EXPLANATORY NOTES FOR DRAFT INSURANCE CONTRACTS BILL DATED 17 JUNE 2014

CLAUSE 1: MAIN DEFINITIONS

A.1 Some provisions of the draft Bill apply to both "consumer insurance contracts" and "non-consumer insurance contracts". Others only apply to one or the other. Clause 1 defines these important terms.

A.2 Clause 1 provides that a "consumer insurance contract" has the same definition as in the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA). Section 1 of CIDRA defines a "consumer insurance contract" as an insurance contract between an insurer[1] and:

> an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession.

A.3 Under this definition, a "consumer" must:

(1) be an individual – that is a natural rather than a non-natural person; and

(2) enter into a contract "wholly or mainly" for purposes unrelated to their trade, business or profession, if any.

A.4 In "mixed use" policies, where the insurance covers some private and some business use, one must look at the main purpose of the insurance to classify it as one or the other.

A.5 Clause 1 defines "non-consumer insurance contract" as any contract of insurance which does not fall within the CIDRA definition of consumer insurance contract.

A.6 An insurance contract may be "non-consumer" for two reasons: either the policyholder is not an individual, or they have entered into the contract wholly or in significant part for trade, business or professional reasons. In many cases, both reasons will apply: the policyholder will be a company or other corporate entity taking out insurance for commercial reasons. However, either reason is sufficient in itself.

A.7 Clause 1 also defines "insurer" and "insured". Each is described as being a "party to a contract of insurance". The definitions also capture the parties who would be the "insurer" and "insured" under a contract of insurance if the contract were entered into. This part of the definitions caters for Part 2 of the draft Bill, which addresses pre-contractual requirements and therefore applies to persons who are not yet parties to the relevant insurance contract.

A.8 The draft Bill does not define insurance. The common law definition of insurance continues to apply.

A.9 Clause 1 also defines "the duty of fair presentation" by reference to clause 3. The content of the duty is discussed in relation to clause {3}.

[1] Defined by section 1 of CIDRA as "a person who carries on the business of insurance and who becomes a party to the contract by way of that business (whether or not in accordance with permission for the purposes of the Financial Services and Markets Act 2000)".

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CLAUSE 2: APPLICATION AND INTERPRETATION

A.10 Clause 2(1) states that Part 2 of the draft Bill, which addresses the duty of fair presentation, "applies to non-consumer insurance contracts only". This is because the law in this area as it applies to consumer insurance contracts was reformed by the Consumer Insurance (Disclosure and Representations) Act 2012.

A.11 The definitions of consumer insurance contract and non-consumer insurance contract are addressed in clause 1 of the draft Bill.

A.12 Clause 2(2) provides that the duty of fair presentation, set out in the remainder of Part 2, applies in the event of a variation to a non-consumer insurance contract as well as upon the initial agreement of the contract. Clause 2(2)(a) follows the current law by stating that the duty to make a fair presentation of the "risk" relates only to the "changes in the risk" which are "relevant to the proposed variation".[2]

[2] See, for example, *Manifest Shipping Co Ltd v Uni Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1, [2003] 1 AC 469, by Lord Hobhouse at [54]. There is no requirement to disclose information relating to the rest of the original policy; see *Lishman v Northern Maritime* (1875) LR 10 CP 179.

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CLAUSE 3: THE DUTY OF FAIR PRESENTATION

A.13 Clause 3 is central to the proposed reforms. Clause 3(1) introduces a requirement on the insured (at this stage, the person or party who would be the insured if the contract were entered into) to make to the insurer a "fair presentation of the risk" before the contract is entered into. Clause 3(2) identifies this as the "duty of fair presentation".

A.14 The duty of fair presentation replaces the existing duties in relation to disclosure and representations contained in sections 18, 19 and 20 of the Marine Insurance Act 1906 (the 1906 Act).[3] However, it retains essential elements of those provisions. Insurers need potential insureds to provide them with the information they require to decide whether to insure a risk, and on what terms.

A.15 Like the current law, the duty of fair presentation attaches "before a contract of insurance is entered into". Since the law regards renewals as new contracts, the duty also applies when an insurance contract is renewed. This is in accordance with the current law.

A.16 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.

A.17 Clause 3(3) sets out the three elements of a "fair presentation of the risk".

A.18 The first element of a fair presentation is a duty of disclosure, introduced in clause 3(3)(a) and further defined in clause 3(4), which provides two ways to satisfy the duty of disclosure. Clause 3(4)(a) effectively replicates the disclosure duty in section 18(1) of the 1906 Act. Its key features are that the insured must disclose "every material circumstance"[4] which the insured "knows or ought to know".[5]

A.19 The second way to satisfy the duty is intended to operate where the insured has failed to satisfy the strict duty in clause 3(4)(a) but has nevertheless disclosed enough information. Under clause 3(4)(b), the insured has satisfied the disclosure duty if it has disclosed sufficient information to put a prudent insurer on notice that it must make further enquiries which, when answered, would reveal material circumstances which the insured knows or ought to know. This reflects the approach already taken by the courts in some cases.[6] The duty in clause 3(4)(b) must, like the rest of the draft Bill, be read subject to the overriding duty of good faith in section 17 of the 1906 Act. Deliberately withholding information from the insurer that the insured knows to be "material" would not satisfy the duty. The second element of the duty of fair presentation, concerning the form of presentation, may also be breached in such cases.

[3] Sections 18, 19 and 20 of the 1906 Act are repealed by clause 19(2) of the draft Bill.

[4] Defined in clause 7(3).

[5] Defined in clause 4.

[6] For example, *CTI v Oceanus* [1984] 1 Lloyd's LR 476; *Garnat Trading and Shipping v Baominh Insurance Corporation* [2011] EWCA Civ 773.

