance industry of the draft Insurance Bill currently proposed by the English and Scottish Law Commissions and to respond to the call for evidence by the House of Lords Special Public Bill Committee on the Insurance Bill. Willis is very supportive of the provisions of the Bill and believe these provisions will enhance the insurance offering of the UK insurance and reinsurance market.

2. Willis Group is a leading global insurance broker headquartered in London, delivering insurance and reinsurance broking services to policyholders and insurers around the world, with offices in nearly 120 countries. We are also one of the largest brokers operating within the London insurance market. For these reasons, Willis is well-placed to comment from both international and domestic perspectives on the positive impact that the draft Bill, if enacted, would have on buyers and providers of insurance and reinsurance products and on the detriment to the wider UK insurance industry if this long-awaited opportunity to rebalance the current law is missed.

3. As found by the Law Commissions in their consultation on commercial insurance law, it is widely acknowledged that the existing legislation, contained in the Marine Insurance Act 1906, is stale and has not kept pace with the unprecedented change in the economic and technological environment in which commercial insurance and reinsurance is transacted. We believe that if the law is not updated, this may negatively impact the insurance industry within the UK by allowing international markets to compete on more favourable terms for business currently placed within the UK.

4. The world insurance market is no longer UK-centric: it is a global marketplace with established centres in the US, Bermuda, Singapore and Frankfurt and developing centres elsewhere. UK insurance law needs to support the commercial competitiveness of the UK insurance market including competitiveness as to the terms and conditions of coverage so that brokers can continue to recommend it to clients who have the ability to spend their premium in other markets. In Willis’ experience domestic and overseas buyers are increasingly aware of the harsher effects of the 1906 legislation as compared to more proportionate remedy regimes which obtain in most other key jurisdictions around the globe, including most of continental Europe. It is telling that even those key Commonwealth jurisdictions which themselves once adopted the 1906 legislation have moved towards amending legislation which affords greater balance between the interests of policyholder and insurer.

5. Amongst certain insurance and reinsurance buyers, their chief financial officers and boards the current law gives cause for concern about the extent to which their purchased coverage will in fact respond if it is later found that there has been a breach of disclosure obligations or contractual terms, even of a minor nature. This in turn gives rise to a lack of confidence that they have adequately managed their risks: a critical consideration for any business.

6. The Law Commissions’ proposals and draft Bill address several areas where the 1906 Act is outdated and no longer reflects a commercial balance:

6.1 Remedies The proposals establish a more proportionate range of remedies should the policyholder fail to provide accurate information. Currently, an insurer has only one draconian remedy: to avoid the policy and walk away from all claims in circumstances even where the non-disclosure was inadvertent and the insurer would have agreed to the contract, albeit on revised terms. These proposals are more in line with other jurisdictions, notably in continental Europe.
6.2 Disclosure The proposals bring much-needed clarity around what information a purchaser of insurance has to provide to the insurer, which of their staff is responsible for doing that and to whom they have to provide it. This is vital given the existing consequences of non-disclosure can often be disproportionate.

6.3 Warranties The Law Commissions also deal with the difficult topic of insurance warranties and other onerous terms in insurance contracts. The present law allows an insurer to be discharged from any liability where a policyholder has breached a warranty regardless of whether that breach, even minor, had any connection to the loss that occurred. One of the Law Commissions’ key proposals, which we support, is that cover should only be suspended if the warranty is not complied with but should restart as soon as compliance occurs.

7. One minor enhancement would clear much confusion and that would be to indicate in the Bill itself that the new provisions apply equally to business insurance and reinsurance. It is clear from the guidance notes that the intention is to include reinsurance but it would resolve any doubt by including an express provision in the Bill clarifying this point.

8. In summary, the draft Bill seeks to do no more than restore a balance to the commercial relationship between policyholder and insurer and rectifies current law which is unduly weighted in favour of the insurer/reinsurer: it does not seek to favour one party over the other. We are aware that the Law Commissions and H.M. Treasury have consulted very widely on their proposals and the draft legislation and we understand from those consultations that they are supported by policyholder representatives and significantly, by most insurers. It is also worthy of mention that even today UK insurers commonly agree to insurance and reinsurance contracts which are governed by laws of jurisdictions with proportionate and more balanced remedy regimes, perhaps in itself indicating an appetite to embrace a move towards more proportionate remedies.

9. In our view, a failure to seize the current opportunity to reform, given the consensus which exists, would be a significant opportunity missed and may lead to other jurisdictions and laws being favoured to the detriment of the insurance and legal markets in the UK.

10. Willis strongly supports the draft Bill for the reasons I have outlined above and on behalf of Willis I would ask that our views are taken into consideration as part of the evidence in connection with the draft Bill.

11. Should you have any queries or wish to discuss any aspect of the issues I have outlined above, please do not hesitate to contact me.

November 2014
10 am

The Chairman of Committees (Lord Sewel): Before the start of today’s proceedings, it might be helpful if I say a word or two about the procedure that we will follow. In nearly all respects, our proceedings will be identical to those of a Grand Committee. Any Member of the House may attend and speak. Members should stand when speaking and they may speak more than once to each amendment or Motion. I will ask the Committee to stand part each clause and schedule. The main difference from Grand Committee is that the Committee may vote on amendments or the questions that clauses stand part of the Bill. If, when I collect the voices, it is clear that there is no agreement, I will call a Division. Only Members of the Committee may vote. The clerk will call out each name in alphabetical order and Members should reply, “Content”, “Not Content” or “Abstain”. I will then announce the result and call the next amendment or Motion. Do any Members wish to declare any interests that they have not already declared?

Lord Davidson of Glen Clova (Lab): As I note that the Faculty of Advocates is given as a stakeholder, I should indicate that I am a member of the Faculty of Advocates.

Lord Lea of Crondall (Lab): Lord Chairman, could I just clarify one thing? If it seems clear to you that there is no agreement, you will call a Division. Only Members of the Committee may vote. The clerk will call out each name in alphabetical order and Members should reply, “Content”, “Not Content” or “Abstain”. I will then announce the result and call the next amendment or Motion. Do any Members wish to declare any interests that they have not already declared?

Lord Newby (LD): Lord Chairman, we had considerable discussion of Clause 4 in our oral evidence sessions. It defines what an insured knows and ought to know. It therefore sets boundaries for what the insured is required to disclose under Clause 3(4). There have been some questions about how it operates. The key point is that the policyholder should disclose both what it knows and what it ought reasonably to have been revealed by a reasonable search. Clause 4 therefore provides a comprehensive package of knowledge provisions, which have a cumulative effect.

Amendment 1 is very minor and is intended to make this point clearer—that is, that the entire clause operates as one. Of course, there are further details in Clause 4, such as guidance about what a reasonable search might entail and an exception for confidential information held by an outside agent. Amendment 2 inserts an “only” into Clause 4(2), to avoid any uncertainty about the effect of the clause, which exhaustively defines what an individual insured knows. I hope that the Committee will agree that these are sensible amendments and support their inclusion in the Bill.

Amendment 1 agreed.
Amendment 2 agreed.

Amendment 3
Moved by Lord Newby
3: Clause 4, page 2, line 41, at end insert—

“(3A) An insured is not by virtue of subsection (2) (b) or (3) (b) taken to know confidential information known to an individual if—

(a) the individual is, or is an employee of, the insured’s agent; and

(b) the information was acquired by the insured’s agent (or by an employee of that agent) through a business relationship with a person who is not connected with the contract of insurance.

