The Insurance Act 2015 and Marine Insurance

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*Speaker Bio*

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# The Nature and Purpose of the 2015 Act

To the marine insurance lawyer (and probably even more so for the non-lawyer) the Insurance Act 2015[[1]](#footnote-1) makes a puzzling contribution to the law in this area. It came into force in mid-August 2016, and yet its precise impact on the field is not yet known with complete certainty. There are a number of predictions that can be made about its likely impact on key issues.

This paper reviews a number of crucial issues, and provides a guide to further sources that might be consulted. This document is a general review of issues and should not be treated as legal advice or relied on as such. There are five key general points of interest to bear in mind:

1. The Insurance Act 2015 is the product of a lengthy investigation by the Law Commission of insurance contract law in the United Kingdom. It was **not** designed to deal specifically with the issues in marine insurance law, indeed there was an underlying assumption that the marine market would ‘contract out’ of any rules that were not suitable.

2. The 2015 Act applies to all non-consumer insurance contracts made after the 12th August 2015.[[2]](#footnote-2) There is no differentiation in the statute between marine insurance and non-marine insurance (or large and small commercial risks). Some marine insurance contracts could be classified as consumer contracts (e.g. some forms of yacht insurance). The definition of a consumer for these purposes is ‘an individual who enters into the contract wholly or mainly for purposes unrelated to the individual’s trade, business or profession’.[[3]](#footnote-3) I will assume for the purposes of this note that the insured is a non-consumer.

3. The statute does not prevent (in most cases)[[4]](#footnote-4) the use of existing contracts or arrangements. It will often change the duties the parties owe to each other under those contracts, and the legal remedies that can be sought in the event of breach.

4. It established a specific framework for parties to ‘contract out’ of the Act, and it is not necessarily enough simply to have a different rule expressed in the contract. This is discussed in detail in the following section, Key Area 1: ‘Contracting Out’.

5. The initial market reaction has been mixed, with some marine providers seeking to revert back to the ‘traditional’ rules as found in the Marine Insurance Act 1906[[5]](#footnote-5) (and associated case law) and others generally following the new provisions. It will be important to understand what principles are being agreed, and not simply look at the terms of the contract (which may not reference the statutes directly).

# Key Area 1: ‘Contracting Out’

The Marine Insurance Act 1906 was, in almost all cases, subject to the agreement made between the parties. The Insurance Act 2015 can also be varied (in almost all cases) by the contract, but establishes a specific procedure by which parties can do so. This is important, as many marine insurance contracts are likely to vary the duties and remedies in the 2015 Act. If the proposals are not done in accordance with the mechanism laid down in ss. 15-17, then a court might be required to enforce the rules in the statute despite the contrary being stated by the contract.

This is established in statutory form in ss. 16(2) and 17. Section 16(2) states that any term ‘which would put the insured in a worse position as respects [the substantive areas covered under the Act] than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect’, unless the conditions laid down in s. 17 are met. Section 17 requires two things:

(1) that the term be ‘clear and unambiguous’ as to its effect; and

(2) that ‘the insurer… take sufficient steps to draw the disadvantageous term to the insured’s attention before the contract is entered into’.

Each requirement is contextual and takes into account the nature of the transaction and the insured. It is likely that ‘standard’ variations (such as the re-imposition of MIA 1906-style rules) are likely to be viewed as less objectionable than unusual alterations. As to the requirement of notice, this will be resolved in most situations in the marine market by s. 17(5), which presumes notice of the clause where the insured or its agent (e.g. broker) had actual knowledge of the clause before contracting. However, the ‘clear and unambiguous’ element will still need to be satisfied and drafters of clauses should take advice.

Even where parties draft effective contractual provisions to replace the 2015 Act, it should be remembered that these are contractual provisions only, and are not statutory in nature. The 1906 Act has been amended by the 2015 Act, and cannot simply be called back into life e.g. by stating that ‘the provisions of the 1906 Act shall apply instead’.

These provisions are significant in many of the discussions to follow, as underwriters (especially the International Group of Protection & Indemnity Clubs) have decided to contract out of much of the 2015 Act, and references to ‘contracting out’ in this paper should be read as referring to the process described by ss.16, 17 IA 2015.

