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Insurance Contract Law
SUMMARY OF RESPONSES TO THIRD CONSULTATION PAPER
The Business Insured's Duty of Disclosure and the Law of Warranties
Chapter 2: The Law of Warranties

This document summarises the responses to chapter 2 of the Law Commissions' third consultation paper in the joint insurance law project

March 2013

THE LAW COMMISSION
THE SCOTTISH LAW COMMISSION

Joint Review of Insurance Contract Law

SUMMARY OF RESPONSES TO THIRD CONSULTATION PAPER: THE BUSINESS INSURED'S DUTY OF DISCLOSURE AND THE LAW OF WARRANTIES

Chapter 2: The Law of Warranties

Contents

Approach taken in this paper

Describing responses

This paper describes the responses we have received to the proposals on warranties set out in our Consultation Paper: The Business Insured's Duty of Disclosure and the Law of Warranties. This document aims to report the arguments raised by the consultees. It does not give the views of the Law Commission or the Scottish Law Commission.

Comments and Freedom of Information

We are not inviting comments. However, if having read the paper you do wish to put additional points to the Commissions, we would be pleased to receive them.

Please contact us:

By email at commercialandcommon@lawcommission.gsi.gov.uk

By post, addressed to Laura Burgoyne, Law Commission, Steel House, 11 Tothill Street, London SW1H 9HL

We will treat all responses as public documents. We may attribute comments and publish a list of respondents' names.

Information provided, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (such as the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002 and the Data Protection Act 1998). If you wish your response to be confidential please explain why. While we will take full account of your explanation, we cannot give assurances that confidentiality will be maintained in all circumstances.

PART 1
INTRODUCTION

1.1 The Law Commission and Scottish Law Commission are carrying out a major review of insurance contract law. As part of that review, in June 2012 we published a joint Consultation Paper on "The Business Insured's Duty of Disclosure and the Law of Warranties".[1]

1.2 The second chapter related to the law of warranties. In general contract law, "warranties" are relatively minor contractual terms. By contrast, an insurance warranty is a particularly important contractual term. It is essentially a promise made by the policyholder to the insurer which, if broken, may have harsh consequences for the policyholder. The current law of warranties is set out in the Marine Insurance Act 1906 (the 1906 Act).

1.3 Section 33(3) states that a warranty "must be exactly complied with, whether material to the risk or not". If it is not exactly complied with then "the insurer is discharged from liability from the date of the breach of warranty". Furthermore, under section 34(2), once a warranty is breached, the policyholder "cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss". These provisions have been held to apply to all types of insurance, not just marine insurance. Their combined effect is that if a policyholder breaches a warranty, the insurer may refuse claims for any subsequent losses. This is true even if the breach was minor, had no relevance either to the risk or the loss, or had already been remedied before the loss took place.

1.4 For many years, the courts have attempted to moderate the harshness of the law with creative reasoning. This approach has allowed the courts to do justice in some individual cases. We have been told that it discourages insurers from taking purely technical points, or attempting to use warranties in a wholly unreasonable way. While this has its advantages, it also introduces complexity and uncertainty into the law.

1.5 We thought that the law of warranties in insurance contracts was in need of reform, and made three main proposals:

(1) "Basis of the contract" clauses should be prohibited. These clauses convert even minor representations an insured has made at placement into warranties and allow the insurer to avoid paying out if it turns out any of them are untrue.

[1] Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties, the Law Commission and the Scottish Law Commission, LCCP 204 / SLCDP 155 (June 2012) (hereinafter referred to as the "Consultation Paper").

(2) Warranties should become "suspensive conditions", meaning that an insurer would not be liable for losses under the policy while the insured is in breach of a warranty, but the insurer's liability could be restored if the breach of warranty is remedied.

(3) Where a term is designed to reduce the risk of a particular type of loss, or the risk of loss at a particular time or in a particular place, then if the insured is in breach of that term the insurer should only be able to avoid paying out under the policy for losses caused by that type of risk. This proposal is not confined to traditional warranties, and would apply to any contract term designed to reduce particular risks.

RESPONSES

1.6 In total, we received 50 responses to the Consultation Paper as shown in the table below.

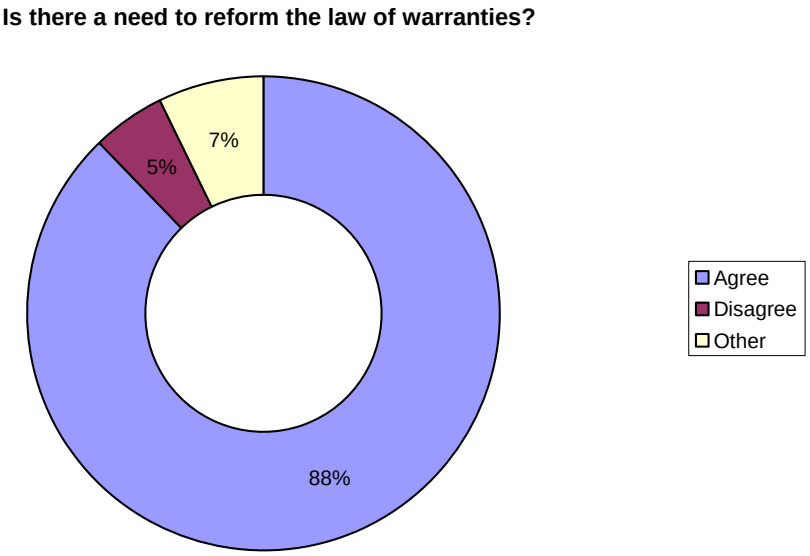
Type of respondent	**Number**
Insurers and insurance trade associations	16
Lawyers, legal associations and the judiciary	15
Brokers and brokers' associations	6
Academics	3
Policyholders and policyholder/consumer groups	3
Other	7
Total	50

THANKS

1.7 We would like to thank all the consultees who responded to our Consultation Paper, or who met with us or contacted us to express their views. Whilst we are unable to directly quote all consultees' submissions in this brief summary, those views are important to us as we put together our recommendations for the final report. A list of all the consultees is contained in the Appendix.

