Fenwick Elliott
The construction & energy law specialists

Issue 44, February 2015

Welcome to February's 2015 edition of ***Insight***, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

This issue considers the rationale behind the Insurance Act, summarises its key points, reviews the provisions of the Third Parties (Rights Against Insurers) Act 2010 and provides the practice points that arise from both Acts.

Insight

The new insurance landscape in the construction context

This 44th issue of Insight (i) considers the rationale behind the Insurance Act; (ii) summarises its key points; (iii) reviews the provisions of the Third Parties (Rights Against Insurers) Act 2010 (the Third Parties Act) (which can now come into force as a result of the Insurance Act); and (iv) provides the practice points that arise from both Acts.

On 12 February 2015, following nine years' work by various Law Commissions and working groups, and a whirlwind of activity over recent months, the Insurance Act 2015 ("the Insurance Act") received Royal Assent. It represents the most significant statutory change to UK commercial insurance law in over 100 years, and it will have a substantial impact on insurance practice and procedures, as it will apply to every insurance policy and re-insurance policy that is written in England and Wales, Scotland and Northern Ireland, as well as any renewals and endorsements.

Rationale behind the Insurance Act

The current insurance law in the United Kingdom is based on the statutory framework of the Marine Insurance Act 1906, which is now out of date and no longer reflects commercial reality and practice. Its replacement, the Insurance Act, was brought in for three reasons: firstly, to modernise and simplify the law; second, to balance more fairly the interests of insurers and the insured; and third, to provide a new framework for an effective and competitive insurance market that is more sensitive to the needs of business.

Contrary to the usual position whereby new Acts of Parliament come into force shortly after receiving royal assent, the Insurance Act will not come into force until autumn 2016 in order to give the industry plenty of time to prepare, and for insurance policies to be made compliant.

Insurance Act: key points

Duty to make a 'fair presentation' of the risk

The duty to make a fair presentation of the risk is probably the most substantial change that has been effected by the Insurance Act, as it relates to the disclosure of material information which enables insurers to assess and therefore price the risk correctly.

The new duty requires the insured to either: (i) disclose every material circumstance which he knows or ought to have known; or failing that, (ii) disclose sufficient information to put a prudent insurer on notice of the fact that it needs to make further enquiries for the purposes of revealing those material circumstances. The disclosure has to be given in a manner which would be reasonably clear and accessible to a prudent insurer. Every material representation as to a matter of fact must be substantially correct, and every material representation as to a matter of expectation or belief must be made in good faith. It will no longer be possible to dump data on insurers indiscriminately without highlighting the key aspects, and insurers will have a new obligation to follow up on any unanswered questions, which represents a sea change to the existing law which places the burden of disclosure squarely on the insured.

Where the insured is an organisation, the relevant knowledge will be the knowledge of anyone who is part of the insured's senior management (this will include the Board, the Risk Manager and anyone who plays a significant role in the making of decisions about how the insured's activities are to be managed and/or organised), as well as anyone who is responsible for insurance. The insured's knowledge is defined having regard to information that could be expected to be found by a reasonable search of information held by the insured, its agent(s), or co-insured. In practice, it is likely that the extent of the search will extend beyond senior management to those who perform a management role, or who otherwise possess relevant information or knowledge about the risk to be insured. This is particularly the case for large companies and organisations, but much will depend upon the structure and management arrangements of the insured.

Insight

As far as insurers are concerned, insurers will be deemed to have knowledge of anything that is known to them or any individual who participates on their behalf in the decision whether to take the risk and, if so, on what terms. In practice, this will be the knowledge of the underwriters, or insurers' claims staff if they are involved in the renewal process. Insurers are "presumed" to know anything that is common knowledge, and anything that an insurer offering insurance of the class in question to the insured in the field in question would reasonably be expected to know in the ordinary course of its business.

Warranties

The Insurance Act makes three changes to the way in which warranties (i.e. terms of the insurance policy) are dealt with. Under the existing law, as a general rule, insurers are discharged from all liability under an insurance policy following a breach of warranty of the insured, regardless of the subject matter or relevance to the actual loss suffered.