# Key Area 2: ‘The Duty of Fair Presentation of the Risk’

The duties to disclose material circumstances (s. 18 MIA 1906) and to not misrepresent (s. 20 MIA 1906) have been bundled into a single duty to make a ‘fair presentation of the risk’ (ss. 3-8 IA 2015). The separate duty on a broker to make full disclosure (under the old s.19 MIA 1906) has been removed. The ‘fair presentation’ label is somewhat unhelpful as the previous duty under s. 18 MIA 1906 had also come to be known by this same shorthand. It is clear that the new duty is different in many ways from the old duty.

**Key changes:**

## 1. The Form and Content of the Presentation

It is not required that the insured disclose every material circumstance as under the old s. 18(1). The duty is in some ways more onerous and in other less onerous than the old law. The insured is now not in breach if it fails to disclose every material circumstance, but has disclosed sufficient information ‘to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances’ (s. 3(4)(b) IA 2015). However, the insured is not now able to ensure compliance by ‘over-disclosing’ information (what had become known as ‘data dumping’), by putting vast amounts of relevant and irrelevant information together into a system and granting the underwriter access to the unsorted whole. The presentation of the risk now must be ‘in a manner which would be reasonably clear and accessible to a prudent insurer’ (s.3(3)(b) IA 2015).

## 2. Who knows what?

One of the ongoing problems of the 1906 Act, and this is exacerbated by the rise of technology, lay in establishing what the insured and underwriter knew (or were taken to know) for the purposes of disclosure. The 2015 Act deals with these issues in considerable detail, but in a manner which is controversial, and likely to attract litigation.

### Knowledge of the Insured

The IA 2015 largely replicates the approach of the 1906 Act in that it asks what the insured knew or ought to have known. Where it differs is in the detailed identification in s. 4 IA 2015 of which human beings hold the requisite knowledge for a corporate insured. This now extends specifically to senior management and/or those responsible for arranging insurance cover. In a multi-national business this may require co-ordination across national boundaries and is likely to be complex and costly. This will only be added to by the new requirement that an insured’s knowledge extend to information which it could discover. In an age of vast quantities of digital information, often collated in databases, the application of the statutory test in s. 4(6) is likely to require careful planning by an insured and its advisors: ‘an insured ought to know what should reasonably have been revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means)’.

### Knowledge of the Underwriter

This is detailed in s. 5 and is significant because an insured need not disclose a circumstance known to the underwriter. There is no equivalent duty to investigate the risk or use available databases, unless that would be routine within the market concerned. S. 5(3) limits insurer knowledge to:

‘(a) things which are common knowledge, and

(b) things which an insurer offering insurance of the class in question to insureds in the field of activity in question would reasonably be expected to know in the ordinary course of business’.

## 3. Remedies for Breach

Under the MIA 1906, the only remedy for failing to make a full disclosure (or making an operative misrepresentation) was avoidance of the contract *ab initio*. This would (unless fraud was proven) require the underwriter to return the premium, but it would not be liable for any losses. This proved an extremely powerful remedy in the hands of underwriters who felt that the claim was unjustified for whatever reason.

The development of the duty to disclose was therefore matched with a softening of the remedies for breach. These are identified by s. 8 IA 2015, but described in detail in Schedule 1 at the end of the statute. The precise remedy applicable now depends on the nature of the breach, and the effect on the underwriter’s position.

### Remedies for ‘Fraud’

The IA 2015 does not use the term ‘fraudulent’ to describe breaches of the duty of fair presentation, but the definition as knowing or reckless untruth broadly matches the common law definition for fraudulent misrepresentation. In cases where the underwriter can prove this standard, it can treat the contract as void and retain the premium. Under the system operated for many years under the MIA 1906, there was little incentive for underwriters to seek to prove that a non-disclosure was fraudulent. Under the new regime, underwriters will need to prove fraud to be certain that they can reject the claim in its entirety (by having the contract declared void).

### Remedies for Non-Fraudulent Conduct

Where the failure to make a fair presentation is negligent or innocent in nature, Schedule 1 IA 2015 provides for a range of proportionate remedies. These essentially seek to mirror what would have happened had a fair presentation been made (i.e. what would have been the outcome of negotiations had the insured disclosed fact [X] which was missed out of the original briefing).