PART 2
THE NEED FOR REFORM

2.1 We asked generally whether consultees agreed that there is a need to reform the law of warranties as set out in sections 33 to 34 of the Marine Insurance Act 1906. Overall there was strong support for reform. Of 41 respondents to this question, 36 (88%) agreed. Two consultees (5%) disagreed and three (7%) marked "other".[2]



Agreement

2.2 The comments of one consultee (who wished to remain anonymous) reflected widely held opinions:

> The current law in relation to warranties brings English law into disrepute and puts the English market at a competitive disadvantage against other jurisdictions in which a more balanced approach to the effect of such terms has been adopted. The draconian nature of a warranty under English law leaves insureds too often at the mercy of the goodwill of insurers in the event of breach.

2.3 Airmic, the risk managers' association, said its members were "overwhelmingly in favour" of reform. K&L Gates LLP "fully agreed with the Law Commission regarding the need to reform this archaic and imbalanced area of law." The Judges of the Court of Session thought that the "law is currently biased too far in favour of the interests of insurers. There is a clear need for reform."

[2] The response form provided tick boxes, namely "agree", "disagree" and "other".

2.4 Direct Line Group thought that reform was "necessary to bring clarity and consistency between the law and common practice", emphasising the need to ensure that "any reform is balanced and protects the interests of both parties". Royal & Sun Alliance Insurance plc (RSA) thought that the current law did not reflect "prudent commercial practice" or what their "commercial customers expect from RSA when they insure with us". In a similar vein the Financial Ombudsman Service (FOS) said that "the proposals put forward by the consultation would bring the law more in line with our own approach".

2.5 The Association of British Insurers (ABI) thought that reform relating to the consequences of a breach of warranty was necessary, but maintained that "in business insurance the guiding principle should be freedom of contract". They took the view that provided an insured was properly informed, they (or the insurer) should be able to extend or limit by contract the circumstances in which an insurer would not have to pay a claim.

2.6 Global insurance broker Marsh supported our proposals, and advocated broad reform:

> We agree that there is a need for reform, but not only as regards warranties but also as regards similar terms which have the same effect as warranties but are given a different title.

2.7 The British Insurance Brokers' Association **(**BIBA) said "conditions precedent to liability are a concern, as are statements of fact. Proposals should also relate to these areas as well as warranties".

Disagreement

2.8 Swiss Re said that while reform in the consumer arena might be appropriate, they "do not believe this approach is required for business insureds who should have freedom to contract as they wish".

2.9 David Hunter thought that:

> if explained properly a warranty will often act as a risk control measure and the insurance underwriter will have priced the risk accordingly. Therefore the insurer has a right to expect that its terms will be fully complied with …

2.10 John Harbergham from Myton Law Ltd also thought that for an underwriter, the subject of a warranty

> goes to the root of the contract. If it is not as the assured has said or promised it will be, it is simply not the bargain that the underwriter though he was getting and, in these circumstances, is entitled to walk away from that contract.

Other comments

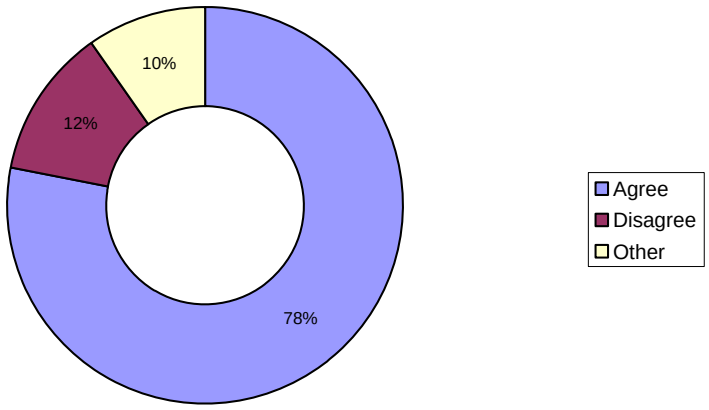
2.11 Catlin supported reform “only to abolish blanket Basis of Contract clauses.” Browne Jacobson LLP thought that although the courts had “sought to moderate the ‘harshness’ of the remedies available” there was still “sense … in amending the law in relation to this area”.

PART 3
ABOLISHING BASIS OF THE CONTRACT CLAUSES

3.1 We explained that the problems posed by warranties are exacerbated by the use of "basis of the contract clauses". If a prospective policyholder signs a statement on a proposal form stating that the answers given form the "basis of the contract", this has the effect of converting all the answers into warranties. A basis of the contract clause allows the insurer to avoid liability for any inaccuracy, however unimportant.

3.2 We asked consultees whether, in business insurance, a term in a proposal form, contract or accompanying document which states that the policyholder warrants the accuracy of the answers given or that the answers form the basis of the contract should be of no effect. Of 41 consultees who answered this question, 32 (78%) agreed with the proposal. Five consultees (12%) disagreed and four (10%) marked "other".

A term which states that the policyholder warrants the accuracy of the answers given at presentation or that the answers form the basis of the contract should be of no effect



Agreement

3.3 The Law Society of Scotland said it "is clauses such as these that give rise to the impression that insurers can avoid liability for an insured risk at their discretion". AXA noted that "basis of contract clauses have already been taken out of the majority of our wordings".

3.4 RSA highlighted how these proposed reforms might interact with other areas of the insurance reform project. They considered:

> … that if a 'basis of contract' clause were to be retained as an operative legal concept it would significantly undermine the effect of the Law Commissions' 'proportionate remedy-based' reforms in relation to the business insured's duty of disclosure as well as the other proposals of the Law Commissions.

3.5 The Lloyd's Market Association (LMA) also gave their support:

> Blanket "basis of the contract clauses" in commercial contracts, i.e. that all representations in the disclosure material be converted to warranties and incorporated into the contract of insurance, should be of no effect.

3.6 Some of the strongest opinions in favour of abolition came from lawyers. Heather Thomas thought "this is the one clause which should trump the general principle that parties are free to contract". K&L Gates LLP said "our experience is that insureds rarely understand the significance of this rather innocuous wording", while Addleshaw Goddard LLP noted "if some of the answers given are particularly important to insurers, appropriate warranties can be included in the main body of the insurance policy". The Bar Council similarly took the view "that if insurers wish to rely on express warranties, they should set them out in writing and provide them to the insured or the insured's broker for onward transmission to the insured."