Under the new regime, firstly, warranties will operate as suspensive conditions, which means that insurers' liability to make payment will remain suspended until such time as any breach of warranty has been remedied, and insurers will remain liable for any losses prior to the breach of warranty. For any warranties that are subject to deadlines, if the deadline is missed, the insured could never cease to be in breach, because the critical time for compliance would have passed, in which case insurers would not be obliged to provide an indemnity.

Second, insurers will no longer be able to rely on a breach of warranty, condition precedent, exclusion clause, or any other term which did not increase the risk of, and was irrelevant to, the loss that occurred. So if, for example, there was a failure to put in place adequate measures for site safety, and the site was then subject to theft, insurers will still be obliged to make payment under the policy, whereas they currently have no such liability.

Finally, "basis of the contract" clauses, which can turn any pre-contractual statement from a policyholder into a warranty, will be abolished. This means that it will no longer be possible for insurers to avoid a claim on the basis of the insured's breach of a contract term in circumstances where the breach is completely irrelevant to the loss suffered by the policyholder.

Insurers' remedies

In the event that the insured fails to make a fair presentation of the risk, the Insurance Act offers a much more flexible and commercial approach than the existing regime. From August 2016, if an insured innocently fails to make a fair presentation of the risk, insurers will only be able to avoid policies if, but for the breach of duty to make a fair presentation, they would not have entered into the insurance contract at all. In such cases, insurers will have a new right to return the premium, avoid the contract and refuse all claims. Alternatively, if insurers would have entered into the contract, but charged a higher premium, then insurers may reduce the amount they pay out, or apply different terms that would have applied had a fair presentation of the risk been made.

Insurers do, however, retain the right of avoidance in circumstances where the insured has not been entirely truthful. If the insured knew it did not make a fair presentation, or did not care whether it had made a fair presentation, then it will be open to insurers to avoid the policy without returning the premium. In the case of outright fraud, insurers will have the new option to give notice to the insured that the insurance policy terminated from the time of the fraudulent act that makes the claim fraudulent, but valid claims made before any fraudulent act would be unaffected.[1]

Contracting out

With the exception of basis of contract clauses, insurers may contract out of the Insurance Act provided: (i) they take sufficient steps to draw any disadvantageous terms to the attention of the insured or its agent before the contract is entered into, or any variation is agreed; and, (ii) the disadvantageous term is clear and unambiguous, having regard to the characteristics of the insured and the circumstances of the transaction. This is a potentially very wide test.

The term "sufficient steps" will depend upon the characteristics of the insured and the circumstances of the transaction. Steps that are sufficient for one insured may not necessarily be sufficient for another, and the extent to which insurers will need to spell out the consequences of a disadvantageous term will depend on the insured, and the extent to which it could be expected to understand the consequences of the provision. Contracting out of the Insurance Act is therefore likely to be a ripe area for disputes.

Third Parties Act

The Third Parties Act is of particular importance in the context of professional indemnity policies, which often contain an exclusion clause providing that insurers will

Insight

not have any liability directly arising out of the insolvency or bankruptcy of the insured and/or that the policy will be automatically cancelled on the insolvency of the insured. Such exclusions would usually be triggered in relation to, for example, a claim for unpaid fees by the supply chain during the course of the works against an insolvent contractor.

At common law, if a person who is insured under a liability policy incurs a liability to a third party but then goes into liquidation, any money subsequently paid out under the policy will form part of the insured's assets and will ultimately be distributed to creditors, leaving the party to whom the liability is owed with nothing.

The Third Parties Act will provide those with a liability claim against an insolvent insured with a recovery by altering the position at common law, and making it easier for parties with liability claims to bring a claim directly against the insolvent insured's insurers. From Autumn 2015, it will be possible to join insurers as a joint defendant with the insolvent insured, without having to first establish a legal liability as against the insured in separate proceedings by a declaration or judgment of the court, arbitration award or settlement,[2] as is the position under the Third Parties (Rights against Insurers) Act 1930, which represents the current law.

It is very important to note however that the ability to make a direct claim against insurers will be subject to any coverage issues that might arise,[3] and coverage may look quite different in August 2016 when the Insurance Act comes into force. This makes it all the more important for those with liability claims against insolvent insured's to be fully aware of the provisions of the Insurance Act that are discussed above.