A.20 Clause 3(3)(b) relates to the form of presentation rather than the substance. It requires that the presentation must be reasonably clear and accessible to "a prudent insurer"; that is, an insurer who is acting prudently to understand and evaluate risks. It is intended to target, on the one hand, "data dumps", where the insurer is presented with an overwhelming amount of undigested information. At the other end of the scale, it is not expected that this requirement would be satisfied by an overly brief or cryptic presentation.

A.21 The third element of the duty of fair presentation, contained in clause 3(3)(c), is based on section 20 of the 1906 Act. It comprises a duty not to make misrepresentations. As under the 1906 Act, where a material representation[7] concerns a matter of fact, it must be "substantially correct".[8] Where it concerns a matter of expectation or belief, it must be made in good faith.

Exceptions to the duty of fair presentation

A.22 As in section 18(3) of the 1906 Act, clause 3(5) of the draft Bill provides exceptions to the insured's duty of disclosure. The exceptions do not apply to the requirement to make the disclosure in a clear and accessible manner, or to the duty not to make misrepresentations. Anything which is the subject of an exception does not have to be disclosed by the insured to the insurer, unless the insurer makes enquiries about that matter.

A.23 Exceptions (a) and (e) replicate the relevant provisions in the 1906 Act almost exactly. The rest of the exceptions relate to circumstances which the insurer "knows", "ought to know" and "is presumed to know". They replace and expand on similar provisions in the 1906 Act. Each of these categories of "knowledge" is expanded on in clause 5.

[7] Defined in clause 7(3).

[8] Defined in clause 7(5).

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CLAUSE 4: KNOWLEDGE OF INSURED

A.24 Clause 4 defines what the insured "knows" and "ought to know" for the purposes of the duty of disclosure in clause 3. It is based on the insured's duty under section 18 of the 1906 Act to disclose every material circumstance known to them, including everything which "in the ordinary course of business, ought to be known" to them.

A.25 Clause 4(2) addresses the position of an insured who is an individual (such as in the case of a sole trader or practitioner). As well as their own knowledge, the insured will also be taken to "know" anything which is known by the person or people who are "responsible for the insured's insurance".

A.26 Clause 4(3) sets out the individuals whose knowledge will be directly attributed to the insured where the insured is not an individual (for example, in the case of a company). They are the insured's senior management and the people responsible for the insured's insurance. These categories reflect important decisions on the common law rules of attribution in the insurance context. However, the intended effect of the phrase "knows only" is that the common law is replaced by the terms of the draft Bill.

A.27 Clause 4(5)(a) defines a person "responsible for the insured's insurance". It is expected to catch, for example, the insured's risk manager if they have one, and any employee who assists in the collection of data or negotiates the terms of the insurance. It may also include an individual acting as the insured's broker.

A.28 Clause 4(5)(b) defines "senior management". It is intended to include (and be more or less limited to), board members or their equivalent in a non-corporate organisation.

A.29 Clause 4(4) defines what an insured "ought to know". It states what has been suggested by some recent cases:[9] that insureds have a positive duty to seek out information about their business by undertaking a reasonable search and by making enquiries of its staff and agents.

A.30 What is "reasonable" will depend on the insured's size, nature and complexity. Clause 4(4) is to be interpreted in light of existing case law. For example, a search may not be expected to evince an admission by a servant of their own negligence.[10] In contrast, the knowledge of an "agent to know", who has a duty to communicate the relevant information to their employer or principal, may well be included.[11] Clause 4(4) explicitly states that a reasonable search may include a search of information held by the insured's agents.

A.31 Unlike section 19 of the 1906 Act, the draft Bill does not include a separate duty on the agent to disclose information to the insurer. The agent's knowledge or other information held by the agent may be caught under clause 4, as discussed above.

[9] See, for example, *Aiken v Stewart Wrightson Members Agency Ltd* [1995] 3 All ER 449.

[10] See, for example, *Australia & New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd* [1960] 2 Lloyd's Rep 241.

[11] See, for example, *Proudfoot v Montefiore* (1867) LR 2 QB 511.

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CLAUSE 5: KNOWLEDGE OF INSURER

A.32 Clause 5 defines what the insurer "knows", "ought to know" and "is presumed to know" for the purposes of the clause 3(5) exceptions to the duty of disclosure. These provisions are based on the exceptions contained in section 18(3) of the 1906 Act and the case law interpreting them.

A.33 Clause 5(1) sets out the individuals whose knowledge will be directly attributed to the insurer, being what the insurer "knows". This provision is intended to capture the person or people involved in making the particular underwriting decision – essentially the underwriter(s). The relevant individual(s) may be, for example, employees of the insurer or of the insurer's agent. Again, the intended effect of the phrase "knows… only" is that the common law is replaced by the terms of the draft Bill.

A.34 Clause 5(2) sets out two types of information which an insurer "ought to know".

A.35 The first, in clause 5(2)(a), is information which an employee or agent of the insurer knows and ought reasonably to have passed on to the underwriter(s). This is intended to include, for example, information held by the claims department or reports produced by surveyors or medical experts for the purpose of assessing the risk.

A.36 The second category, at clause 5(2)(b), is intended to require the responsible underwriter(s) to make a reasonable effort to search such information as is available to them within the insurer's organisation, such as in the insurer's electronic records.

A.37 Clause 5(3) defines what the insurer is "presumed to know".

A.38 The reference to common knowledge in clause 5(3)(a) replicates the language of the 1906 Act. The reference to "common notoriety" has not been retained, because the meaning of that phrase appears to have changed since 1906. At the time the 1906 Act was drafted, "notoriety" appeared to mean the state of being "well known", whereas now it suggests an element of infamy.