Disagreement

3.7 Swiss Re thought that abolition of basis clauses "eliminates the ability of insurers to rely on important information being provided".

3.8 The International Underwriting Association (IUA) said:

> We supported the abolition of basis of contract clauses in the consumer context. However, in the business context, in upholding the concept of contractual freedom, there should be no impediment to using such clauses if that is the desire of the commercial parties involved.

3.9 The IUA also thought however that:

> … if insurers wish to use such clauses we would expect that these would be clearly outlined in both the terminology used and the consequences of failing to meet the requirements.

Other comments

3.10 Professor Howard Bennett was concerned that "basis clauses could be reinserted by appropriate (if repetitive) drafting" depending on what the reforms outlawed:

> Apparently … it will remain possible to turn an individual answer into a warranty. In that case, will it remain possible to transform more than one by a joint characterisation clause or will it always have to be individually? And could it be done individually in respect of each and every answer?

3.11 Direct Line Group thought that “these clauses should remain, but will be interpreted in the light of the reforms and the spirit of any subsequent legislation.” They believed that in some circumstances avoidance by use of a basis clause was justified.

PART 4
REMEDIED OR EXCUSED NON-COMPLIANCE

WARRANTIES AND THE SUSPENSION OF LIABILITY

4.1 Section 33 of the 1906 Act provides that if a warranty is not "exactly complied with", the insurer is discharged from liability from the time of breach: the insurer is not liable for any claims arising after that event. The harshness of the current law is compounded by the fact that even if the policyholder remedies the breach this does not restore cover. Section 34(2) of the 1906 Act prevents this:

> Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss.

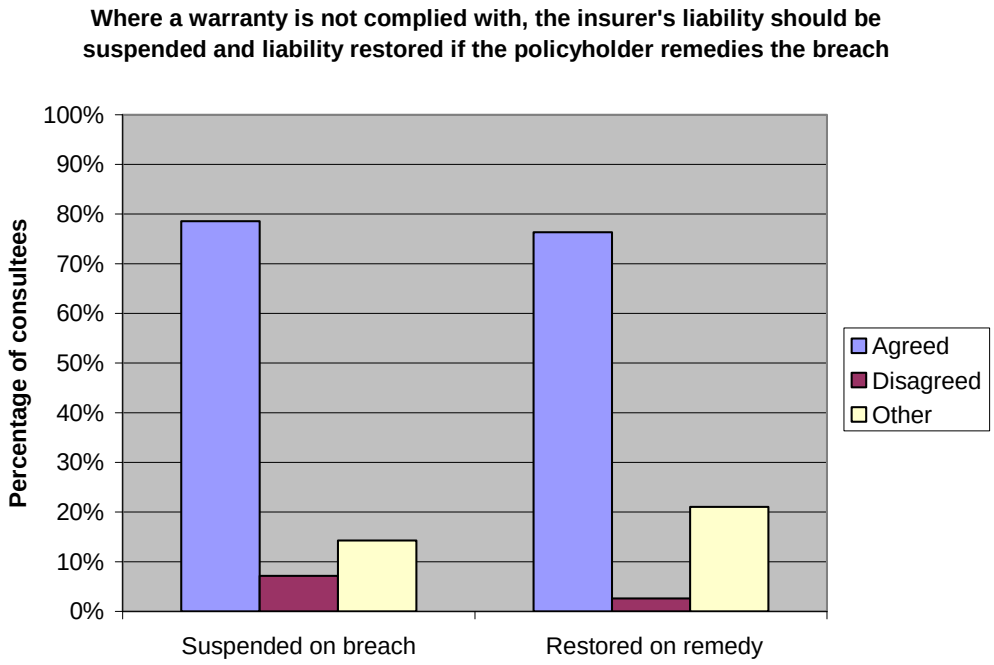
4.2 In the Consultation Paper we gave the example of a policyholder who has warranted to service a burglar alarm within one week, but does not do so for two weeks. In this scenario, the insurer's liability is discharged in its entirety after one week. The policy is automatically void, although the insured remains liable to pay the premium.

4.3 We asked whether consultees agreed whether the law should be changed to provide that where a warranty is not complied with:

(1) the insurer's liability should be *suspended* during the period of breach; but

(2) liability should be restored if and when the policyholder remedies the breach.

4.4 There was strong support for the first proposition. Of 42 consultees who responded to this question, 33 (79%) agreed with our proposals. Three (7%) disagreed and six (14%) marked "other". Of 38 consultees who commented on the second proposition, 29 (76%) agreed that liability should be restored if the breach is remedied. Only one consultee disagreed. Eight marked "other".



4.5 Although the two questions were asked separately, the responses go hand in hand and are addressed together in this summary.

Agreement

4.6 Professor John Birds, reflecting the sentiment of many consultees, said:

> These are clearly sensible and desirable reforms, ridding the law of unnecessary distinctions. It does seem a better approach than using a causal test, preserving protection for the insurer when necessary.

4.7 Professor Howard Bennett analysed the problem theoretically in terms of attachment of risk, and concluded that "there is no logical reason why the discharge of liability triggered by a breach of warranty need be permanent; there is no logical reason why it should be impossible to cure a breach of warranty."

4.8 Heather Thomas said "there is no justification for any stronger automatic effect."

4.9 RSA emphasised the importance of warranties, saying:

> The inclusion of a warranty in an insurance policy properly reflects the fact that RSA has considered and determined that the subject matter of that warranty and compliance with its terms is fundamental to our decision to underwrite the risks associated with that warranted subject matter.

4.10 Nevertheless, RSA thought that the insurer should only be able to avoid liability "during any period in which that warranty is not and/or was not being complied with".

4.11 The IUA agreed, and made an interesting point about premium payment warranties (PPWs):

> Though some PPWs terminate the contract with immediate effect, many PPWs include a stated notice of cancellation period – often 30 days – that can be used when payment is not forthcoming by the settlement due date. These, then, are not strict warranties as understood by the law. However, if a claim is forthcoming during that notice period then, as we understand it under the proposed rules, the insurer would have no liability as there would legally be no cover in place. However, in many cases this does not follow market practice on the basis that, for the most part, having issued notice, the premium is almost always received during the notice period (and the claim paid). Given this, the operation of certain types of PPWs may be an instance where the parties may wish to move away from the default provisions via their contractual provisions.