Finally, in addition to making a direct claim against insurers possible, the Third Parties Act will also make it easier for parties with liability claims against insolvent insured's to obtain information from the insurers or the broker on a pre-action basis. If will be possible to seek information about: (i) the identity of the insurer; (ii) whether there is a policy in place that might cover the alleged liability; (iii) the terms of the policy; (iv) whether the insurer has denied liability; (v) whether proceedings have been issued by the insured in respect of the cover; (vi) whether there is an aggregate limit of indemnity, and, if so, how much if anything has been paid out on other claims; and, (vii) whether there are any fixed charges that would apply to any sums that might be paid out. The insurer or broker is under an obligation to provide the information requested within 28 days, and in circumstances where information is not available, explain why it cannot be provided and who else might have it. If the insurer or broker fail to comply, then the party with the liability claim may seek a court order requiring the information (or documents) to be provided.

Some practice points

- It is open to insurers to contract out of most of the provisions of the Insurance Act, and this contracting out may affect the rules against which you will be measured when you present your risk. Review any new policy in detail so that you understand how the policy will operate and what is required of you.
- Ascertain who needs to be consulted, both within your company or organisation and also externally, to ensure you have the right information from the right people so that you may fairly present your risk to insurers.
- If you can, try and contract out of the knowledge provisions in the Insurance Act and replace them with something that is tailored to fit the management structure of your company or organisation. Ideally, you should generically define who the knowledge-holders are for the purposes of the information obligations under the policy so that your obligations are clear.
- For the first time, the Insurance Act provides guidance on the placement process and you must present information (including complex information) in a manner that is clear, accessible and meaningful to a third party who may have no technical knowledge. Do not "data dump" on insurers indiscriminately, or overwhelm them with lots of irrelevant material.
- If you have a liability claim against a third party that is insolvent but has liability insurance, it is now easier for you to make a direct claim in respect of the Third Party's liability against it's insurers under the Third Parties Act. You will be able to claim provided that (i) the insolvent insured meets the definition of "insolvent" under the Third Parties Act, and, (ii) you have a valid liability claim against the insured.
- Prior to presenting a claim under the Third Parties Act, you should approach the insolvent party's insurers to request a copy of the policy to check whether there is liability cover, and ask for their confirmation that the policy will respond to your claim, if appropriate. If insurers confirm that cover has been declined, or proceed under a reservation of rights in relation to coverage, they

Insight

are not obliged to communicate their reasons for not confirming an indemnity as this information will be confidential. Insurers may, however, be prepared to provide the information you seek and provide you with a copy of the policy on a voluntary basis if the declinature is valid in order to avoid the issue of legal proceedings. An informal approach to insurers in correspondence is therefore worthwhile prior to issuing proceedings.

Conclusion

Insurers, underwriters, brokers, and the insured will have a lot to do in advance of August 2016. Insurers will have to review existing policy wordings; underwriters will have to amend their underwriting policies and procedures; and brokers will have to become familiar with the implications of the Insurance Act and the effect on commercial insurance. The insured will need to change the way they present risks, understand how warranties will operate under the new regime, and appreciate the new remedies that will be available to insurers in respect of fraud and in the event that the presentation of risk is unfair.

Much is set to change and only time will tell whether the Insurance Act will achieve its stated aims of modernising and simplifying insurance law. If its provisions are not commercially feasible, then contracting out of the Insurance Act is likely to become widespread, in which case extensive case law is likely to follow in its path.

Footnotes

1. In the case of a professional indemnity policy, for example, this would be the fraudulent notification of a claim, even though no loss would have occurred.
2. Albeit, many liability policies specifically exclude liability claims that have arisen purely as a result of agreement between the parties, in which case a declaration would be preferable to ensure that the Third Parties Act will bite.
3. If, for example, the insolvent insured failed to make a fair presentation of the risk (as to which see above) when taking out the cover, then insurers may decline the cover, or make a reduced payment.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston.
lkingston@fenwickelliott.com.
Tel +44 (0) 207 421 1986

Fenwick Elliott LLP
Aldwych House
71-91 Aldwych
London WC2B 4HN
www.fenwickelliott.com