A.39 Clause 5(3)(b) is intended to be a modernisation of the reference in section 18(3)(b) of the 1906 Act to "matters which an insurer in the ordinary course of his business, as such, ought to know". The clause explicitly references different classes of insurance and different fields of activity. Many underwriters work by class of business (such as property or professional indemnity insurance) rather than by industry sector (such as oil and gas). An insurer ought to have some insight into the industry for which it is providing insurance, but this insight may reasonably be limited to matters relevant to the type of insurance provided. Thus an employers' liability insurer should know something about the range of industries they insure such as the usual rates of injury in construction or off-shore marine business. It is unrealistic to suppose that they will have a detailed knowledge of all the industries they provide cover for.

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CLAUSE 6: KNOWLEDGE: GENERAL

A.40 Clauses 4 and 5 respectively set out the categories of individual whose knowledge will be directly attributed to the insured and insurer. These rules are intended to replace the common law in the context of the duty of fair presentation. This leaves questions around exactly what an individual "knows", and whether their knowledge should in all cases be attributed to the relevant entity. In this regard, there are useful rules to be drawn from the common law. Clause 6 sets out three further rules about an individual's knowledge.

A.41 Clause 6(2) provides that what an individual knows includes not only what it actually knows but also "blind eye" knowledge. The courts have consistently interpreted knowledge to include cases where someone has deliberately failed to make an enquiry in case it results in the confirmation of a suspicion.[12]

A.42 Clause 6(3) makes further provision about the knowledge of an individual acting as an agent of the insured or insurer. Where the insured's agent knows confidential information which it acquired through a business relationship with someone other than the insured, that information will not be attributed to the insured. The same rule applies as regards the insurer's agent and the insurer.

A.43 This provision will be particularly relevant to the insured's broker. Clause 6(3) is intended to mean that they are not required to break their obligation of confidentiality to one client in order to assist another client with its duty to make a fair presentation. The insured would not be taken to "know" the information and would not have to disclose it. Clause 6(3) also applies in the case of confidential information held by the *insurer's* agent. The insurer would not be taken to know the relevant information and therefore it would not be the subject of an exception to the insured's duty of disclosure.

A.44 Clause 6(4) concerns the situation in which an individual (an employee or agent) perpetrates fraud against his or her principal (whether the insured or the insurer). It is intended to capture a common law exception to the general rules of attribution, known as the *Hampshire Land* principle, which broadly means that a company or other principal is not fixed with knowledge of a fraud practised against it by an agent or officer.[13] However, the exact scope of the principle is far from clear and the Law Commissions did not consider it desirable to legislate prescriptively to constrain it.

A.45 Clause 6(4) therefore preserves "any rule of law" according to which the knowledge of a fraudster is not attributed to the party on whom the fraud is practised.

[12] See, for example, Lord Scott in *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1, [2003] 1 AC 469 at [112].

[13] From *Re Hampshire Land Company* [1896] 2 Ch 743. For Scotland, see L Macgregor, *Agency* (2013), para 13-24.

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CLAUSE 7: SUPPLEMENTARY

A.46 Clause 7 makes further provision about the duty of fair presentation, including definitions of some terms used in earlier provisions.

A.47 Clause 7(1) states that a "fair presentation" does not have to be made in a single document or oral presentation. The draft Bill is intended to recognise that the insurer may need to ask questions about the information in the initial presentation in order to draw out the information it requires to make the underwriting decision. All information which has been provided to the insurer by the time the contract is entered into will therefore form part of the presentation to be assessed.

A.48 Indeed, as is set out in clause 7(6), an insured may withdraw or correct any information provided, or representation made, to the insurer, before the contract is entered into. Once the contract has been entered into, the presentation will "crystallise" for the purposes of assessing whether the insured has complied with the duty of fair presentation.

A.49 Clause 7(2) concerns the scope of the term "circumstance", which is the language used in the 1906 Act. Clause 7(2) repeats the terms of section 18(5) of the 1906 Act in order to make clear that the terms are used in the same way in both pieces of legislation.

A.50 Clause 7(3) contains a definition of material circumstance and material representation, used in clause 3. It is based on sections 18(2) and 20(2) of the 1906 Act. It provides that something is "material" if it would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms. The term "prudent insurer" is also taken from the 1906 Act, and it is intended that existing case law will be used to interpret it. The retention of the "prudent insurer" test means that whether there has been a "fair presentation of the risk" is still assessed principally from the perspective of an insurer.

A.51 Clause 7(4) sets out three examples of things which may constitute "material circumstances". Whether circumstances falling within these examples are in fact "material" will depend on the facts of each case. Of the examples, (c) has particular potential for development by the market. It is intended to recognise that the type of information which should be disclosed may vary significantly dependent on the "class" of insurance being purchased (for example, employers' liability, property) and the "field of activity" in which the insured operates (for example, shipping, financial auditing). It would be helpful for insurers, brokers and policyholder bodies to work together to develop guidance setting out what a standard presentation of the risk should include in particular circumstances.

A.52 Clause 7(5) makes further provision about the duty in clause 3(3)(c) not to make misrepresentations. It defines "substantially correct" in the context of a representation as to a matter of fact. This definition is based on section 20(4) of the 1906 Act.

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CLAUSE 8: REMEDIES FOR BREACH

A.53 This clause sets out the circumstances in which an insurer will be entitled to a remedy for an insured's breach of the duty of fair presentation.

A.54 Clause 8(1) requires the insurer to show that it would have acted differently if the insured had not failed to make a fair presentation; that is, that the insurer would not have entered into the contract at all, or would have done so only on different terms. This "inducement test" reflects the current law as developed following the decision in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*.[14]

A.55 Before the insurer can claim a remedy for breach of the duty of fair presentation, it must therefore show that it was induced to enter into the policy on the relevant terms by the proposer's breach. Clause 8(3) gives the label "qualifying breach" to a breach for which the insurer has a remedy.

A.56 Clause 8(4) distinguishes between qualifying breaches which were "deliberate or reckless", and all other breaches. As under CIDRA, an insurer has different remedies depending on whether or not the proposer's breach of the duty of fair presentation was deliberate or reckless.