* Where the underwriter can show that it would not have contracted on any terms, had circumstance [X] been disclosed, then it can treat the contract as void but must return the premium;
* Where the underwriter can show that it would have made the contract but on different terms (other than terms relating to price) then the contract is enforced as if those terms had been agreed.
* Where the underwriter would (perhaps in addition to other changes) have required a higher premium, then the claim is reduced proportionality. So if the premium would have risen from £30,000 to £40,000, then of the initial claim is payable.

In many cases, this will provide a suitable basis for negotiating an appropriate settlement. In hard cases, it is likely to lead to complex litigation. So, for example, let us assume that the evidence shows that if circumstance [X] had been disclosed the underwriter would have insisted on a strict warranty; the insured counters by persuading the court that a ‘held covered’ clause would have been agreed to ‘soften’ the warranty. When enforcing this ‘new’ version of the contract do we assume that the insured would have given proper notice to trigger the held covered clause? Or not? How would evidence on this be brought before the court? Past dealings between the parties? Between the underwriter and the brokers? Within the market more generally?

# Key Area 3: Breach of Warranty and Risk Management Clauses

The ‘insurance warranty’ enshrined for many years in s. 33 MIA 1906 has been long criticised for its strictness. Under the interpretation adopted in *The Good Luck*,[[6]](#footnote-6) breach of an insurance warranty automatically discharged the underwriter from liability, irrespective of the (possibly) temporary nature of the breach, or lack of relevance to the claim submitted. This led, over time, to the reclassification of many former warranties in marine insurance policies into some other form of risk management clause, with a more limited remedy. Nonetheless, insurance warranties continue to exist in many marine policies and in the MIA 1906. On obvious problem with the law prior to the IA 2015 was the difficulty of classifying a term within English law as a warranty or something else. Certainly, even the use of the word ‘warranty’ came to indicate very little.

There are two major statutory provisions in the 2015 Act that alter this position. These are subject to ‘contracting out’ and some market participants have already indicated their willingness to restore the old s. 33 rule to life.

Section 10 abolishes the strict compliance/permanent discharge rule and replaces it with a new standard default rule:

‘An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied’ (s. 10(2)).

Two key points can be made about this rule. First, it not only removes underwriters’ liability for the period of non-compliance (from ‘breach’ to ‘cure’) but extends that to losses attributable to something happening during that period. Second, it creates potential conflict about when breach was cured. The statute provides for two different types of cure; (1) no longer being in breach of warranty and (2) where something had to be done by a particular date, by bringing the level of risk down to the level anticipated by the contract. One minor point to note is that the statute does not determine which of the parties has to prove breach or cure. It is assumed that the underwriter has to prove breach (as under the s. 33 model) but that (probably) the insured has to establish that it has been cured.

This new remedy applies whether the warranty is express or implied, and so the ‘marine statutory warranties’ are amended in kind, although they are of diminishing practical significance in most markets. (For the sake of clarity, s. 39(5) on unseaworthiness for H&M cover is not affected as it is not a ‘warranty’).

Section 11 applies instead to all risk management clauses, not only warranties. This is a provision which went through many iterations and the final version also raises many questions.

‘This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following—

(a) loss of a particular kind,

(b) loss at a particular location,

(c) loss at a particular time’.

There is no agreed understanding of the limits of a term which defines the risk as a whole. It cannot be clauses that do the kinds of things described in (a), (b) and (c), but it is not certain that these two lists are comprehensive. This is problematic because that type of clause escapes the regulatory effect of s. 11 entirely, and this is therefore of paramount importance. The controls on the use as defences of ‘risk management obligations’ are found in ss. 11(2), (3):

‘(2) If a loss occurs, and the term has not been complied with, the insurer may not rely on the non-compliance to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3)’.

This then deprives the underwriter of the ability to limit its exposure for insured perils because the defence is not unjustified in the terms of the Act. The underwriter can only limit or exclude liability where the insured is not able to satisfy s, 113):

‘(3) The insured satisfies this subsection if it shows that the non-compliance with

the term could not have increased the risk’.

The combined effect of this is that any clause related to risk management, except those defining the risk as whole are subject to s. 11(2), where s. 11(3) is satisfied. This does not provide any protection against non-risk management clauses that limit liability, such as claims notification clauses. They remain unregulated.

