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Welcome to the July 2016 edition of *Insight*, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

This issue examines the major changes to the insurance legislation which come into effect in August 2016.

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The New Insurance Act

Major change is afoot in the insurance industry. On 1 August 2016, the Third Parties (Rights against Insurers) Act 2010 comes into force. Then 12 days later, the Insurance Act 2015 comes into effect. The Insurance Act has been described by the Government as "*the biggest reform to insurance contract law in more than a century*". The 61st Issue of Insight looks at what these changes may mean for the construction industry.

On 12 August 2016 the Insurance Act 2015 (the "*Insurance Act*") will come into force bringing with it a new default regime for business insurance in the UK. 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 reinsurance policy that is written in England and Wales, Scotland and Northern Ireland, as well as any renewals and endorsements.

Just a few days prior to this date, on 1 August 2016, the Third Parties (Rights against Insurers) Act 2010 comes into force. The essential idea behind this Act is to try and make it easier for a third party to pursue a claim directly against liability insurers where the insured is or becomes insolvent.

The Insurance Act is designed to complement the other relatively recent but significant change to the insurance industry, the Consumer Insurance (Disclosure and Representations) Act 2012 (the "*Consumer Insurance Act*"), which implemented a number of reforms for consumer insurance contracts. The Insurance Act sets out new industry standards for commercial insurance contracts, which are the product of an extensive industry review and consultation.

However, while the new terms are designed to represent the industry benchmark, the Insurance Act does allow parties to contract out of and adjust the default terms within specified guidance. Parties who use commercial insurance contracts would therefore be well advised to consider carefully how the default rules might affect their operations, and which insurance-related rules should be amended. Indeed one reason for the long lead-in time, the Insurance Act having received Royal Assent in February 2015, was in order to give the industry plenty of time to prepare, and for insurance policies to be made compliant.

To clarify the effects of the Insurance Act, this issue of *Insight* considers the areas covered by the new Act and some of the practice points that arise.

Why the need for change?

Insurance law in the United Kingdom was previously based on a mix of a lengthy history (Lloyds of London began life as a coffee shop in London in the seventeenth century) and the old statutory framework of the Marine Insurance Act 1906. It was felt that many aspects of the old legislation were outdated and no longer reflective of commercial reality and practice. The new replacement, the Insurance Act, has been introduced to modernise and simplify the law, to balance more fairly the interests of insurers and the insured, and to provide a new framework for an effective and competitive insurance market that is more sensitive to the needs of business.

The Insurance Act is designed to encourage cooperation between the insured and insurer during the pre-contract negotiation stage.

Insurance Act: key points

What does the Insurance Act cover?

Once the Act comes into force on 12 August 2016, it will apply to all new commercial (but not consumer[1]) insurance contracts, as well as any variations of existing insurance contracts entered into on or after

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that date. The rule about variations is subject to one exception: parts 3 and 4 of the Insurance Act which deal with warranties and fraudulent claims will not be applicable to variations of insurance contracts entered into before 12 August 2016.

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 to be effected by the Insurance Act. All insurance policies depend on the disclosure of material information by the party seeking insurance which enables insurers to assess and therefore price the risk correctly. Currently under the common law, a party seeking insurance has a pre-contractual duty of utmost good faith to disclose all relevant facts to the insurer free of any misrepresentation. The Act codifies and builds upon this duty as a "*duty of fair presentation*". Prospective insured parties must now disclose to the insurer all relevant "*risks*"[2] and every material representation must be made in good faith. The new duty[3] 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 that would be reasonably clear and accessible to a prudent insurer.[4] 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 large amounts of data on insurers indiscriminately without highlighting the key aspects, and insurers will have a new obligation to follow up on any unanswered questions. This might become burdensome if that party is involved in a large number of construction projects.