(3B) For the purposes of subsection (3A) the persons connected with a contract of insurance are—

(a) the insured and any other persons for whom cover is provided by the contract, and

(b) if the contract re-insures risks covered by another contract, the persons who are (by virtue of this subsection) connected with that other contract.”

Lord Newby: My Lords, the current subsection (5) of Clause 4 covers a relatively minor, yet important, point. It balances the interest of the insurer in accessing all available information to inform its underwriting decision against the need for the broker to be able to keep confidential information that it has received through a completely unconnected client. The Government’s proposed amendments, which are technical rather than substantive, are designed to ensure that the words of the Bill implement the policy of the Government and the Law Commission on the discrete matter of confidential information held by the agent on behalf of a different client. The noble Baroness, Lady Noakes, has tabled a similar amendment. The government amendment goes slightly further, but both take into account representations made to the Committee, the Government and the Law Commission since the Bill was introduced.

This provision limits the extent to which the knowledge of the broker is imputed to the insured for the purposes of the duty of fair presentation. The exception is to apply when information acquired by an agent is confidential and has been acquired from other clients who have no connection with the insurance being raised. This exception should apply only to information which the insured itself does not know and which the broker knows and holds confidentially by virtue of a business relationship with a party that is unconnected with the policy for which the presentation is being made.

The Government’s amendments aim to make this clearer and to clarify who is taken to be connected with the contract of insurance. Amendment 3 refers to,

“the insured and any other persons for whom cover is provided by the contract”

of insurance. It also refers to parties connected with a related reinsurance contract. By specifically making provision for reinsured risks on the face of the Bill, this provision helps to make it clear that the Bill generally applies to reinsurance, without leading to the problems in defining insurance or explicitly applying the Bill to reinsurance. The amendments also take the opportunity to clarify the meaning of “employee” in this context, as the courts have interpreted it more narrowly in recent cases than is intended here. I hope that I have sufficiently explained why these amendments are necessary and I urge the Committee to accept them.

It is clear that my noble friend’s Amendments 8 and 9 share the same aim as the government amendments, which is to make it clear that a broker cannot withhold information that is acquired through their relationship with a party who is covered by the insurance contract. However, the government amendments are consistent with those tabled by the noble Baroness and go even further to reflect a concern raised with the Law Commission since the Bill was introduced. There is therefore no need for Amendments 8 and 9 and I urge the noble Baroness to withdraw them.

Baroness Noakes (Con): My Lords, as the noble Lord, Lord Newby, said, I have Amendments 8 and 9 in this group, which he has asked me to withdraw. Of course, I have not moved them and, for the avoidance of doubt, I say at the outset that I have no intention of moving them when we reach them in their place on the Marshalled List. I am content that the Government’s amendments cover the narrow point that I was trying to make and, indeed, go further in relation to reinsurance, a point that I welcome, although it was not an issue that I had thought to cover in my amendments.

I have just one query for the Minister. Amendment 10 defines an employee in relation to the insured’s agent as including,

“any individual working for the agent, whatever the capacity in which the individual acts”.

Could he explain what that is to cover? For example, if a professional adviser is working for an agent, does this deem that individual to be an employee and therefore for the knowledge of the professional adviser to flow through and, in effect, to be treated as that of the agent? It seemed to me that this widening of “employee” carried with it some dangers, so I would be grateful for the Minister’s observations.

Lord Newby: My Lords, I am grateful to the noble Baroness for her intervention. At first blush, it seems to me that the definition would not cover an external adviser, because they would not fall under the definition of “employee”. The purpose of
the amendment is simply to make it clear that the definition is all-encompassing within the normal definition of the word “employee”. If I have got that wrong, I will of course write to the noble Baroness.

Amendment 3 agreed.

Amendment 4

Moved by Baroness Noakes

4: Clause 4, page 3, line 1, after “insured” insert “and to any person who may benefit from the contract of insurance”

Baroness Noakes: My Lords, I rise to move Amendment 4 and will speak to Amendment 5 in this group. The amendments concern subsection (4) of Clause 4, which deals with reasonable search. I should state at the outset that I support the concept of a reasonable search to determine the information that an insured ought to know for the purposes of the duty of fair presentation in Clause 3. The concerns that I raise by means of my two amendments in this group are about the scope of the subsection.

Amendment 4 would extend the reasonable search requirements to information available to a person who may benefit from the contract of insurance. The result of my amendment is intended to be that the insured ought to know things that would reasonably be revealed by a reasonable search of information available to the persons who can benefit from the contract of insurance. Therefore, where subsidiary companies are included within a policy arranged by a holding company, in the context of a reasonable search the holding company should include information available to those subsidiaries.

I acknowledge that the language that I have used in the amendments of persons who benefit from the insurance contract is out of line with the language of the previous group of amendments, which refers to, “persons for whom cover is provided by the contract”,

but I think that we are basically on the same page in relation to the people whom we are trying to get at. For that reason alone, I regard my amendment as probing for the purposes of the Committee. If the thrust of the amendment receives approval, I hope that it can be dealt with, with better wording, at Report.

My second amendment in the group, Amendment 5, was always intended to be a probing amendment. The amendment deletes the words in parenthesis at the end of subsection (4) about information held by the insured,

“whether within its own organisation or held by others, for example its agent, and whether the search is conducted by making enquiries or by any other means”.

By deleting these words, I am trying to probe whether the language that is used in the subsection is sufficiently precise to be helpful to those who will have to implement it. It will need to be interpreted by those taking out or writing insurance policies and I believe that we have a duty to be as precise as possible.

The Lloyd’s Market Association and the International Underwriting Association, which provided the Committee with much useful evidence, said in their written evidence to us that the reasonable search test in subsection (4) of Clause 4 is,

“drafted in broad and vague terms which are apt to lead to disputes”.

When the LMA gave oral evidence to us, we discussed the extent to which this new provision would result in disputes and the extent to which those disputes would be costly. We clearly cannot settle that conclusively in advance—it is going to be a matter of opinion rather than fact—but I believe that we should ensure that, as far as possible, the Bill avoids the scope for disputes arising.

There are several aspects to subsection (4) to which I draw attention. First, there is the reference to the insured’s “own organisation”. What does that mean? In the context of a group of companies, does it mean the holding company or does it extend to subsidiary companies? What about associates or other companies in which there is not a controlling interest? If insurance is arranged for a group by a company within a group that is not itself the holding company, how do we determine “own organisation” in relation to that company?

10.15 am

Secondly, there is the reference to “others”, who are referred to as holding relevant information. Where do these “others” begin and end? The subsection says that this includes agent; it says, “for example its agent”. Does this mean that all the others need to be in some senses like agents in their relationship to the insured? Does “others” include all subsidiary companies or fellow subsidiary companies even if they are not covered by the insurance?

Thirdly, we are told that the search can be,

“conducted by making enquiries or by any other means”.

My question to the Government is: what does “any other means” actually mean? The only “other means” that I could think of were mind-reading or the divining techniques used by ancient religions, but I do not think that either of those is intended. I consulted the Explanatory Notes for help on this but was not surprised to find that I did not
get much help. The Law Commission has written quite a bit on the concept of reasonable search, but I was rather more surprised that I could not find anything in its papers that helped to identify what these words are all about. That is why I have tabled my probing amendment. I beg to move.