How is s. 11(3) met? It is not enough to show that the breach of the term did not contribute to the actual loss that occurred (a causation-type enquiry). It must be shown that the breach could not have affected the type of loss that occurred- this is a functional enquiry: ‘was this clause incorporated to control this kind of loss?’ The precise application of this rule is likely to be difficult, but it may cause difficulties for both claimant and underwriter, as uncertainties arise on both sides of the issue. Section 11 is then the most difficult provision on which to give precise advice, and this may lead to it being ‘contracted out of’ in many commercial contracts, at least in time.

# Key Areas 4: Miscellaneous - Fraudulent Claims; Duties of Utmost Good Faith; Late Payment of Claims

The IA 2015 contains a number of less significant provisions on insurance contract law. These are important in specific cases, but of less general significance.

### Fraud

The rules on fraudulent claims in ss. 12-13 IA 2015 are useful in that they clarify the operation of the remedies following a fraudulent claim, but do not seek to define what is or is not fraudulent behaviour. That has been left to the courts, as this can be seen in the recent Supreme Court decision in *Versloot Dredging*.[[7]](#footnote-7)

### Duties of Utmost Good Faith

The original version of s. 17 MIA 1906 stated that a failure to act with the utmost good faith entitled the other party to treat the contract as void and unenforceable. This provision was tested extensively in litigation, but to no great effect. S. 14 IA 2015 removes the remedy from the doctrine, but does not prevent the courts assigning remedies other than avoidance to utmost good faith. This may be of greater academic interest than practical significance, at least in the short term.

### Late Payment of Claims

The IA 2015 will be amended to introduce a duty on underwriters to pay claims in a timely fashion. These measures were originally meant to be included in the 2015 Act but proved too controversial and so were introduced by the subsequent government legislation, in ss. 28-30, Enterprise Act 2016. This change will take effect in Spring 2017.

Table 1: Key Changes to Marine Insurance Law

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| Subject Area | New Provision | Old Provision | Amends or Replaces | Comments |
| Pre-contractual non-disclosure & misrepresentation | Ss. 2-8 IA 2015 | Ss. 17-20 MIA 1906 | Replaces, with new levels of duty and new range of remedies | Now called ‘duty of fair presentation of the risk’; same label used as shorthand for old duty, but not identical. |
| ‘Risk Management’ duties, including navigation, crewing, seaworthiness etc. | Ss. 10-11 IA 2015  (s. 9 not normally relevant to marine insurance practice) | Ss. 33-34, 36-41 MIA 1906 | Replaces s. 33-34, amends ss. 36-41 MIA 1906 | Removal of strict ‘automatic’ discharge rule for implied and express insurance warranties.  Control of when ‘non-compliance’ with risk management clauses can be used as a defence. |
| Contracting Out | ss. 15-17 IA 2015 | n/a | Requires express contracting-out or notice. |  |
| Fraudulent Claims | s. 12-13 IA 2015 | n/a | Codifies ‘forfeiture’ remedy and clarifies effect of later hones claims and group policies. | Does not codify limits of ‘fraudulent claim’ See *Versloot Dredging* [2016] 2 Lloyd's Rep 198 for a recent Supreme Court case on limits of operative fraud. |
| ‘Utmost Good Faith’ | s. 14 IA 2015 | s. 17 MIA 1906 |  |  |
| Late Payment by Underwriter | s.28-30 Enterprise Act 2016 | n/a |  |  |

1. Hereafter, the ‘IA 2015’ or the ‘2015 Act’. [↑](#footnote-ref-1)
2. Many of the provisions apply equally to consumer contracts. [↑](#footnote-ref-2)
3. S. 1, Consumer Insurance (Disclosure & Representations) Act 2012. [↑](#footnote-ref-3)
4. There is a specific statutory prohibition on the use of ‘basis of the contract’ clauses, but these have not traditionally been used in the marine market. [↑](#footnote-ref-4)
5. Hereafter, the ‘MIA 1906’ or the ‘1906 Act’. [↑](#footnote-ref-5)
6. [1991] 2 Lloyd's Rep 191. [↑](#footnote-ref-6)
7. *Versloot Dredging BV* v *HDI Gerling Industrie Versicherung AG, The “DC Merwestone”* [2016] 2 Lloyd's Rep 198 [↑](#footnote-ref-7)