A.57 Clause 8(5) defines a "deliberate or reckless" qualifying breach. An insured acted deliberately if it knew that it did not make a fair presentation. In this context, "not caring" is intended to be more culpable than acting "carelessly" in the sense of not taking sufficient care. "Deliberate or reckless" is particularly intended to include fraudulent behaviour.

A.58 The deliberate or reckless definition echoes that in CIDRA. However, in CIDRA a "qualifying breach" must be either deliberate/reckless or careless, since the consumer's duty is to take reasonable care not to make a misrepresentation to the insurer. In non-consumer insurance, breaches do not have to be careless or deliberate/reckless in order to be actionable. "Innocent" breaches of the duty will also give an insurer a remedy if the insurer can show inducement. This reflects the current law for non-consumer insurance.

A.59 Clause 8(6) states that the onus of proving that a qualifying breach is deliberate or reckless is on the insurer. This follows normal legal principles that the party alleging wrongdoing must substantiate it.

A.60 Clause 8(2) provides a signpost to the details of the remedies available for breach of the duty of fair presentation, which are set out in the Schedule.

[14] [1995] 1 AC 501.

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CLAUSE 9: WARRANTIES AND REPRESENTATIONS

A.61 This clause abolishes "basis of the contract" clauses in non-consumer insurance. "Basis of the contract" clauses in consumer insurance were abolished by section 6 of the Consumer Insurance (Disclosure and Representations) Act 2012.

A.62 Under the current law, an insurer may add a declaration to a non-consumer insurance proposal form or policy stating that the insured warrants the accuracy of all the answers given, or that such answers form the "basis of the contract".[15] This has the legal effect of converting representations into warranties. The insurer is discharged from liability for claims if the insured made any misrepresentation, even if it was immaterial and did not induce the insurer to enter into the contract.

A.63 Clause 9(2) prevents a term in the policy or on the proposal form turning representations into warranties in this way.

A.64 The clause is limited in scope. It remains possible for insurers to include specific warranties within their policies. A warranty may deal with an issue that is covered by a question on the proposal form or is otherwise part of the presentation. However, insurers cannot employ a device that purports to convert a representation into a warranty.

[15] *Dawsons Ltd v Bonnin* [1922] 2 AC 413, 1922 SC (HL) 156; *Genesis Housing Association Ltd v Liberty Syndicate Management Ltd for and on behalf of Liberty Syndicate 4472 at Lloyd's* [2013] EWCA Civ 1173, [2013] WLR (D) 368.

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CLAUSE 10: BREACH OF WARRANTY

A.65 Clause 10 replaces the existing remedy for breach of a warranty in an insurance contract, which is contained in section 33(3) of the 1906 Act. Under that section, the insurer's liability under the contract is completely discharged from the point of breach. Section 34(2) makes clear that remedying a breach of warranty does not change this. Clauses 10(1) and 10(7) repeal these existing statutory rules, and any common law equivalent.

A.66 However, the draft Bill does not make any change to the definition of warranty. Warranties are defined in section 33(1) of the 1906 Act with regard to marine warranties, and the common law has developed in parallel in regard to other types of insurance. It is still the case that a warranty "must be exactly complied with, whether material to the risk or not".[16]

A.67 The effect of clause 10(2) is that breach of a warranty by an insured *suspends* the insurer's liability under the insurance contract from the time of the breach, until such time as the breach is remedied. The insurer will have no liability for anything which occurs, or which is attributable to something occurring, during the period of suspension.

A.68 Clause 10(4)(b) makes explicit that the insurer will be liable for losses occurring after a breach has been remedied. It acknowledges, however, that some breaches of warranty cannot be remedied.

A.69 The "attributable to something happening" wording is intended to cater for the situation in which loss arises as a result of an event which occurred during the period of suspension, but is not actually suffered until after the breach has been "remedied". This may be relevant where, for example, a warranty in a policy covering fine wines requires the bottles to be stored on their sides. The insured mistakenly stores them upright, with the effect that the corks shrink and the wine becomes oxidised. Although the insured may "remedy" the breach by laying the bottles on their sides, the permanent loss of quality is "attributable to something happening" during the period of breach so the insurer is not liable.

A.70 Generally, a breach of warranty will be "remedied" where the insured "ceases to be in breach of warranty". This is set out in clause 10(5)(b). However, some warranties require something to be done by an ascertainable time. If a deadline is missed, the insured could never cease to be in breach because the critical time for compliance has passed. Clauses 10(5)(a) and 10(6) are intended to mean that this type of breach will be remedied if the warranty is ultimately complied with, albeit late.

A.71 Clause 10 applies to all express and implied warranties including the implied marine warranties in sections 39, 40 and 41 of the 1906 Act.

[16] 1906 Act, s 33(3).

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CLAUSE 11: TERMS RELEVANT TO PARTICULAR DESCRIPTIONS OF LOSS

A.72 Clause 11 concerns warranties and other terms which are 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. In the event of breach of such a term, it is intended that the insurer's liability will only be excluded for losses of that type, or at that particular time or place.

A.73 Clause 11(1) refers to contractual terms which, if complied with, "would tend to reduce the risk" of loss of a particular kind, or loss at a particular location or time. This is intended to enable an objective assessment of the "purpose" of the provision: if the term were to be complied with, what sorts of loss might be less likely to occur as a result?

A.74 Clause 11(1) does not apply only to warranties and may catch other types of contractual provision such as conditions precedent and exclusion clauses. However, not all such terms will be caught, because some do not relate to particular types of loss or losses at a particular location or time.

A.75 Clause 11 is not intended to apply where a clause goes to the entirety of the nature of the risk (such as a requirement that a ship remains in class, or that a vehicle is not used commercially).