Lord Woolf (CB): My Lords, perhaps it would be helpful if I spoke to my amendment at this point. My Amendment 6 is meant to help to clarify this point and perhaps meet, to some extent at any rate, the problems that the noble Baroness, Lady Noakes, has properly identified. The amendment seeks to provide a test that is of some value and some clarity. It focuses on any “person who may benefit”. Those are the people to whom you need to go for this specific purpose. The amendment would insert the words, “from whom the insured could reasonably be expected to obtain the relevant information for the purpose of complying with its duty of fair presentation, for example its agent or a person who may benefit from the insurance contract”.

I hope that the Minister and the noble Baroness, Lady Noakes, would both regard that as producing some clarity where it could be useful.

Lord Newby: My Lords, Clause 4(4) provides that the insured “ought to know” that which would have been revealed by a reasonable search of information available to it. This has occupied much of our attention in the past couple of weeks.

Before introduction, the Law Commission worked with stakeholders to reflect their key concerns in the drafting as far as possible. For example, there is explicit recognition that some relevant information may be held by people or organisations outside the insured itself. The example of agents is given to illustrate this. However, this could equally encompass individuals or entities who are covered by the insurance but are not “the insured” in the sense of being the contracting party. There is also explicit acknowledgement that conducting an appropriate search may include making inquiries of people.

The noble and learned Lord, Lord Woolf, and the noble Baroness, Lady Noakes, have both tabled amendments to Clause 4(4) in order to refer specifically to persons covered by the insurance contract or who could benefit from the contract. The noble Baroness’s amendments go further, deleting other elements of detail. I am grateful to the noble and learned Lord and the noble Baroness for tabling these amendments and for encouraging the discussion and to the Law Commission for looking at these provisions again. The evidence that we have heard suggests there may be a benefit, in order to make the meaning of this subsection clear, in mentioning the so-called covered persons explicitly. However, any such amendment should be carefully considered in light of the attention that has gone into producing the existing draft of Clause 4(4). The noble Baroness, Lady Noakes, pointed out that, as currently drafted, the clause leaves open some areas of potential interpretation.

My only comment, as a layman, is that legislation can only go so far in these things. People in the insurance world have to apply a bit of common sense to the legislation as, I am sure, the courts would if relevant cases were brought.

The noble Baroness asked what “any other means” might be. “Others” may mean a range of people outside the organisation: agents, suppliers and other parties covered by the insurance. “Any other means” includes, for example, searches of written records and information, as well as inquiries.

The amendments have pointed up a number of areas where the drafting could be improved. Based on what we have heard today, and in previous sessions, the Government will now carefully consider whether the Bill should include further examples. I can, therefore, assure the noble Baroness and the noble and learned Lord that we will take this away with a view to bringing forward, on Report, an amendment that meets their concerns. With that assurance, I urge the noble Baroness and the noble and learned Lord not to press their amendments at this stage.

Baroness Noakes: My Lords, I am grateful for what the Minister has said. We look forward to seeing that revised amendment and to any discussions on it that he thinks might be useful in advance of Report. I beg leave to withdraw.

Amendment 4 withdrawn.
Amendment 5 not moved.

Lord Woolf: My Lords, I will not move Amendment 6, which I have been helped in producing, but I suggest that it introduces a degree of certainty, because whether or not a person benefits can be objectively established. I am grateful to the Minister for taking it away, but will he remember that specific point when he does so?

Amendment 6 not moved.

The Chairman of Committees: I have to point out that if Amendment 7 is agreed to I cannot call Amendments 8 and 9, by reason of pre-emption.

Amendment 7
Moved by Lord Newby
7: Clause 4, page 3, line 4, leave out subsection (5)
Amendment 7 agreed.

Amendment 10
Moved by Lord Newby
10: Clause 4, page 3, leave out line 8 and insert—
“(6) For the purposes of this section—

15 December 2014 Committee Stage
Amendment 10 agreed.

Amendment 11
Moved by Baroness Noakes
11: Clause 4, page 3, line 14, leave out paragraph (b) and insert—
“(b) “senior management”, in relation to an organisation, means the persons who play significant roles in—

(i) the making of decisions about how the whole or a substantial part of its activities are to be managed or organised, or

(ii) the actual managing or organising of the whole or a substantial part of those activities.”

Baroness Noakes: My Lords, I rise to move Amendment 11. I will also speak to Amendment 12 in this group. These concern the definition of who is intended to be covered by the term “senior management” for the purposes of Clause 4. This is important because the knowledge of senior management is imputed to a corporate insured person and we need to be clear which people we are talking about. We had a number of discussions about this when the Committee took evidence, notably when we heard from the Law Commission, the Lloyd’s Market Association and the Association of British Insurers.

When I first read the Bill, I thought that the wording in paragraph (b) of Clause 4(6) was about right. It defines “senior management” as,

“those individuals who play significant roles in the making of decisions about how the insured’s activities are to be managed or organised”.

However, as discussed earlier, I then read the Explanatory Notes, which say that this is,

“intended to include (and be more or less limited to) board members”,
or their non-corporate equivalents. I then had serious concerns and thought that intending to confine the wording to the board of directors was just wrong in today’s world of boards and complex groups of companies. It is just not correct that boards of directors are equivalent to “senior management” in large corporates in the terms in which they are described in subsection (6).

Boards of large companies come in all shapes and sizes. It is normal in listed companies for a majority of the directors to be independent non-executive directors. It is increasingly the case that only two or three executive directors sit on the board. You do not expect to find most of the people who are running the company on the board of directors. Executive functions are delegated to the chief executive and executive teams. In practice, these people make most of the decisions about how a business is managed and organised. They do so within the context of a scheme of delegations and matters that are formally reserved to the board for decision-making. In my experience, insurance is rarely such a matter. It is delegated. The board is ultimately responsible for what happens in a company, but it does not make many of the decisions.

My amendments tackle this issue in two ways. Amendment 11 deletes the current definition in paragraph (b) and replaces it with the definition of senior management that is found in the Corporate Manslaughter and Corporate Homicide Act 2007. It is wider wording than in the existing paragraph (b), as it covers those who play a significant role in managing a significant part of an organisation and therefore clearly applies below board level. Amendment 12 merely makes it clear that the term “senior management” includes the board of directors. Its intention is to make it clear that “senior management” is definitely broader than the board of directors. In its letter of 5 December, the Law Commission said that it believed that using the 2007 Act definition would create uncertainty. It seems to me that we do not avoid uncertainty by legislating in 2007 to call senior management one thing and then trying to make it mean something else in 2014.

The Minister told us, during an earlier Committee session, that the Government intend to change the Explanatory Notes; the Law Commission’s letter of 5 December says that it will work with Her Majesty’s Treasury to that effect. My concern is that the Law Commission has an unduly narrow concept of what it intends by “senior management”, as is evident from its report of July 2014 and subsequent exchanges with the Committee. I believe that the term should be interpreted broadly so that the practical realities of those who are senior managers within an organisation are captured. I fear that the Treasury and the Law Commission, working together, will produce a new version of the Explanatory Notes that will remain narrow in context. I am not at all sure that just rewriting the Explanatory Notes will be satisfactory.

Since I tabled my amendment last week, the Committee has received a further submission from the Lloyd’s Market Association and the International Underwriting Association. This includes an alternative formulation of “senior management”, which is close to that in Amendment 11 but helpfully limits the term to those concerned with “relevant activities” of the insured—those relevant to the insurance contract. Incorporating
that concept is useful in getting an understanding of the people who need to be captured within “senior management”. For that reason, and because I have tabled Amendments 11 and 12 as alternatives in order to have a debate in Committee, I regard these as probing amendments for today. I beg to move.