Disagreement

4.12 The Forum of Insurance Lawyers (FOIL), who marked "other" but in substance disagreed, noted the broader implications of a breach of warranty:

> A company which accepts a warranty in its insurance policy to inspect its sprinkler system is accepting a responsibility it is under a contractual obligation to meet. If it fails to meet that obligation it gives an indication that this is not a well-run organisation mindful of the need to reduce risk. What other basic precautions are being ignored?

4.13 They took the view that "although the remedies for breach of warranty are harsh, they are proportionate." Browne Jacobson LLP also considered that "the very fact a breach occurred in the first place is indicative of an insured's approach to risk."

4.14 David Hunt also disagreed and said:

> The whole principle of insurance is to compensate for fortuitous rather than inevitable losses. Therefore should the insured fail to comply with the warranty to maintain the sprinkler system in full and effective condition, why should insurers and shareholders pay the claim? Ignorance of the law is no excuse and the same should apply to ignorance of insurance contracts.

Other comments

4.15 A few consultees noted that there were some breaches of warranty that could not be remedied. The British Insurance Law Association (BILA) suggested that irremediable breaches would be common:

> We would point out that most marine insurance warranties are ones that either are or are not complied with and cannot be remedied e.g. towage or the requirement to make the vessel seaworthy at the outset of the voyage.

4.16 The LMA cited a confidentiality clause as an example of an irremediable breach. They foresaw "new areas of dispute regarding whether or not a breach was remedied, and exactly when a breach was remedied, and where the burden of proof lies."

4.17 AXA agreed with the proposal but noted that:

> … certain circumstances do exist where a suspensive warranty may not be an adequate remedy for an insurer. In marine insurance for instance, express warranties can be crucial to the insurer in assessing and pricing the risk.

4.18 The Bar Council supported the proposals but "would have preferred a proposal to reform the law to the effect that insurers should not be able to rely on a breach of warranty unless the breach is causative of the loss."

4.19 The ABI posited a scenario:

> If a ship were, in breach of warranty, to sail off course, be struck and sustain damage but not sink until well after it has returned to its warranted course, the loss of the ship would have happened by reason of the breach … It is important that any losses flowing from the breach, although occurring after it has been remedied, are still excluded from liability. Here there would need to be a causal link between breach and loss for liability to be excluded once the breach had been remedied.

EXCUSED NON-COMPLIANCE AND WAIVER

4.20 The 1906 Act provides two instances where the breach of a warranty does not end the insurer's liability for loss.

4.21 First, section 34(1) provides that non-compliance is excused in circumstances where, by change of circumstances, the warranty ceases to be applicable or compliance is rendered unlawful by subsequent law. Secondly, section 34(3) gives the insurer the power to waive a breach of warranty. This is regardless of the automatic discharge of the insurer's liability under section 33(3).[3]

4.22 We asked whether consultees agreed that sections 34(1) and 34(3) of the Marine Insurance Act should be retained. There was very strong support, with 32 of 34 consultees (94%) who responded to this question agreeing. Only one consultee (3%) disagreed and one marked "other".

Agreement

4.23 RSA agreed

[3] Although there is considerable academic debate about how liability which has ceased to exist can be resurrected by waiver. See paragraph 12.38 and following of the Consultation Paper for a brief discussion.

> … that where there is a breach of a warranty that is no longer applicable to the circumstances of the policy this should not be considered non-compliance on the part of the insured.

4.24 The Bar Council also agreed with our proposed reform:

> … so that the insurance contract is not automatically terminated by breach of warranty but that insurers are entitled to rely on breach of warranty to bring the insurance to an end or to waive the breach.

Other comments

4.25 The Law Society of Scotland agreed, but commented on terminology:

> … we would like to see some wording referring only to simple "waiver" in Scotland, rather than to waiver "by election or by estoppel". A major source of legal uncertainty in an Act such as the 1906 Act, in Scots law, is a lack of thought being given to how English terminology translates into Scottish legal vocabulary.

4.26 The Faculty of Advocates said the "difference in the operation of the waiver in Scots and English law should be respected."

A CONTRACTUAL RIGHT TO CANCEL

4.27 In 2007 we proposed that where the policyholder has breached a warranty, the insurer should have a statutory right to cancel the contract by giving reasonable notice, and returning premiums on a pro-rata basis. Respondents to that consultation felt that such a right was of limited use. It was pointed out that policies often include a contractual right to cancel. A statutory right to cancel may be overly complex, especially if it included provision for reasonable notice and pro-rata repayment, as we provisionally concluded that it should.

4.28 On further consideration, we suggested in the Consultation Paper that the matter is best left to the terms of the contract. We asked consultees whether they agreed. We received 100% agreement.

4.29 The IUA said "this is best dealt with in the contractual terms." Direct Line Group said that this accorded with current industry practice. Reynolds Porter Chamberlain LLP thought that a contractual right to cancel "allows greater flexibility to both insurer and insured; it also provides greater transparency as to the parties' intentions."

4.30 The ABI agreed and commented on terminology:

> A breach of warranty should provide the insurer with the right to terminate cover on notice if such a right is included in the contract. Any right to terminate should only arise from the date of any breach so that the insurer would cover any claims prior to breach. For this reason the term "terminate" is preferable to "cancel."

4.31 Heather Thomas suggested that "there should be reasonable notice, not immediate cancellation."

PART 5
TERMS TO REDUCE PARTICULAR RISKS

5.1 As previously set out, section 33(3) of the 1906 Act states that a warranty "must be exactly complied with, whether material to the risk or not". If it is not exactly complied with then "the insurer is discharged from liability from the date of the breach of warranty". The effect of this provision is that breach of a single warranty discharges liability for all risks covered by the policy. In strict law, breach of a warranty which is associated with one risk, such as fire, will nevertheless discharge the insurer from liability for all losses of any kind, such as flood and theft.