A.76 Clause 11(2) is intended to mean that, if a term falls within clause 11(1), breach of that term will only affect the insurer's liability in respect of losses of the particular type, or at the particular location or time. The insurer will remain liable for other kinds of loss, or losses at a different place or time.

A.77 For example, breach of a warranty requiring a policyholder to have a fire safety system in place would result in suspension of the insurer's liability in respect of fire-related losses, but not in respect of flood losses. Breach of a condition that a building must retain a night watchman would mean that the insurer will have no liability for losses occurring at night, while a watchman should be present.

A.78 A direct causal link between the breach and the ultimate loss is not required. That is, it is not relevant whether or not breach of the term actually caused or contributed to the loss which has been suffered. The clause is intended to provide that the insurer will not be liable for any loss falling within the particular category of loss with which the warranty or other term is concerned.

A.79 Clause 11(3) provides that clause 10 and clause 11 may apply together. This will only arise where the relevant term is found to be a warranty, because clause 10 only applies to warranties. Breach of a warranty would suspend the insurer's liability under the whole contract, under clause 10(2), unless it is found that the warranty is caught by clause 11(1). If that is the case, then the insurer's liability will only be suspended for losses of the relevant type, or at the relevant location or time. If the breach is remedied, the insurer's liability will be restored.

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CLAUSE 12: REMEDIES FOR FRAUDULENT CLAIMS

A.80 This clause sets out the insurer's remedies where the insured makes a fraudulent claim. It does not apply where a third party commits a fraud against the insurer or the insured, such as where a fraudulent claim is made against an insured, who seeks recovery from its insurer under a liability policy.

A.81 The clause does not define "fraud" or "fraudulent claim". The remedies will apply once fraud has been determined in accordance with common law principles.[17]

A.82 Clause 12(1)(a) puts the common law rule of forfeiture on a statutory footing. Where the insured commits a fraud against the insurer, the insurer is not liable to pay the insurance claim to which the fraud relates. Clause 12(1)(b) makes explicit that, where the insurer has already paid out insurance monies on the claim and later discovers the fraud, the insurer may recover these sums from the insured.

A.83 Clause 12(1)(c) provides the insurer with a further remedy. It gives the insurer an option to treat the contract as if it had been terminated at the time of the "fraudulent act". This is dependent on the insurer giving notice of their election to do so to the insured.

A.84 The "fraudulent claim" is, in clause 12(1), to be distinguished from the "fraudulent act", which is intended to be the behaviour that makes a claim fraudulent, which may be after the initial submission of the claim. The timing of the "fraudulent act" is relevant in determining when the liability of the insurer ceases for the purposes of clause 12(1)(c). For example, if an insured submits a genuine claim in January and adds a fraudulent element in March (for example, adding an additional, fabricated, head of loss), the "fraudulent act" takes place in March. This is the point at which the contract may be treated as having been terminated, and from which the insurer's liability ceases.

A.85 Clause 12(2) sets out the consequences if the insurer elects to treat the contract as terminated under 12(1)(c). It can refuse to pay claims relating to "relevant events" occurring after the time of the fraudulent act. It does not have to return any premiums already paid by the insured.

A.86 "Relevant event" is explained in clause 12(4). It refers to any event that would trigger the insurer's liability under the particular insurance contract. Usually, this will be the occurrence of loss or damage which is insured under the contract. However, some insurance contracts, such as professional indemnity insurance contracts, are written on the basis of a "claims made" policy. In such cases, the "relevant event" may be the notification of a claim against the professional, even where no loss has actually occurred.

A.87 Clause 12(3) makes clear that the insurer remains liable in respect of relevant events that took place before the date of the fraudulent act.

[17] For example, see the test for fraud in *Derry v Peek* (1889) LR 14 App Cas 337.

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CLAUSE 13: REMEDIES FOR FRAUDULENT CLAIMS: GROUP INSURANCE

A.88 Group schemes are an important form of insurance. Many schemes are set up by employers to provide protection insurance for their employees. The policyholder is typically the employer, who arranges the scheme directly with the insurer. The group members (typically employees) have no specific status. As they are not policyholders, if a group member makes a fraudulent claim, the insurer's remedies are uncertain.

A.89 This clause is intended to give the insurer a remedy against a fraudulent group member, while protecting the other members who are covered by the insurance.

A.90 Clause 13(1) defines a group scheme to which this clause applies. It follows the definition in section 7 of CIDRA. It covers not only the typical employment scheme, but may also cover block building policies taken out by landlords for tenants, or buildings insurance taken out by landlords for long leaseholders. It is possible for group insurance to cover only one member, where (for example) a freeholder takes out insurance for a single leaseholder.

A.91 To fall within the clause:

(1) A policyholder (A) must take out a policy which is of direct benefit to a third party (C), rather than simply covering A's liability towards C.

(2) C must not be a party to the contract.

(3) It would have been a consumer insurance contract if C had taken out the cover directly.

(4) One of the Cs (CF) must make a fraudulent claim. (If A is fraudulent, clause 12 will apply as normal and the entire policy will be affected.)

A.92 Clause 13(2) provides that the insurer has the same remedies against the fraudulent group member (CF) as it would have against a policyholder who makes a fraudulent claim. These remedies are set out in clause 12. This means that the insurer is not liable to pay the fraudulent claim. It may retain any premiums paid by, or on behalf of, CF. It may also treat CF's insurance cover as having been terminated at the time of the fraudulent act. To exercise this option, it must serve notice on both the policyholder A and CF.

A.93 Importantly, the insurer may not treat its entire liability under the contract as terminated, but only its liability to CF. Clauses 13(2)(a) and (b) provide that the remedies are only exercisable against, and can only affect the rights of, that fraudulent member.