10.30 am

Lord McNally (LD): My Lords, I support the noble Baroness, Lady Noakes, in these amendments. There is a clear indication of unhappiness, both in her eloquent explanation and in the Committee’s earlier discussions. A guideline for the future might be, “Don’t put two different definitions in the Bill and the Explanatory Notes”. Given that this concern has been raised, and the clear view of any layman that a board of directors is far too restrictive a definition, I hope that the Minister’s response to these amendments will be conciliatory.

Lord Newby: My Lords, I am grateful to my noble friend Lady Noakes for tabling this amendment. It has drawn our attention again to the issue of the statement in the Explanatory Notes, which requires attention and amendment. However, I am concerned by the amendment, as it will unhelpfully broaden the meaning of “senior management” to the detriment of large, corporate policyholders, for whom Clause 4 provides much needed certainty about what is required for a fair presentation.

Before discussing the amendment, it is important to reiterate where Clause 4 (6)(b) fits into duty of fair presentation. As a whole, Clause 4 defines what an insured knows, or ought to know, for the purpose of fair presentation. It provides a package of rules about knowledge which need to be considered jointly. What an insured knows, for these purposes, is that which is known by individuals in the insured’s senior management and information known by individuals responsible for the insured’s insurance. Everything known by the senior management is, therefore, directly attributed to the insured. If someone in the senior management conceals something and it is not disclosed, then the duty of fair presentation will be breached.

Because knowledge is being directly imputed to the insured, “senior management” is intended to be a relatively narrow concept. The individuals whose knowledge is directly imputed are: first, those people who are so aligned with the insured that they can properly be said to be its directing mind and will; and, secondly, those who are responsible for the particular matter at hand, which is arranging the insurance. This is framed to reflect important decisions on the common law rules of attribution in the insurance context, which have limited attributed knowledge in this way. There are likely to be people, including employees and agents at all levels, who have highly relevant information. Examples are strategic or regulatory compliance officers or regional managers of significant parts of the entity. Much of their knowledge will be relevant but although they may know, in extreme detail, the day-to-day happenings of the insurance business, it may not always be appropriate for that level of detail to be attributed directly to the insured. The knowledge of such people should, generally, be caught by the reasonable search requirement. For them, the question is more flexible: should it reasonably have been revealed by reasonable search? The new definition proposed in my noble friend’s amendment includes individuals who play a significant role in the making of decisions about how the whole, or a substantial part, of the insured’s activities are organised, or in the actual managing or organising of such matters. Policyholder groups and brokers have told us that insureds need to be able to know how knowledge will be attributed to them.

My concern is that widening the definition of senior management would introduce considerable uncertainty. In a large multinational, there may be very many people managing parts of the business who could not be described as the directing mind and will. This broadening could have the effect of frustrating the aim of the provision. The Law Commission considered and consulted on the definition in these terms and rejected it as too broad. The Government have, however, already conceded that the Explanatory Notes are unhelpful in their assertion that senior management is limited to the board of directors or equivalent.

However, most of those who gave evidence, including the ABI, Lord Mance, Lord Justice Longmore and AIRMIC, accepted that the definition in the legislation itself is appropriately scoped. I found particularly helpful the evidence given by AIRMIC, whose representative described what actually happens in practice and how the proposed definition is relevant to that. It is flexible and able to accommodate the many ways in which an insured may be structured. It is unnecessary to make specific reference to the board of the company in the Bill, as the noble Baroness has suggested. This could, in fact, have a limiting effect on the interpretation of the term, which would be contrary to the result looked for.

The Government propose to amend the Explanatory Notes to clarify this point. I would be very happy to show the redraft to Members of the Committee to ensure that it meets what they, and the Law Commission, are seeking to achieve. With that assurance, I hope that the noble Baroness will feel able to withdraw the amendment.
Baroness Noakes: My Lords, I am grateful for the support of my noble friend Lord McNally. Because of the nature of the discussions that occurred during the taking of evidence, I am disappointed that the Minister does not think it appropriate to amend the Bill. Unfortunately, I was not present when AIRMIC gave evidence and I have not had an opportunity to read the transcript of it. I am not clear whether that would have changed my view. I am grateful for the offer of seeing the revised Explanatory Notes, but I am left with the slightly uncomfortable feeling that the intention is to target a narrow group of people. This might well have been in keeping with the concept of directing mind and will, as developed in the Victorian era, but it is not in line with what today’s corporate world is about. As I stated at the outset, I thought that the wording of the Bill looked appropriate until I heard an explanation of what it was intended to cover and saw the Explanatory Notes. Given this confusion, we have to have some way of getting clarity about what we mean. I am not sure that we have followed this discussion through to a conclusion, but I am happy to look at revised wording for the Explanatory Notes and consider, in the light of that, what I might do with this amendment or a similar one on Report. As I indicated, I regard these as probing amendments and I beg leave to withdraw.

Amendment 11 withdrawn.
Amendment 12 not moved.
Clause 4, as amended, agreed.
Clauses 5 to 10 agreed.

Amendment 13
Moved by Lord Woolf
13: After Clause 10, insert the following new Clause—

“Terms not relevant to the actual loss

(1) This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it 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,
(c) loss at a particular time.

(2) If a loss occurs, and the insured has breached a term to which this section applies, the insurer may not rely on the breach to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3)

(3) The insured satisfies this subsection if it shows that its breach of the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

(4) This section may apply in addition to section 10.”

Lord Woolf: This amendment is, I suggest, important and I look forward with hope and anticipation to what the Minister has to say about it. The history is that the Law Commission was intending to have exactly the same wording in the Bill. I do not know why it was dropped, but it was and I am sure it was thought there was a good reason for doing so at the time.

The Committee heard evidence from two distinguished judges who have substantial experience in this type of issue. They thought that it was a mistake to drop it and that the Bill would be better if it was returned. I am bound to say that, without having the same distinction as the two judges to whom I have just referred, at least in this field, mere common sense makes it clear how important the proposed amendment is. It is important that, after the time that has elapsed since the previous Insurance Act was passed in 1906, we remedy what can be a very unfortunate approach that can lead to severe injustice.

Lord Mance told us about his experience when he looked at the policy of insurance for his home. He was worried about it, because he could see that there could be situations in which, if your burglar alarm was not working, you could lose cover even though you wanted to claim for was in respect of flood damage—one does not have any connection with the other. That is just one example. I am bound to say that, even with regard to my insurance, I was concerned about a provision in relation to a burglar alarm and one can think of many other examples. In his evidence, Lord Justice Longmore, with his experience, was strongly in favour of the clause that had been omitted. I will not take up time repeating his evidence; you just need to read it to see the importance that he attaches to the issue. I hope that what I have said is sufficient and that we get to a situation where clauses that have no relevance to a possible claim have no impact on that claim.

Lord Newby: My Lords, I am grateful to the noble and learned Lord, Lord Woolf, for tabling this amendment. It relates to a matter that has received attention, both positive and negative, from stakeholders since the Bill was introduced, as is evident in the various submissions made to the Committee.