The use of the words "*ought to know*" is important. Currently, the requirement is limited to what a firm knows in the ordinary course of business. The Insurance Act states that what the insurer ought to know is information that should be reasonably obtainable through "*reasonable search of information available to the insured*". This will include information that is "*held within the insured's organisation or by any other person (such as the insured's agent or a person for whom cover is provided by the contract of insurance).*" This wide-ranging definition is likely to increase the level of disclosure required. It may cover information held by other parties in construction projects such as designers who can be "*any other person*" and covered by "*reasonable search*".

The Act provides details of what constitutes "*material circumstances*" which need to be disclosed. These include a catch-all category covering "*anything which those concerned with the class of insurance and field of activity in question would generally understand*". Again this might be quite wide-ranging. It may also be difficult to apply when it comes to construction all risks (CAR) insurance as it may require disclosure of a broader range of information (including about subsidiaries but also subcontractors, subconsultants and designers).

Where the insured is an organisation, the relevant knowledge will be the knowledge of anyone who is part of the senior management of the insured (this will include the Board, the Risk Manager and anyone who plays a significant role in the making of decisions about how the activities of the insured are to be managed and/or organised), as well as anyone who is responsible for insurance. The knowledge of the insured 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 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.

As far as insurers are concerned, they 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

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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. The Insurance Act refers to information that is "*readily available*".[6] This may include their own surveyor's report assessing the risks associated with the construction project as it is information that ought to have been provided to the underwriter, held by the insurer, or available to the underwriter. Further, the definition "*readily available*" may well cover the insurer's archive of claim reports and the insured's past performances.

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, first, 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 will remain, and cannot cease to be, in breach, given that the critical time for compliance has passed, and insurers will therefore not be obliged to provide an indemnity in such cases.

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 were 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[7]

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 fair presentation would have changed the insurance contract, when the breach was neither deliberate nor reckless, the contract will be treated as if it had been entered into on those different terms. For example, 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. However, the insurer has to prove with evidence that it would not have been willing to write it at all if there were fair presentation.

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 now have the option to notify the insured that the insurance policy is terminated from the time of the fraudulent act (which renders the claim fraudulent), and can refuse liability in respect of a relevant event taking place after the fraudulent act. Valid claims made before any fraudulent act will, however, be unaffected.

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

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unambiguous, having regard to the characteristics of the insured and the circumstances of the transaction. The Act defines such terms as disadvantageous if they "*would put the insured in a worse position*".[8] This is potentially a 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 an area ripe for dispute.

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 not have any liability directly arising out of the insolvency or bankruptcy of the insured and/or that the policy will automatically be cancelled on the insolvency of the insured. Such exclusions are usually 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 insurers of the insolvent insured. From 1 August 2016, 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,[9] 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.[10] This makes it all the more important for those with liability claims against insolvent insured 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 to obtain information from the insurers or the broker on a pre-action basis. It 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 fails 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.
- Review your disclosure process. Build in enough time to deal with the reporting requirements.
- 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

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present your risk to insurers. Who are your senior management? Who is responsible for insurance within your business?

- If possible, try to 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.
- As always with insurance, engage with your brokers and/or insurers to make sure you understand their requirements.
- 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 its 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 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

There has been a fairly lengthy lead-in period in respect of both Acts. Insurers will need to have reviewed their existing policy wordings; underwriters will have been amending their underwriting policies and procedures. The insured will now 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, contracting out of the Insurance Act will likely become widespread, in which case extensive case law is likely to follow.

Footnotes

1. An insurance contract entered into by an individual mainly for purposes unrelated to the individual's trade, business or profession.
2. "Risk" is defined as any information that "would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms".
3. See section 3(4) of the Act.
4. See section 3(3)(b) of the Act.
5. See section 5(6) of the Insurance Act.
6. See section 5(2) of the Insurance Act.
7. Sections 16 and 17 of the Insurance Act.
8. See section 16(2) of the Act.
9. 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.
10. 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 Jeremy Glover.
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