



## **Insurance contract law for business – the need for reform**

Insurance contract law is out of date and no longer serves the UK business insurance market. In a report published today, the Law Commissions of England and Wales and of Scotland make recommendations for reform that will modernise business insurance law. The majority of these recommendations are included in the Government's Insurance Bill, introduced into Parliament today.

The existing law that governs business insurance contracts is based on 18th and 19th century cases, which were codified in the Marine Insurance Act 1906. It is now out of step with the modern insurance market. It is weighted in favour of insurers, giving them wide-ranging powers to refuse claims. Even if rarely used, these powers can undermine trust between insurers and policyholders and generate uncertainty among brokers and buyers as to whether insurers will pay. These doubts can lead to policyholders buying on price, driving down quality in the market.

The Law Commissions are recommending reform in four areas:

**Disclosure and misrepresentation** – existing duties on business policyholders can be difficult to comply with, allowing insurers to refuse claims. The Commissions are recommending a replacement “duty of fair presentation”. Business policyholders would still have a duty to volunteer information but it would be clearer what this involves. Insurers would have a duty to play a more active role in asking questions. The single remedy of avoidance under the current law, where insurers can refuse to pay the whole of a claim, would be replaced with a scheme of proportionate remedies.

**Warranties** – when a policyholder makes a promise, or a “warranty”, to mitigate risk, for example to keep a burglar alarm working, the warranty is breached if the alarm breaks. The insurer can then refuse a claim, even if the alarm is fixed before there is any loss. Insurers can also refuse a policyholder's claim even if it is not related to the breach of warranty.

The Commissions are recommending that, once a breach of warranty has been remedied, insurers should be required to pay any claim arising after that point. “Basis of the contract” clauses, which can turn any statement from a policyholder into a warranty, would be abolished under the Commissions' recommendations.

The Commissions also recommend that breach of a warranty or similar term that relates to a particular type of loss should not enable an insurer to escape liability for losses of a completely different kind. For example, an insurer should not be entitled to refuse a flood claim because the policyholder has installed the wrong type of lock.

**[more]**

**Fraud** – the report provides insurers with clear, robust remedies for fraud. It commends the common law rule that, where any part of a claim is fraudulent, the whole claim should be forfeit. It clarifies the insurers’ right to refuse claims that are made after a fraud but also sets out their liability to pay earlier, valid claims.

**Late payment** – the Commissions are recommending that insurance law should be brought into line with other areas of contract law, making insurers potentially liable for losses caused by their failure to pay valid claims within a reasonable time.

These recommendations would be a default scheme for business insurance, leaving the parties free to agree alternative arrangements in their contracts. For consumer insurance, the Commissions are recommending a mandatory scheme.

The Commissions’ recommendation relating to late payment has not been included in the Government’s Bill. Also not included is the recommendation that terms designed to reduce the risk of one type of loss should not be used to refuse claims for a different type of loss. Following consultation, the Government did not consider these clauses sufficiently uncontroversial at this stage for the Law Commission special procedure. The Government has asked the Law Commissions to continue to work with stakeholders to find a workable solution, and will introduce any solution at the next legislative opportunity.

David Hertzell, Law Commissioner for commercial and common law, said:

“Insurance underpins a healthy and prosperous society. It enables businesses and individuals to protect themselves against risk. But the law no longer reflects the realities of today’s commercial practices.

“We are delighted the Government has taken forward the majority of our recommendations in the Insurance Bill. While it is disappointing that two of our recommendations are not included, we will continue to work with insurers, brokers and buyers to find the solutions they are looking for.”

Professor Hector MacQueen, Scottish Law Commissioner, said:

“Our reforms will balance the interests of insurers, brokers and buyers, and provide the framework for an effective, competitive and trusted business insurance market. The support we have received for our proposals from across the insurance market shows that these reforms are urgently needed, and we look forward to the Bill making a swift passage through Parliament.”

The report, Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment, is available on [www.lawcom.gov.uk](http://www.lawcom.gov.uk) and [www.scotlawcom.gov.uk](http://www.scotlawcom.gov.uk).

### **Third Parties (Rights against Insurers) Act 2010**

The Insurance Bill also includes a provisions that will amend the Third Parties (Rights against Insurers) Act 2010 so that it can be brought into force. The Act, which derived from recommendations of the Law Commission and Scottish Law Commission, simplifies the procedure by which third parties can claim against an insurer when the insured is, in broad terms, insolvent or has been dissolved.

**[ends]**

## **Notes for editors**

1. The Law Commission and the Scottish Law Commission are non-political independent bodies, set up by Parliament in 1965 to keep all the law of England and Wales and of Scotland under review, and to recommend reform where it is needed.
2. For more details on this project, visit the Insurance Contract Law project pages on <http://www.lawcom.gov.uk> or <http://www.scotlawcom.gov.uk>
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