A.94 The arrangements for payment of insurance monies under a group insurance contract differ. The insurer may either pay insurance monies to the policyholder, A (who would pass it on to the relevant group member) or may pay the group member directly. Clause 13(3)(a) provides that the insurer may reclaim any sums paid in respect of the fraudulent claim from either A or CF, depending on which of them is (or was last) in possession of the money.

EXPLANATORY NOTES

CLAUSE 14: IMPLIED TERM ABOUT PAYMENT

A.95 Under the current law, the courts in England and Wales have found themselves unable to say that the insurer has an implied obligation to pay valid insurance claims within a reasonable time.[18] Clause 14(1) implies this obligation into all contracts of insurance. In the interests of certainty, this applies also to Scotland. Because it is a contractual term which is created, breach of the term will give rise to the usual remedies for breach of contract, including damages.

A.96 Clauses 14(2) and 14(3) make further provision about a "reasonable time". Under clause 14(2), this will always include time to investigate and assess the claim. Clause 14(3) contains a non-exhaustive list of factors which might be relevant in considering whether the insurer has acted within a reasonable time.

A.97 The type of insurance involved may be relevant because, for example, claims under business interruption policies usually take longer to value than claims for property damage. In terms of size and complexity, larger more complicated claims will usually take longer to assess than straightforward claims. A claim may be complicated by its location, for example: if an insured peril occurs abroad, it is possible that investigation will be more difficult.

A.98 The reference to relevant statutory or regulatory rules or guidance might include, for example, rule 8 of the Financial Conduct Authority's Insurance: Conduct of Business sourcebook (ICOBS), and paragraph 27 of Schedule 1 to the Consumer Protection from Unfair Trading Regulations 2008.

A.99 A number of factors beyond the insurer's control might delay payment. For example, investigations may be held up because the policyholder or a third party fails to provide relevant information in a timely manner. An insurer's decision may also be dependent on the actions of another insurer. This may arise as a result of the interaction between business interruption and property insurance, or in the subscription market where a follower may be dependent on the lead insurer.

A.100 Clause 14(4) gives the insurer a defence to a claim for breach of the implied term where it had reasonable grounds for disputing the validity or quantum of a claim. In such a case, more must be shown before an insurer who makes a reasonable but ultimately wrong refusal will be found to be in breach.

A.101 Clause 14(4)(b) provides that the insurer's conduct in handling the claim may be a relevant factor in deciding whether the term was breached and, if so, when. An insurer who has a reasonable basis for disputing a claim or at least conducting further investigations may still be in breach of the implied term if, for example, it conducts its investigation unreasonably slowly, or is slow to change its position when further information confirming the validity of the claim comes to light.

[18] *Insurance Corporation of the Channel Islands Ltd v McHugh* [1997] 1 Lloyd's Rep IR 94. This is not the case in Scotland; see for example *Strachan v The Scottish Boatowners' Mutual Insurance Association* 2010 SC 367.

A.102 Clause 14(5) preserves the distinction between claims for breach of the implied term in clause 14(1) and claims for (a) the substantive insurance claim and (b) interest, whether contractual, statutory or otherwise. Breach of the implied term must be argued and proven separately.

EXPLANATORY NOTES

CLAUSE 15: GOOD FAITH

A.103 Section 17 of the Marine Insurance Act 1906 provides that insurance contracts are contracts based upon the utmost good faith. It also provides that, "if the utmost good faith be not observed by either party, the contract may be avoided by the other party." The common law mirrors this provision in relation to non-marine insurance.

A.104 Clause 15 is intended to remove avoidance as a remedy for breach of good faith. Clause 15(1) abolishes any legal rule allowing a party to avoid an insurance contract where the other party has not acted in good faith. This addresses the common law. Clause 15(3)(a) removes the statutory reference to the remedy of avoidance from section 17 of the 1906 Act.

A.105 Clauses 15(2) and 15(3)(b) provide (respectively) that the common law good faith rule and section 17 of the 1906 Act are subject to the provisions of the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) and this Bill.

A.106 Clause 15(4) repeals section 2(5) of CIDRA, which is superseded by the provisions of this clause.

A.107 The intention of clause 15 is that good faith will remain an interpretative principle, with section 17 of the 1906 Act and the common law continuing to provide that insurance contracts are contracts of good faith.

EXPLANATORY NOTES

CLAUSE 16: CONTRACTING OUT: CONSUMER INSURANCE CONTRACTS

A.108 This clause applies to all consumer insurance contracts.

A.109 Clause 16(1) prevents insurers from contracting out of the provisions of the draft Bill to the detriment of the consumer. A policy term, or a term in any other contract, is rendered void to the extent that it would put the consumer in a worse position than the provisions in the draft Bill on:

(1) Breach of warranty (clause 10);[19]

(2) Terms relevant to particular descriptions of loss (clause 11);

(3) Remedies for fraudulent claims (clause 12);

(4) Remedies for fraudulent claims: groups (clause 13); and

(5) Implied term about payment (clause 14).

A.110 Clause 16(1) applies, not only to any term of a consumer insurance contract, but also to "any other contract". This makes provision for situations where there may be a contracting out agreement that is separate from the insurance contract.

A.111 Clause 16(2)(a) makes explicit that the restriction on contracting out also applies to variations to a consumer insurance contract.

A.112 Clause 16(2)(b) applies to consumers who are beneficiaries of a group insurance contract caught by clause 13. The policyholder in this situation will usually be a non-consumer insured (such as an employer) and therefore the contract will usually be a non-consumer insurance contract. This is covered by clause 17(4) and discussed below. However, it is possible that a consumer may take out a policy for the benefit of other consumers who become group members. In this situation the contract would be a consumer contract. This is covered by clauses 16(1) and 16(2)(b). The effect of these provisions is that a term of such a contract which seeks to put the members of a group scheme in a worse position than they would be in under clause 13 is, to that extent, of no effect.