5.2 In the Consultation Paper we proposed that, where a term is designed to reduce the risk of a particular type of loss, a breach of that term should only suspend liability in respect of that type of loss. Thus failure to comply with a requirement to regularly inspect and maintain fire retardant lagging in kitchen ducting should suspend liability for fire loss but not theft loss. The same should apply where the term is designed to reduce the risk of loss at a particular time or in a particular location. A failure to employ a night watchman should suspend the insurer's liability for losses at night, but not for losses during the day.

5.3 We therefore made two proposals and asked whether consultees agreed:

(1) Where a term is included to reduce the risk of a particular type of loss then, in the event of a breach of the term, the insurer's liability should be suspended only in respect of that type of loss.

Of 36 consultees who responded to this question, 29 (81%) agreed that breach of a term intended to reduce the risk of a particular type of loss should result in suspension of the insurer's liability only in respect of that type of loss. Four consultees (11%) disagreed and three (8%) marked "other".

(2) Where a term is included to reduce the risk of a loss at a particular time or in a particular location then, in the event of breach of the term, liability should be suspended only in relation to losses at that time or at that location.

Of 35 consultees who responded to this question, 30 (85%) agreed that breach of a term intended to reduce the risk of loss at a particular time or location should result in suspension of the insurer's liability only in respect of losses at that time or place. Three consultees (9%) disagreed and two (6%) marked "other".

5.4 These responses to these questions are considered together, as very similar arguments were made.

Agreement

5.5 Direct Line Group was "supportive" of the proposal and said it would "bring the law into line with current practice." Direct Line also suggested that the proposal would have an indirect beneficial effect on the way policies were written and described to insureds:

> This would mean that there will be a requirement to set out at policy, section or item level, detailing the specific insured perils to which the warranty applies. For instance, 24 hour watch may be in place to prevent arson as well as theft … We believe that this will bring much needed clarity to the contractually insured party.

5.6 Airmic said:

> [Our 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.

5.7 RSA agreed with the proposal and considered "that the issue as to what is to be considered to be of the same "type of loss" as the subject matter of a warranty should be a matter for the courts to determine."

5.8 Berrymans Lace Mawer LLP thought that although our proposal "will inevitably involve some consideration of causation of loss (and possible reduction in clarity), such issues are routinely considered in practice."

5.9 The majority of BILA's members agreed with the proposal. A minority thought that the proposed reforms should go further, adopting a causation test to avoid being "out of step with a number of other legal systems."

5.10 The ABI agreed with the proposal, but thought it:

> … important to acknowledge that certain terms are intended to improve a wide category of risk. For example, where an insured has breached a warranty by failing to install locks on doors, but a theft occurs because someone breaks in through a window, the insurer should be able to decline that risk in recognition that the intention of the term was to safeguard the risk of theft in general and to encourage responsible behaviour toward security.

Disagreement

5.11 While some consultees lamented the fact that a causation-based approach was not proposed, Catlin was "concerned that the proposed change … introduces causation by the back door despite the fact that the Law Commission has previously taken on board the difficulties of causation."

5.12 The LMA disagreed with the proposal and wondered whether it would be possible to distinguish consistently between types of loss. They picked up on the yacht example in the Consultation Paper[4] and asked:

> where there is a lock warranty requiring the [main] hatch to be secured by a special type of padlock, what if this is breached, but the break-in is via the forehatch? Is the cover suspended because the loss was due to theft? Or is cover not suspended because the theft was not via the main hatch?

5.13 The LMA's key concern was that a reference to a type of loss in a warranty should not prevent that term being treated as a "true warranty" when the parties had intentionally contracted on that basis.

Other comments

5.14 The Faculty of Advocates, agreeing with the proposal, said:

> It might be appropriate to afford the insurer the opportunity to demonstrate that the term … was taken into account in setting the premium (by taking into account of it in relation to more than one type of risk).

5.15 Reynolds Porter Chamberlain LLP agreed in principle, but thought there was a need for a "carve out" where insurers could decline liability totally if a breach of warranty was fraudulent or reckless.

[4] See Consultation Paper, paragraphs 15.5 to 15.8.

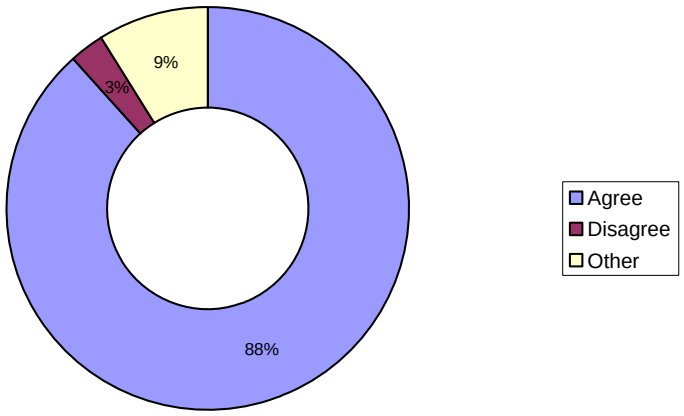
PART 6
CONTRACTING OUT

CONTRACTING OUT: CONSUMER INSURANCE

6.1 We thought that where a contract was between an insurer and a consumer, the parties should not be free to negotiate an alternative regime for dealing with remedies. We proposed that any term which purported to put a consumer in a worse position than they would be under our proposals should be of no effect.

6.2 This proposal received strong support, with 30 of 34 consultees (88%) who responded to this question agreeing. Only one consultee (3%) disagreed, and three (9%) marked "other".

In consumer insurance, a term purporting to put the consumer into a worse position as regards breach of warranty should be of no effect



Agreement

6.3 The LMA agreed "that consumer law on warranties should be aligned with ICOBS and current practice." One consultee thought that this was "an important safeguard for consumers who have limited, if any, negotiating power with insurers over the core terms of their policies."

6.4 The IUA noted that our proposals were "consistent with the widely accepted approach adopted in the Consumer Insurance (Disclosure and Representations) Act."

Other comments

6.5 Heather Thomas hoped "that the Unfair Terms regulations would anyway have this effect." The Faculty of Advocates asked:

> should the insured be afforded additional rights to withdraw from the contract? In any event, it may be that there would be an appropriate regulatory response to such conduct…

6.6 Professor John Birds said “the drafting will have to take account of the fact that a term may or may not be a warranty in the current strict sense, for example a condition precedent.”