As noble Lords will be aware, the original Clause 11 was omitted from the Bill before introduction. Although the Government were sympathetic to the aims of the clause, the submissions put to the Government in July suggested that, as drafted, it was too controversial to go through the special procedure for uncontroversial Law Commission Bills. The original clause intentionally preserved significant flexibility and significant scope for interpretation by the courts. Some stakeholders
objected strongly to the uncertainty that would result.

It is, however, difficult to argue against the policy and to say that insurers should be entitled to refuse liability for a loss that is of a completely different nature from that contemplated by the breached term. To that extent, the Government committed to revisiting the matter at the next legislative opportunity and asked the Law Commission to explore alternative drafts which would deliver the same policy but which would gain a consensus of support.

The amendment before us now is the Law Commission’s new draft, which is intended to minimise the uncertainty inherent in the first formulation. Some of the written and oral evidence put to the Committee over the last two weeks has addressed the matter directly and it seems apparent that there is a greater body of support for this new formulation. I personally feel that the weight of positive evidence that the Committee heard is sufficient to conclude that the clause is no longer controversial.

I have sympathy with those calling for this clause to be added to the Bill, but in the time available I have not had the opportunity to seek formal support for the clause across government. However, I think that there is a robust case for doing so and I will make that case to my colleagues in the Treasury with a view to considering introducing a government amendment at Report, if appropriate. I hope that these assurances are comfort enough that the noble and learned Lord will withdraw his amendment today. It may be for the benefit of the Committee for me to say that, although I cannot give a firm date, Report stage will be very soon in the new year, as we need to get the Bill through.

**Lord Woolf:** I am grateful to the Minister. In view of what he said, I will certainly not press the amendment. I wish the Minister well in his advocacy before his colleagues. I am sure that he will be as persuasive to them as he is to us, so that we can expect a positive response. He explained why the original Clause 11 was not adopted, which clarified my understanding—in fact, I should have appreciated that it was because of the amended Clause 11 that I said what I did. I do not propose to press the amendment.

**Amendment 13 withdrawn.**

**Clause 11 agreed.**

10.45 am

**Clause 12: Remedies for fraudulent claims: group insurance**

**Amendment 14:** Clause 12, page 6, line 28, leave out paragraph (c)

**Baroness Noakes:** My Lords, I rise to move Amendment 14. I shall also speak to the companion amendment, Amendment 15. Clause 11 deals with remedies for fraudulent claims and Clause 12 deals with how those remedies will apply for group insurance contracts. In essence, this allows the remedies to apply to the fraudulent element within the group contract but not otherwise. This seems sensible and fair. The problem is that Clause 12 restricts itself to policies that would have been consumer insurance contracts if they had been entered into by an individual within the covered group. My Amendments 14 and 15 are designed to remove this restriction so that any group insurance contract can be dealt with in this way.

We received evidence from a number of sources, including the Association of British Insurers, the British Insurance Law Association and Lloyd’s Market Association, that there was no basis for restricting the operation of Clause 12 in this way, so my amendments pose the question to the Government: why? I beg to move.

**Lord Newby:** My Lords, these amendments respond to representations made to the Committee that the application of Clause 12 on fraudulent claims in consumer group insurance should be extended to group insurance contracts in the non-consumer context. I am grateful to the noble Baroness for bringing this matter to the Committee’s attention today.

The Law Commission did not recommend this course initially because it was not advised that there was a need to do so in the non-consumer context and it did not wish to go further than was necessary in order to address the problems identified. However, we have now heard representations to the contrary. I can see that there is force in these arguments and, as I say, I am grateful to the noble Baroness for bringing this matter to our attention.

Any change needs careful consideration before it can be accepted, in terms of how it would operate in the many different types of contracts that arise in the non-consumer context—indeed, contracts that cover both consumers and non-consumers as group members under the same policy. In addition, further consequential amendments may be required to Clause 12 itself, certainly to the contracting-out provisions, in order to make provision for group insurance contracts in the non-consumer context. I therefore urge the noble Baroness to withdraw her amendment at this stage, with the assurance that I plan to bring forward an amendment that seeks to meet her concerns at Report.

**Baroness Noakes:** My Lords, I can ask for nothing more. Other than a complete acceptance
of my amendments, this is a good second best. On that basis, I beg leave to withdraw the amendment. Amendment 14 withdrawn. Amendment 15 not moved. Clause 12 agreed.

Amendment 16
Moved by Lord Lea of Crondall
16: After Clause 12, insert the following new Clause—
“Power to make regulations about late payment of claims

(1) The Secretary of State may, by regulations made by statutory instrument, provide that 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 the time specified in those regulations.

(2) Regulations under subsection (1) must specify that, if the insurer shows that there were reasonable grounds for disputing the claim (whether as to the amount of any sum payable, or as to whether anything at all is payable)—

(a) the insurer does not breach the implied term merely by failing to pay the claim (or the affected part of it) while the dispute is continuing, but

(b) the conduct of the insurer in handling the claim may be a relevant factor in deciding whether that term was breached and, if so, when.

(3) Regulations under subsection (1) must specify the remedies available for breach of the implied term which are to be in addition to and distinct from—

(a) any right to enforce payment of the sums due, and

(b) any right to interest on those sums (whether under the contract, under another enactment, at the court’s discretion or otherwise).

(4) Regulations under this section may—

(a) make different provision for different purposes or cases;

(b) make different provision for different areas;

(c) make provision generally or for specific cases;

(d) make provision subject to exceptions;

(e) make incidental, supplementary, consequential, transitional or transitory provision or savings.

(5) A statutory instrument containing regulations under subsection (1) may not be made unless a draft of the instrument has been laid before, and approved by a resolution of, each House of Parliament.”

The Chairman of Committees: It might be of help to the Committee if I point out that Amendments 16 and 18 raise an issue in that, although Amendment 16 does not pre-empt Amendment 18, they are incompatible, so it may be prudent for the Committee to decide not to support both amendments.

Lord Lea of Crondall: My Lords, in moving Amendment 16 I first put on record how much I have appreciated the work of the past couple of weeks, which has been quite intensive in some ways, on this special procedure. I have also found it an eye-opener to have what I might call the rather surreal experience that the Committee has had in dealing with this question of late payments. I would like to elaborate for a moment on why I say that. The procedure has been that we heard evidence jointly from the Treasury, in the shape of the Minister, and the Law Commission. The Law Commission had produced its weighty tome and devoted no less than 50 pages, with clear and positive conclusions, to this question of late payments. It is a chapter that has somehow, to use the current vernacular, been redacted. It is no longer there—at least, it is, but you cannot see it now, as it were.

The conclusion of the Law Commission was strongly to advocate what had been draft Clause 14—after all, it was its work. However, it has now been put in what I would have thought was the somewhat invidious position of being asked to give evidence along with a Minister who is pronouncing something with the opposite intent from that of the Law Commission on this question. The Law Commission has agreed, no doubt through gritted teeth, because of the argument about what constitutes a consensus.

I now turn to that point. There is a common Oxford dictionary sense of what a consensus is. If it is not 100% then an overwhelming majority would be thought to be a consensus, from all my experiences. The question is therefore: “Do we not just take a common-sense view about what a consensus is?” Let us say that it was 80% or 85% of the insurance industry, or whatever; I will mention some figures to the Committee in a moment. Or is the conclusion, as I believe to be the case—the evidence points to this being the case, as the Minister keeps pointing only in one direction—that Her Majesty’s Government are content to allow the Lloyd’s market traders tail to wag the whole of the insurance sector dog, if I may put it that way, so that it is Lloyd’s that has to make the law?