A.113 Clause 16(3) states that clause 16 does not apply to contracts to settle claims. A settlement of a claim will therefore continue to provide certainty for the parties. It would not be possible for a consumer to go behind a settlement by alleging that it was less favourable than their entitlement under the draft Bill.

[19] Clause 9 does not apply to consumer insurance contracts; an equivalent provision for consumer insurance contracts appears at section 6 of CIDRA.

EXPLANATORY NOTES

CLAUSE 17: CONTRACTING OUT: NON-CONSUMER INSURANCE

A.114 This clause applies to all non-consumer insurance contracts. It concerns the situations in which an insurer can use a term of the non-consumer insurance contract to put the insured in a worse position than it would be in under the default rules contained in the draft Bill.

A.115 Clause 17(3) provides that, generally speaking, parties can agree to contract terms which are less favourable to the insured than provisions of the draft Bill. Such terms may appear in the insurance contract itself or any separate contract. However, such terms will only be valid if the insurer has complied with the "transparency requirements", contained in clause 18 and discussed below.

A.116 There are only two situations in which the insurer cannot contract out to the detriment of the insured. These are set out in clauses 17(1) and 17(2). They are:

(1) the prohibition on "basis of the contract" and similar provisions, in clause 9; and

(2) deliberate or reckless breaches of the insurer's duty, contained in clause 14(1), to pay claims within a reasonable time. Clause 17(5) defines "deliberate or reckless" in this context.

A.117 Clause 17(4) addresses the situation in which a non-consumer policyholder, such as an employer, takes out a group insurance policy for the benefit of members who are consumers. The contract is a non-consumer insurance contract but the real beneficiaries are consumers and should be protected from contracting out as they are under clause 16. Clause 17(4) therefore provides that an attempt to put the consumer members in a worse position than they would be in under the provisions in the draft Bill on fraudulent claims in group insurance (contained in clause 13) is, to that extent, of no effect.

A.118 Clauses 17(6) and 17(7) repeat clauses 16(2)(a) and 16(3) but for non-consumer insurance. Clause 17(6) makes explicit that the provisions on contracting out also apply to variations to a non-consumer insurance contract. Clause 17(7) states that clause 17 does not apply to contracts to settle claims. A settlement of a claim will therefore continue to provide certainty for the parties. It would not be possible for an insured to go behind a settlement by alleging that it was less favourable than their entitlement under the draft Bill.

EXPLANATORY NOTES

CLAUSE 18: THE TRANSPARENCY REQUIREMENTS

A.119 As discussed above, clause 17(1) provides that a contractual term which puts the non-consumer insured in a worse position than it would be in under the terms of the draft Bill is of no effect unless the requirements of clause 18 are satisfied. Such a term is referred to in clause 18(1) as a "disadvantageous term".

A.120 The clause 18 conditions (the "transparency requirements") are set out in clauses 18(2) and 18(3).

A.121 The requirement, in clause 18(2), that the insurer take sufficient steps to draw the term to the insured's attention is intended to ensure that the insured is given a reasonable opportunity to know that the disadvantageous term exists before it enters into the contract.

A.122 Under the general law of agency, this requirement could also be satisfied by taking sufficient steps to draw the term to the attention of the insured's agent. If the insured (or its agent) has actual knowledge of the disadvantageous term, clause 18(5) makes clear that an insured may not claim that the insurer has failed to draw the term sufficiently to its attention.

A.123 The requirement should be interpreted flexibly to take account of the full range of participants in the insurance market. This is implied by the phrase "sufficient steps".

A.124 In addition, clause 18(4) makes explicit that in determining whether the transparency requirements have been met, the characteristics of insured persons of the kind in question should be taken into account, as should the circumstances of the transaction. What is sufficient for one type of insured may not be sufficient for another. It is intended that the extent to which a term should be brought to the attention of a policyholder could vary considerably depending on whether the policyholder is, for example, a sole trader buying standardised retail public liability insurance or a charterer purchasing a voyage policy at Lloyd's using a broker.

A.125 Under clause 18(3), the term must also be clear and unambiguous as to its effect. This is intended to require the *consequences* of the disadvantageous term to be clear and unambiguous. For example, it would not normally be sufficient to say that "section 14 of the Insurance Contracts Act 20XX does not apply to this contract", despite the fact that this is clear and unambiguous in itself. Rather, an insurer wishing to contract out of the requirement to pay sums due within a reasonable time might have to say that "Section 14 of the Insurance Contracts Act 20XX does not apply to this contract, meaning that we shall have no liability to you in respect of any loss or damage suffered by you as a result of our failure to pay sums due to you under this contract within a reasonable time".

A.126 Again, how far the term has to spell out the consequences will depend on the nature of the insured party and the extent to which it could be expected to understand the consequences of the provision.

EXPLANATORY NOTES

CLAUSE 19: PROVISION CONSEQUENTIAL ON PART 2

A.127 This clause affects:

(1) the Marine Insurance Act 1906, sections 18, 19 and 20;

(2) the Road Traffic Act 1988, section 152(2); and

(3) the Consumer Insurance (Disclosure and Representations) Act 2012, section 11.

Marine Insurance Act 1906, sections 18, 19 and 20

A.128 Part 2 of the draft Bill now provides the content of the duty imposed on the non-consumer insured in the pre-contractual phase of the relationship between insurer and insured. Clause 19(2) therefore omits sections 18 to 20 of the 1906 Act, which currently govern the pre-contractual relationship between insured and insurer. Clause 19(3) abolishes any rule of law to the same effect as those provisions.

A.129 The combined effect of the relevant provisions of the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) and of this draft Bill is to replace sections 18, 19 and 20 of the Marine Insurance Act 1906.