CONTRACTING OUT: BUSINESS INSURANCE

6.7 We proposed that in business insurance contracts, the parties should be free to negotiate alternative remedies for breaches of a warranty provided that both parties are aware of and understand the consequences of departing from the default regime.

6.8 We therefore asked consultees whether, in business insurance, a term which permits an insurer to refuse a claim entirely:

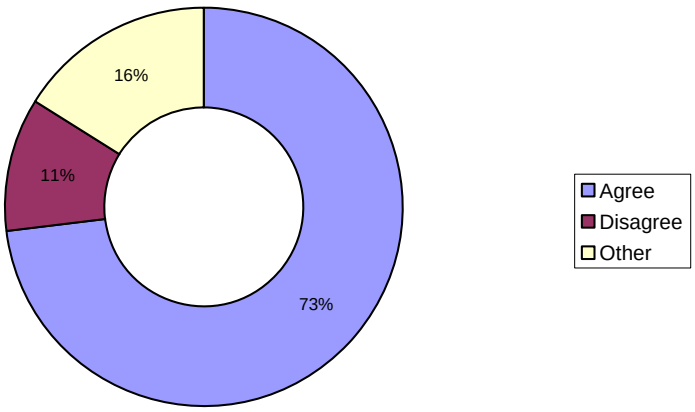
(a) for breach of warranty which was remedied before the loss; or

(b) for breach of a term designed to reduce the risk of another type of loss (or loss at a different place or time);

should be effective only if written in clear, unambiguous language and specifically brought to the attention of the other party before the contract is formed.

6.9 37 consultees responded to this question, of whom 27 (73%) agreed with our proposal. Four consultees (11%) disagreed and six (16%) marked “other”.

In business insurance, a term extending remedies for breach of warranty should be clear, unambiguous and brought to the attention of the other party



Agreement

6.10 RSA agreed and said our proposals could operate to provide:

> … certainty as to whether or not a contractual term in an insurance contract will in fact operate as a warranty; and clarity as to the extent of their respective obligations and remedies where such a warranty applies.

6.11 Airmic members were:

> … overwhelmingly 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.

6.12 Berrymans Lace Mawer LLP thought that "a clear, specific indication of acceptance to such a contracting out by the commercial policyholder in a policy schedule would be preferable to inclusion as a standard policy term." Allen & Overy LLP expressed concern that "an opt-out would become the norm", and suggested that our proposals be mandatory.

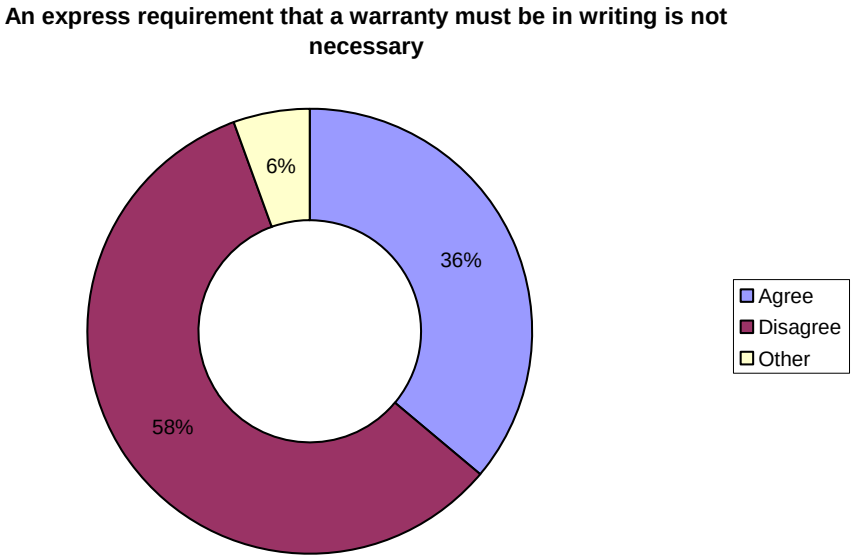
Other comments

6.13 The IUA agreed with the first two parts of the proposal, but thought that "going further than this in the business context is, in our view, not necessary or proportionate." They did not therefore support the inclusion of a requirement that the term had to be brought specifically to the attention of the insured.

6.14 Several consultees, such as Chartis, noted that "the "other party" should be deemed to include the policyholder's broker".

PART 7
REQUIREMENT FOR WRITING

7.1 Section 35(2) of the Marine Insurance Act 1906 requires warranties to be in writing, either in the policy itself or in another document referred to in the policy. This requirement only applies to marine insurance. We suggested that the law should be consistent between marine and non-marine insurance, and therefore proposed abolishing section 35(2). 36 consultees responded to this question. 13 consultees (36%) agreed, 21 (58%) disagreed and two (6%) marked "other".



Agreement

7.2 Most consultees who agreed with this proposal did so on the basis that in practice all warranties would be in writing anyway. Swiss Re said "warranties will be in writing in practice. We do not see a need to expressly stipulate that."

7.3 The IUA said:

> Warranties will continue to be done in writing, either via hard copy policy or slip production or (increasingly) through electronic means. There are market initiatives, such as contract certainty, that suitably also address and manage this issue. As such, we agree that there is no need to specifically identify warranties in this respect.

Disagreement

7.4 The majority of consultees disagreed with this proposal. The Bar Council said:

> We consider that warranties are usually important terms. They should be set out in writing by insurers and provided to insureds directly or through their brokers for onward transmission to their clients. This should be done so as to make policyholders aware of what the warranties require. We appreciate that under the Law Commissions' present proposals warranties would be treated much like definitions of the risk and exclusions, which do not have to be set out in writing. However we consider that it would be desirable (and possibly lead to less disputes) if such provisions were required to be provided in writing.

7.5 Reynolds Porter Chamberlain agreed with other consultees that in practice "warranties will almost always be in writing." Nevertheless they thought "it is desirable that this should continue to be required."