I take it that we are here as a Committee to review the evidence that we have heard. That is our job, so I would like to put it on record, and I trust that colleagues will find it a fair summary, by quoting from each piece of evidence. I begin with the Law Commission itself. On 2 December in evidence session 1, Mr Hertzell referred to what is stated on page 265 of the report, which says that:

“87% of respondents … agreed that insurers should be under a contractual obligation to pay claims within a reasonable time”,
and that,

“81% … agreed that a failure to meet this obligation should trigger a liability to pay damages for any foreseeable loss which results”.

As I say, in any other area of public policy those figures would normally constitute a consensus, so why does there not seem to be one? How is the Minister able to say in terms, “There is no consensus”?

First, it is because the Treasury can, within the procedure, apparently determine what is controversial. Does the Minister think that that is a fair representation? If the Treasury says that it is controversial, it is—and that means that it cannot be allowed in the Bill. At least, it would kill the Bill. In making that statement, one is inexorably reminded of Humpty Dumpty in Through the Looking-Glass. Needless to say, I am not referring to Humpty Dumpty in any respect in regard to the physiognomy of the Minister. However, Humpty Dumpty remarked:

“When I use a word … it means just what I choose it to mean — neither more nor less”.

I will now cite evidence from the sectors—three of them in turn, in fact. In the oral evidence given on this question on 2 December, Mr Hertzell from the Law Commission quoted on page 6 a publication called Commercial Risk Europe. It published the following quote from what Mr Hertzell said was,

“a risk manager of a global company operating in 28 countries and employing 9,000 people. He said of insurance generally, bearing in mind that his purchasing programmes are all around the world: ‘I agree that most claims are paid on time. The London market is a different story. Claims can be harder to deal with in London as you come up against 20 lawyers … The system is not working and a lot of European companies will not go to London any more because if there is a claim you are in deep trouble’”.

Mr Hertzell added, and this was not redacted:

“That is very disturbing to read. It may be just one person’s view, but it would be dangerous if that became common currency”.

I dwell on this question of consensus and how one defines it because it seems that the Minister needs to respond in terms to whether he thinks it sensible to allow lawyers to wag the whole of the insurance market dog.

One of my colleagues on the Committee asked me the other day, “How do we define ‘controversial’?” I said that it would appear to be a term of art, but that cuts several ways round. The view from around the world can only be that the standards set in London would only be enhanced if we moved in the direction of this amendment. In effect, it simply goes back to the original proposed Clause 14—although done through a statutory instrument procedure, which I will come to finally in a second.

11 am

There seemed to be a degree of special pleading, on the edge of the preposterous, in the way in which Lloyd’s approached this matter. Let me demonstrate this by a couple of other pieces of evidence. On page 21 of evidence session 2, on 3 December, we have the following statement by Mrs Philippa Handside of the Association of British Insurers. She said that:

“No member of the ABI came out against this clause”—that is, the old Clause 14. She referred to her own members, regarding a clause on late payment, as being “very supportive of it” and that they,

“point out that for their SME customers, a claim being paid within a few months can be the difference between survival and failure. I represent members who are very strongly in favour of the introduction of a clause along these lines. Others are more agnostic … but no one has set their teeth against it”.

It happens to be the case that, as we speak, a Bill is going through this House in regard to SMEs which would make late payment a major subject of legislation for the SME sector. That would of course not work here on its own, because it is fair to say that this is a wide-ranging sector with some vast multinational corporations.

In session 3 on 9 December, Mr John Hurrell from the Association of Insurance and Risk Managers in Industry and Commerce said:

“Most of the insurers that our members use operate throughout the whole of the rest of the world, where the insurance payment is regarded as a contractual payment, against which failure to honour the contract could lead to a claim for damages. I do not believe that has brought the sky in anywhere else in the world. Insurers operate very satisfactorily in jurisdictions where damages could be charged for failure to observe the contract”.

On page 21 of the same day’s evidence, Mr Graham Terrell of the British Insurance Brokers’ Association referred to,

“a survey of some 410 companies in the UK with an annual turnover in excess of £50 million”.

He said that 40% of those,

“said that they had made strategically significant claims … Of those claims, 45%—nearly half—had been disputed by the insurers and those claims had
taken an average of 35 months, or nearly three years, for resolution. In those circumstances, where you have a major claim, inevitably”,

whatever,

“the size of the company, that … cash flow must impact on your bottom line … As a result … they may lose a contract or go out of business”. He added that he recognised that late payment can only be deemed to commence once the claim has been settled, but that that is an indication of the seriousness of this question and why across many areas of industry and commerce, at present, late payment has become such an emotive question.

In answer to a question from the noble Lord, Lord Carrington of Fulham, Mr Terrell added that,

“although in an ideal world we would like to see it back in the Bill, so long as it remains a live issue for discussion we would be perfectly prepared to see it dealt with by way of a further statutory instrument at a later date”. At that I, for one, pricked my ears up. This was one of the factors that led me to discuss with my colleagues how to think through how our statutory instrument procedure could be an area for creative consideration—beginning, as it would need to, with an enabling clause in the Bill, such as this amendment, and then by having consideration in consultation with the industry about application in due course. This is in stark contrast to what we seem to have on offer from the Government at present. If I am not wrong, we are here to weigh the evidence.

I need to turn, as the Committee may be glad to know, to the question of the timetable by which this could be implemented. Primary legislation would not be for this Government: with four months to go before we finish for the general election, it is not for them to say “We will do this, that or the other” in primary legislation. It is a statement of the obvious that, in terms of primary legislation in a new Parliament, there would be bigger issues in the total national scheme of things as viewed by those writing the Queen’s Speech. As we all know from the Joint Committee on Statutory Instruments, which many of us have served on, to consider an instrument arising from the proposed new clause that I have now tabled, after consultation, is very much simpler and more credible. I mean “credible” also in terms of getting a legislative slot.

It follows that I have tabled an amendment that was provoked and stimulated by the amendment in the name of the noble Baroness, Lady Noakes. If I may pay tribute to her, it is stimulated also by reflection on the fact that her amendment would be deemed controversial, as I am sure the Minister will say. It would go very much further across the line than would mine, which arises from consideration of that very problem. I therefore hope that the Minister will recall, that in relation to something that I said on 2 December, he said on page 22 of the evidence that,

“the Government think that there should be movement in this area and are committed to looking for another vehicle to bring forward a proposal for it. We have a problem with this vehicle”—

that is, the original Clause 14—

“for doing it, given the lack of consensus”. Is he open to other ways forward and would that include this approach of using a statutory instrument?

Finally, I thank the noble and learned Lord, Lord Woolf, for whom we all have the greatest respect, for his chairmanship of the Special Public Bill Committee and for his Amendment 17 today, which I trust he will agree is compatible with mine. As this is the season of good will, I am sure that it would be better if we found some sort of answer today. As the position stands, if there is no movement I will hope to test the feelings of the Committee. To leave it until Report on the Floor of the House would restrict our room for manoeuvre, so I will listen with great care to what the Minister has to say, as will my colleagues. It is in that spirit that I beg to move Amendment 16.