Road Traffic Act 1988, section 152(2)

A.130 The Road Traffic Act 1988 (RTA 1988) provides for a scheme of compulsory motor insurance. Motor insurers generally have an obligation to satisfy judgments obtained by third parties, even if the insured has breached the insurance contract. There is a limited exception in section 152(2) of the RTA 1988, by which an insurer may obtain a declaration that it is entitled to avoid a policy because the insured has made a non-disclosure or misrepresentation. However, the effect of this section is much more limited than first appears. Under an agreement between the Motor Insurance Bureau and the government, insurers have undertaken to ensure that the third party is compensated.

A.131 Section 11(3) of CIDRA amended section 152(2), so that an insurer is only entitled to avoid a consumer insurance policy under section 152(2) if it may avoid the policy under the provisions of CIDRA.

A.132 Clauses 19(4), 19(5), 19(6) and 19(7) further amend section 152(2), so that an insurer is only entitled to avoid a non-consumer insurance policy under section 152(2) if it may avoid the policy under Part 2 of this draft Bill.

Consumer Insurance (Disclosure and Representations) Act 2012

A.133 As a result of the amendments to the 1906 Act and the RTA 1988 set out in clause 19, sections 11(1) and 11(2) of CIDRA, which deal with the points in relation to consumer insurance, are now superseded and are omitted.

EXPLANATORY NOTES

CLAUSE 20: SHORT TITLE, COMMENCEMENT, APPLICATION AND EXTENT

A.134 Under clause 20(2), the lead-in time for the coming into force of the Act (once passed) is 18 months, to enable insurers to prepare for the new regime.

A.135 Clauses 20(3) and (4) set out which insurance contracts and variations the Act will apply to once it is in force.

A.136 The draft Bill extends to England and Wales and to Scotland (clause 20(5)). Neither the Law Commission nor the Scottish Law Commission has the requisite mandate to make recommendations or draft legislation to cover Northern Ireland, the Channel Islands or any other jurisdiction.

EXPLANATORY NOTES

SCHEDULE: INSURER'S REMEDIES FOR QUALIFYING MISREPRESENTATIONS

PART 1: CONTRACTS

A.137 Part 1 of the Schedule sets out the remedies available for qualifying breaches of the duty of fair presentation made before the contract is entered into. This would include breaches of that duty in relation to renewals.

Deliberate or reckless breaches

A.138 Paragraph 2 specifies the remedies for qualifying breaches that are deliberate or reckless, as defined in clause 8. Under paragraph 2(a), the insurer is entitled to avoid the contract. Under paragraph 2(b), the insurer may keep the premiums paid.

Other breaches

A.139 If the breach of the duty of fair presentation was not deliberate or reckless, the remedy is based on what the insured would have done if the insured had not made the qualifying breach; that is, if the insured had made a fair presentation of the risk. The remedies are as follows:

(1) Where an insurer would have declined the risk altogether, the policy may be avoided, the claim refused and the premiums returned (paragraph 4).

(2) Where the insurer would have contracted on different terms (except for those relating to the premium), those terms are applied to the claim. Thus if the insurer would have excluded a particular type of claim, the insurer should not be obliged to pay claims that would fall within the exclusion. Similarly, if an insurer would have imposed a warranty or excess, the claim should be treated as if the policy included the warranty or excess (paragraph 5).

(3) Where an insurer would have increased the premium, the claim should be reduced proportionately to the under-payment of premium. For example, if an insurer only charged £10,000 but should have charged £15,000, the insured would receive two thirds of the claim (paragraph 6).

In some cases, both paragraphs 5 and 6 will apply: if the insurer would have entered the contract on different terms (other than terms relating to the premium) and would have charged a higher premium, the different terms may apply to the claim and, in addition, the claim may be reduced proportionately.

PART 2: VARIATIONS

A.140 Part 2 of the Schedule sets out the remedies available for qualifying breaches of the duty of fair presentation made when an insurance contract is being varied.

Deliberate or reckless breaches

A.141 Paragraph 8 specifies the remedies for qualifying breaches that are deliberate or reckless in the context of variations. Under paragraph 8(a), the insurer is entitled to treat the contract as having been terminated with effect from the time the variation was made. Under paragraph 8(b), the insurer may keep the premiums paid.

Other breaches

A.142 If the breach of the duty of fair presentation was not deliberate or reckless, the remedy is based on what the insurer would have done had the insured made a fair presentation of the additional or changed risk on variation.

A.143 In some cases, the draft Bill makes a distinction between variations involving a reduction in premium (paragraph 10), and all other variations (that is, where the premium was increased, or not changed, as a result of the variation) (paragraph 9). This is intended to reflect the fact that, where the overall premium is reduced, the overall bargain between the parties is affected. The variation therefore goes to the heart of the insurance policy.

A.144 In either case, if the insurer would not have agreed to the variation on any terms, the insurer may treat the contract as if the variation was never made. If the premium was increased, the insurer must return the additional premium paid for the variation (paragraph 9(2)). If the premium was reduced, the insurer may pay a proportionate reduction of claims after the variation (paragraphs 10(2) and 11).

A.145 Again, in either case, if the insurer would have included additional terms relating to the variation (for example a warranty relating to the new risk), the insurer may treat the variation as if it contained those terms (paragraphs 9(3)(a) and 10(3)(a)).

A.146 If the insurer would have charged a different premium for the variation, or would not have changed the premium when in fact it has increased or reduced it, any claims arising after the variation may be reduced in proportion to the premium that the insurer would have charged (paragraphs 9(3)(b) and 10(3)(b)). Paragraph 11(3) makes further provision about the formula, depending on whether the insurer increased or reduced the premium or did not change it.

PART 3: SUPPLEMENTARY

A.147 Section 84 of the Marine Insurance Act 1906 sets out an insurer's duties to return premiums. Section 84(3)(a) states that where the policy is avoided by the insurer from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured. Under paragraph 12, this is to be read subject to the provisions of the Schedule, which allows the insurer to retain premiums in some cases.