7.6 Several consultees thought that the requirement for writing was important to clarity. NFU Mutual said writing avoided "misinterpretation and misunderstanding." One of the responses to Marsh's internal survey asked "how [else] would the client be aware of the warranty and its terms?" Another said: "The warranty must be in writing to provide evidence."

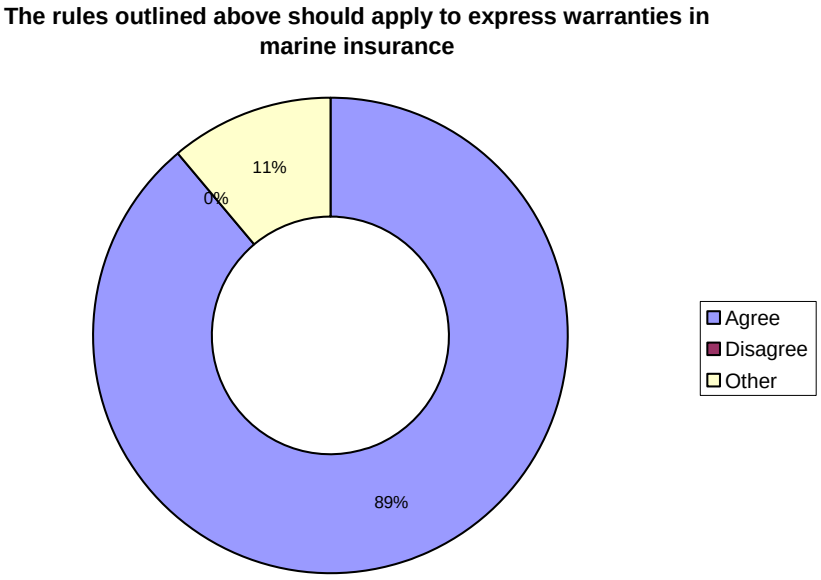
Other comments

7.7 The ABI's members differed "about whether there is still a place for implied warranties."

PART 8
MARINE INSURANCE

APPLICATION OF PROPOSALS TO EXPRESS WARRANTIES IN MARINE INSURANCE

8.1 We thought that our proposals, outlined above, should if adopted apply to express warranties in marine insurance in the same way they applied to other types of insurance. We asked consultees if they agreed and received strong support. Of 27 consultees who answered this question, 24 (89%) agreed that our proposals should apply to warranties set out in marine insurance policies. None of our consultees disagreed with this proposal. Three (11%) marked "other".



Agreement

8.2 Consultees had very little to say on this issue, beyond the fact that they saw no reason to distinguish between marine and non-marine insurance.

8.3 The LMA said:

> We do not agree with all the rules outlined above. However, if such rules are made, generally speaking we believe that insurance contract law should not differentiate between different classes of insurance business.

8.4 IUA said: "There is no compelling reason to treat marine and non-marine risks differently in relation to the use of express warranties."

THE IMPLIED MARINE WARRANTIES

8.5 The 1906 Act implies four warranties into marine insurance contracts: seaworthiness, portworthiness, cargoworthiness and legality.[5] We asked whether these should be retained.

8.6 Of 24 consultees who responded to this question, 16 (66%) agreed that implied marine warranties should be retained. Four consultees (17%) disagreed and four marked "other".

Agreement

8.7 The LMA said "these remain important, are well understood, and should be retained. We are not aware of any problems in this area." The IUA described the implied marine warranties as "a useful comfort blanket underpinning the contractual provisions."

8.8 The Judges of the Court of Session noted that the "four warranties … have existed for over a hundred years without causing problems or calls for reform."

8.9 Professor Howard Bennett said:

> In my opinion, the implied warranties should be retained. Notwithstanding the views of brokers, it is hard to see an argument in favour of illegality or in favour of removing provisions that contribute at least a little towards promoting decent standard shipping. Indeed, I have suggested in writing that law reformers might like to consider whether the underlying law on unseaworthiness of ships insured under time policies (as the vast majority are) should not be strengthened (see 'Reflections on Values etc' at 176-178). English law currently grants a shipowner a licence to be negligent with respect to the seaworthiness of its ships at the expense of its insurers. This is hardly to English law's credit.

Disagreement

8.10 A substantial minority of consultees thought there was no reason to retain the implied warranties. The Bar Council said:

> It is accepted that the parties should be free to agree warranties as to seaworthiness and legality. However, we do not consider it necessary for such terms to be implied …

8.11 RSA thought that if a warranty is to apply to a marine insurance contract the contract should:

> (a) contain an express written provision stating that the relevant term is to operate as a warranty; and

[5] See the Marine Insurance Act 1906, ss 39, 40 and 41.

(b) such provision referred to in (a) above should clearly set out the terms and scope of that warranty.

8.12 Another (confidential) response "strongly disagreed" with retention, and thought "that if an insurer wishes to impose a warranty then he should do so expressly. We see no reason why marine risks should be subject to implied warranties when other classes of insurance are not."

MARINE WARRANTIES: SUSPENSIVE EFFECT

8.13 We proposed that the implied marine warranties should operate in exactly the same way as express warranties, ie as suspensive conditions. We asked consultees whether they thought we were correct to say that there should be no distinction between marine insurance and other insurance in this regard. 23 consultees answered this question, of whom 18 agreed (78%) and 5 marked "other" (22%).

Agreement

8.14 The IUA said:

> The arguments relating to the use of suspensive conditions is generally the same for both implied and express provisions – though the public policy arguments are even stronger for the implied provisions.

8.15 Claims Against Professionals (CAP) believed "the effect should be the same as for other warranties."

8.16 Several consultees who agreed emphasised that parties to marine insurance contracts should be able to opt out of the suspension/restoration regime.

Disagreement

8.17 The LMA marked "other", and suggested that they would prefer that warranties in this context "should remain as true MIA warranties."

Other comments

8.18 The Bar Council reiterated its preference for a causative link approach. It also commented:

> We suspect that many marine insurers would wish breach of warranties to result in termination of the insurance and would not wish to be back on risk when a breach has been remedied.

VOYAGE CONDITIONS

8.19 Sections 42 to 49 of the 1906 Act create implied conditions in marine insurance contracts which must be fulfilled before the risk will attach and the insurer can become liable for loss. We had had no calls from either insurers or insureds to make changes to this part of the 1906 Act, and we therefore did not make any proposals to change this area of the law.

Agreement

8.20 Many consultees agreed without further comment. BIBA said:

> Like implied warranties, the voyage conditions should be retained in the statute, especially as in our experience they do not in practice cause any problems and as the parties are free to contract out of them.

8.21 The Bar Council thought that "the voyage conditions in section 42 to 49 are of fundamental importance to the operation of voyage policies" and advocated their retention. They did though think that this might be a good opportunity to undertake some reform, such as "clarifying the distinction between sections 44 and 45 MIA …"

Disagreement

8.22 One (confidential) response wondered why:

> Insurers are not able to include express voyage conditions in their policies to the extent that they are relevant to any given risk. This would at least ensure that all relevant express terms of the policy are in the contract and easily read and understood by the insured.

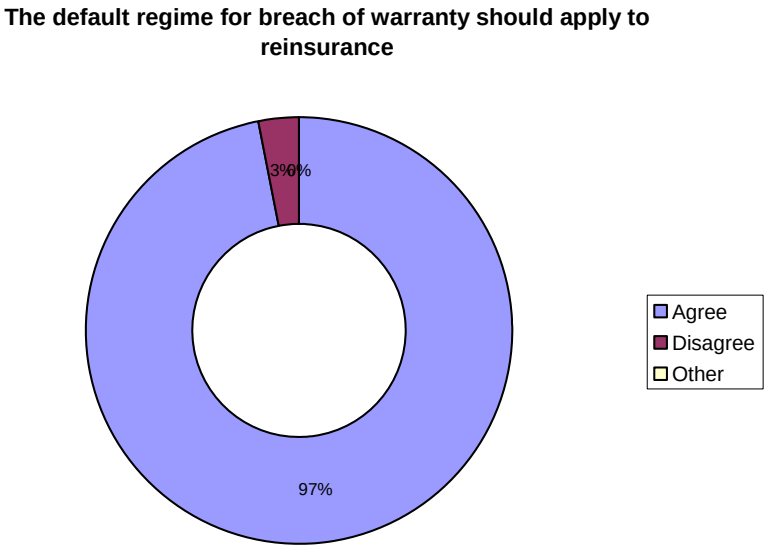
8.23 Steven Goodacre gave a detailed criticism of the operation of statutory voyage conditions, suggesting they created a "significant gap" in cargo policies:

> Cargo owners might be surprised to learn that by reason of this section [44 MIA 1906], though their goods be insured on an "all risks" basis from warehouse to warehouse, there are circumstances in which they could be stolen through no fault of their own and yet insurers escape liability entirely. I am speaking of where a fraud is perpetrated by the shipowner whereby the vessel loads the cargo with the intention of taking it to a different port from that mentioned in the policy for his own ends.

8.24 He noted that this gap had been dealt with by the 2009 Institute Cargo Clauses, but suggested "this emphasises the deficiency in the underlying law, which should not be unnecessarily perpetuated."

PART 9
REINSURANCE

9.1 We proposed that our reforms should apply to reinsurance in exactly the same way as it applied to primary insurance contracts. We anticipated that many reinsurers would want to negotiate bespoke remedies for breaches of warranty, but where they did not do so we thought our regime should apply by default. 32 consultees responded to this question. 31 (97%) agreed and 1 (3%) disagreed.



Agreement

9.2 Direct Line Group agreed, "combined with the freedom for both parties to contract out of the default position." They "would expect full support from Re-Insurers."

9.3 RSA considered that:

> In order to maintain the alignment between direct insurance and reinsurance we believe that it is correct that the proposed default regime in respect of a breach of warranty should apply equally to both.

9.4 IUA did not "see a compelling reason to differentiate primary insurers and reinsurers in respect of warranties."

9.5 Berrymans Lace Mawer LLP were concerned that "insurers should not be left disadvantaged by having different rules applying to their reinsurance unless the parties have clearly and unambiguously contracted out."

Disagreement

9.6 David Hunter was the only consultee to disagree with this proposal. He said:

The reinsurance contract should be between insurer and re-insurer. Re-insurance is written in books of business rather than individual contracts. The re-insurer does not have the same relationship with the insurer and/or the insured's agent/broker.

Other comments

9.7 Investment & Life Assurance Group (ILAG) wanted safeguards to ensure that "the reinsurer would have the option not to be bound by the insurer's decision to waive its rights in respect of a breach of warranty".

APPENDIX
LIST OF CONSULTEES

Addleshaw Goddard LLP
Airmic
Allen & Overy LLP
Association of British Insurers (ABI)
AXA Corporate Solutions Assurance, UK Branch (AXA)
The Bar Council
Professor Howard Bennett
Berrymans Lace Mawer LLP
Professor John Birds
British Insurance Brokers' Association (BIBA)
British Insurance Law Association (BILA)
British Property Federation
Browne Jacobson LLP
Catlin Underwriting Agencies UK Ltd, Catlin Insurance Company (UK) Ltd
Chartered Insurance Institute
Chartis Europe Limited
Mr Philippe Chennaux
Claims Against Professionals (CAP)
Direct Line Group
Faculty of Advocates
Financial Ombudsman Service (FOS)
Forum of Insurance Lawyers (FOIL)
Mr Steve Goodacre
Group Risk Development (GRiD)
Mr John Habergham, Myton Law Ltd
Mr David Hunter
International Underwriting Association (IUA)
Investment & Life Assurance Group (ILAG)
Judges of the Court of Session
K&L Gates LLP
Keoghs LLP
Law Society of Scotland
Mr Geoffrey H. Lloyd
Lloyd's Market Association (LMA)
London & International Insurance Brokers' Association (LIIBA)
Mactavish
Marsh Limited
Munich Re UK Life Branch
NFU Mutual Insurance Society Ltd
Mr Peter Patient
Mr John Potter
Reynolds Porter Chamberlain LLP
Royal & Sun Alliance Insurance plc (RSA)
RWA Group
Swiss Re Europe S.A., UK branch
Ms Ratchuda Thoieam
Ms Heather Thomas
Zurich Insurance Group

We received two responses in confidence from broking firms.