Lord Woolf: My Lords, I think that because of the order of the amendments, I should go next. I immediately take the point by saying that I find that my suggestion is compatible with the other proposals, although it is meant to alleviate the problem if nothing is done in this area. I suggest that that would be desirable. At the moment interest rates are very low, as we know, but if we go back to the times that we saw not so long ago, then interest could become extremely important. That is especially the case while you are out of funds. You may then have to borrow from an appropriate source the funds that you need. There have been movements to extend, through specifically statutory interventions, the position with regard to interest. However, that is generally left to the Law Reform (Miscellaneous Provisions) Act, which allows for simple but not compound interest, although there are inroads on that situation.

Depending on the outcome of the amendments tabled by the noble Lord, Lord Lea, and the noble Baroness, Lady Noakes, I ask for consideration to be given to what I propose because there is a clear need to ensure that, if the insurance market works
as it should, there is a provision for interest and preferably for compound interest. As between the amendments of the noble Lord, Lord Lea, and the noble Baroness, Lady Noakes, I could not help but be concerned by the issues raised by Lord Mance, with the suggestion that there should be a claim for damages for what is in effect breach of contract. That would be the inevitable consequence of the amendment of the noble Baroness, Lady Noakes. What is being suggested would lead to double breaches of contract claims.

This is a complicated and technical situation, but we are dealing here not with the consumer but with large insurance for commercial concerns. I would not want to disregard the warnings given by Lord Mance. He certainly caused me to reassess those warnings. It was partly because of that that I had the idea of having a statutory instrument that might enable us to square the circle and avoid the difficulty of having primary legislation in this area. I will be interested to hear what the Minister says in due course but, meanwhile, I commend the common sense behind the proposal of the noble Baroness, Lady Noakes.

**Baroness Noakes:** My Lords, I have tabled Amendment 18 in this group in order that the Committee could have a debate on this issue, because it is certainly one that occurred right from the outset of our discussions in Committee. Perhaps I could say at the outset that I am happy to support Amendment 17, in the name of the noble and learned Lord, Lord Woolf. However, I do not think that it deals with the same issues as those addressed by my amendment and that of the noble Lord, Lord Lea.

The noble and learned Lord, Lord Woolf, referred to Lord Mance’s evidence and the legal problem of having a second claim of damages. I approached the issue not from that direction but from it being a natural and obvious thing to seek to have in an insurance contract—that there be an implied term that it gets paid on a reasonable basis. Indeed, I was rather surprised to find that that was not the case, which is why I have been attracted to this issue forming part of the Bill from the outset. It seems that the only reason for this being contentious is that the Lloyd’s Market Association expressed itself not content with it. All the other evidence that we had was either in favour or neutral and, if you weighed it, you would certainly say that it was pretty heavily in favour of having this clause in the Bill. That was why I thought it quite right for us to debate its inclusion. As I said, it is the right sort of thing to exist in the insurance market.

We were told at some stage that there might be fears of claims management companies taking undue advantage of what is, effectively, a new course of action. As somebody who is involved in financial services and bears the scars of the activities of claims management companies in the case of banking, I would certainly not want to do anything to encourage that economic activity. On the other hand, we should not be afraid of legislating for things that are right because of the possibility that claims management companies might seek to exploit them.

As between my amendment and that of the noble Lord, Lord Lea, there are many attractions in leaving the power within the Bill to bring implied contracts in at a later stage, if there could be sufficient agreement to satisfy the Government that this was the right and proper thing to do rather than going directly to inserting the clause in the Bill, as the Law Commission initially drafted it. My preference would be to have the provisions in the Bill now, but if the Government were happy to put a provision in the Bill along the lines of the amendment of the noble Lord, Lord Lea, I would support that, too. I look forward to hearing what the Government have to say.

**11.15 am**

**Lord McNally:** My Lords, before the Minister replies, let me say that obviously I am sympathetic to the desires of the noble Lord, Lord Lea, and the noble Baroness, Lady Noakes, to deal with this problem of late payment. I listened carefully to what was said about what is consensus and what is controversial. I worry that such an important and eminent body as Lloyd’s has concerns and, even though it may be in the minority, this Committee has to give full weight to such an important part of the London market having reservations. I am also worried because I have been an enthusiastic supporter of this House fast-tracking Law Commission Bills since the procedure began. That has been based on the Committee that is set up having the common sense not to go a bridge too far in stretching the procedure by amendments during its considerations. I will therefore listen carefully to the Minister, because I would not like to lose an important piece of legislation if, in reality, these amendments are a bridge too far where this procedure is concerned.

**Lord Newby:** My Lords, the Committee has participated in considerable discussions about the issue of late payment or non-payment of valid insurance claims. It has heard from a number of witnesses that, although the concept of liability for late payments is broadly supported by most stakeholders, the inclusion of it in the Bill is accepted as being controversial, not least because of the possibility for this proposed clause to lead to speculative litigation or to have the unwelcome effect of being used to exert undue pressure to expedite claims settlement.
The ABI highlighted that claims management companies could exploit an uncertainty, for example, in a bid to obtain additional income streams. We also heard from AIRMIC and the British Insurance Brokers' Association that the problems are worse in theory than they are in practice. As I expressed in my recent letter to the noble and learned Lord, Lord Woolf, the Financial Conduct Authority is currently undertaking a thematic review in relation to the handling of commercial claims, so the issue is under active consideration from the relevant regulator.

The Committee will remember, for example, the evidence that we heard from one or more witnesses that the insurance market is extremely competitive. If you have settled a claim and not paid it, and you get a reputation for settling claims and not paying them, you do not stay in the market for very long. At an earlier stage, the Law Commission had not given this issue as much priority as many of the others that we have been dealing with, simply because it was not apparent that it was a significantly important and real issue. We also heard in the evidence from Lord Mance, the ABI and the LMA that the difficulties of fending off speculative claims would be very real indeed. As the potential difficulties presented by this clause appear to outweigh any practical advantage to be gained from it, this must surely place into question whether it is necessary or appropriate for these reforms to be made at the current time.

Although we heard from Lloyd's of its concern about this issue, it is wrong for the noble Lord, Lord Lea, to suggest that the people there are the only ones who had concerns about this issue when the Law Commission consulted on it. There was, for example, a suggestion from ACE that it should be dealt with through regulation. The IUA had questions about the definition, QBE expressed concerns about what was initially proposed and Munich Re thought that a statutory remedy was unnecessary. David Turner QC thought that the change would be an unnecessary interference with the autonomy of parties to a commercial contract. This is clearly a much more complicated and contentious issue than it appears at first sight.

Although the Law Commission works on a consensus basis, not all its recommendations will necessarily be appropriate for the procedure of uncontroversial Law Commission Bills. I respectfully suggest that this is one of those cases. It is not a question of the Law Commission, or indeed the Government, wishing to push this issue under the carpet. However, we believe that it would be inappropriate for it to be introduced in this Bill at this stage, given the degree of controversy.

There is, unhelpfully for a Minister, no precise definition of what does and does not constitute controversy for the purposes of a Law Commission Bill. If the Bill were to include matters that are clearly controversial, as this is, the question is whether they could reasonably be expected to prejudice its passage through either your Lordships' House or the House of Commons. Our view is that there is a risk that, if these amendments were agreed to, the Bill could be placed in jeopardy. I cannot say with what probability I assess that risk, not least because it would depend very much on what happened in the House of Commons—and that certainly is another place, as far as I am concerned, when it comes to understanding rules of procedure.

This is not an inconsequential area and that is why the Government do not feel able to accept these amendments at this stage. However, I should say that, of the amendments, that of the noble Baroness, Lady Noakes, uses the Law Commission text and so that will be the starting point for further legislative work in this area. Although I accept that we are virtually at the end of this Parliament, that does not mean that the Treasury and the Law Commission will put all the papers on this issue to bed. They will consider how they can bring it forward again in a more normal legislative vehicle.

The amendment moved by the noble Lord, Lord Lea, contains a power for the Government to introduce a late payment provision by way of secondary legislation at a later stage. The very fact that the Government feel unable to include the substantive clause in this uncontroversial Bill is relevant here. If the provision itself is too controversial, then giving the Government the power to legislate on the same issue by way of a statutory instrument is likely to generate the same level of controversy, if not more. I am grateful to the noble Lord for looking at how he could engineer a workaround, but it is clear that delegation of a controversial power such as this is not really suitable for the Law Commission's special procedure.

Given that this would, by common consent, be a significant change in the law and given the range of opinions, which we have discussed, it deserves to be the subject of full scrutiny by the House. As I say, the Government are committed to taking this forward in the future. By “full scrutiny” in the House, I draw a distinction between something that appears on the face of a Bill and secondary legislation. The truth is that secondary legislation is unamendable. We have seen throughout the passage of the Bill that almost every provision has proved capable of amendment, almost as it has passed through the Committee. For a provision such as this, an unamendable bit of secondary legislation really will not do the trick.
The amendment tabled by the noble and learned Lord, Lord Woolf, on compound interest, would allow the court the discretion to award either simple or compound interest when it finds an insurer liable to pay an insurance claim. The effect of awarding compound interest would vary significantly, depending on general interest rates. If interest rates are low, as now, then compound interest will afford little additional compensation for the policyholder. Equally, when interest rates were high, insurers could face significantly increased costs without the policyholder having necessarily to show that the insurer had behaved unreasonably. The calculation of compound interest is difficult and providing a discretion for the judiciary to award it here is likely to be controversial. There has been no opportunity for either the Law Commission or the Government to seek views on it, not just from the insurance market but from the government departments or agencies responsible for court remedies.

This amendment would represent an entirely new policy and there is not enough time to undertake the required analysis of the impact of the suggested reforms during consideration of the Bill. The special procedure for these Bills assumes that the relevant reforms have been subject to extensive consultation by the Law Commission and are generally well supported by stakeholders. The special difficulty with the compound interest proposal is that this consultation is simply lacking. I therefore suggest that the noble and learned Lord’s amendment is not suitable for this particular legislative vehicle and I urge him not to press it.

To sum up, the Government’s position from the outset has been that they support the policy behind the late payment provision and are committed to exploring future legislative opportunities. However, normal government Bills are not constrained by the requirement to ensure that clauses are uncontroversial, as they will be fully debated in the usual way. In light of the various arguments that I have made against the amendments, I hope that the noble Lords will feel able not to press them.

Lord Lea of Crondall: My Lords, I thank the Minister for that response. There are two or three issues that I thought he might have addressed but did not. First, this arrangement works around most of the world. Why is it only in London and, if I may say so, only in the particular features of the Lloyd’s Market Association that it would be the end of the world as we know it? Secondly, when exactly could we see another Bill? How many years—or how many Parliaments—would it be before we saw another Bill? This offer that was thrown out to look into it in the not too distant future in another Bill is simply not credible.

The wording of my amendment—I do not think that the Minister acknowledged this—has in its first phrase of the proposed new clause “may”, not “shall”. There is scope for a lot of consideration as to what in fact would be provided. I do not think that the Minister thinks that this enabling clause to make provision for a statutory instrument would kill the Bill. I notice that he did not say that it would; I do not think that it would. Given the lack of a pragmatic response, I would like to test the feeling of the Committee.

11.28 am
Division on Amendment 16
Contents 2; Not-Contents 7; Abstentions 2.
Amendment 16 disagreed.

Division No. 1

CONTENTS
Lord Lea of Crondall
Lord Davidson of Glen Clova

NOT CONTENTS
Lord Ashton of Hyde
Lord Carrington of Fulham
Baroness Goudie
Lord McNally
Lord Newby
Lord Sherbourne of Didsbury
Lord Tomlinson

ABSTENTIONS
Baroness Noakes
Lord Woolf

11.30 am
Amendment 17 not moved.
Clauses 13 to 16 agreed.
Amendment 18 not moved.
Clauses 17 to 21 agreed.
Schedules 1 and 2 agreed.

In the Title

Lord Woolf: Lord Chairman, I hope that this is not inappropriate. I was not quite sure whether I should wait until you had put the last matter, but as the Chairman during the time when the Committee was not sitting in the way that it is today, perhaps I could express some words of appreciation. First, I am grateful to the Chairman of Committees for performing the function that he has today, thus enabling me to take part in the Committee’s deliberations in the way that I have. Secondly, I thank the clerk and his team, who have given every Member of the Committee very considerable help. He really has been the mastermind behind the Bill and made sure that we have got to this stage.
I would also like to single out the Law Commission, which provides a tremendous service to Parliament and to the public in getting important legislation before the House in a way that usually is not controversial. The point that I would particularly make here is that it has demonstrated, to my satisfaction at any rate, that this type of procedure can work—and work very well. I hope that the success that has occurred in using this procedure in respect of this by no means easy Bill will be an encouragement for there to be other situations in which the unfortunately large number of reports of the Law Commission awaiting implementation could be brought to an end.

I also know, as I think all the members of the Committee know, that David Hertzell, who has been the author of its monumental report and done a huge amount of work in connection with the Bill, is about to retire. It is a wonderful testimony to the qualities of his work in the Law Commission that we have been able to deal with the Bill in the way that we have. We all, including the public, should be indebted to him, because the Bill is important both to the commercial world of insurance and to those who resort to that world to protect themselves against the hazards of commercial life. The Bill should bring the law up to a state that better represents the needs of insureds and insurers. I thank the Committee very much for indulging me and allowing me to make the statement that I have.

**The Chairman of Committees:** Not at all. I am sure that we are all grateful to the noble and learned Lord, Lord Woolf, for his kind words and acknowledgements on this occasion. Thank you very much—but I had better go back to the proper question now.

*Title agreed.*

*Bill reported with amendments.*

*Committee adjourned at 11.36 am.*
APPENDIX: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Lord Ashton of Hyde
Lord Carrington of Fulham
Lord Davidson of Glen Clova
Baroness Goudie
Lord Lea of Crondall
Lord McNally
Lord Newby
Baroness Noakes
Lord Sherbourne of Didsbury
Lord Tomlinson
Lord Woolf (Chairman)

Declarations of Interest

Lord Ashton of Hyde

Shareholder in Marsh Inc. (insurance broking / financial services)
Future recipient of pension from Marsh Inc.

Lord Carrington of Fulham

No relevant interests declared

Lord Davidson of Glen Clova

Member, Faculty of Advocates

Baroness Goudie

No relevant interests declared

Lord Lea of Crondall

No relevant interests declared

Lord McNally

No relevant interests declared

Lord Newby

Minister in charge of the Bill

Baroness Noakes

Shareholdings in a wide range of listed companies, as set out in the Register of Lords’ Interests, including companies in the insurance industry (Prudential plc and Legal & General plc)
Potential beneficiary of various directors’ and officers’ liability insurance policies

Lord Sherbourne of Didsbury

No relevant interests declared

Lord Tomlinson

No relevant interests declared

Lord Woolf

No relevant interests declared

A full list of Members’ interests can be found in the Register of Lords’ Interests: http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests