there has been much criticism in recent years of the harshness of legal principles and practices within the London insurance market, which appear outdated and designed to benefit the insurer. The English courts have been constrained by rules which do not always produce just results for the policyholder. Despite the fact that there have been numerous reports recommending reform, there has to date been no firm response from the legislature. At the start of 2006, however, the Law Commission published a scoping paper, which set out possible areas for reform of insurance contract law in so far as it affects consumers and commercial policyholders.

The paper requests views on how the Law Commission should approach the task, and on possible areas for reform. Possible solutions to the problems identified will be the subject of a separate consultation paper, currently scheduled for May 2007. The Law Commission will then produce its final report around 2008 and, if necessary, a draft bill. The scoping paper is therefore just the first step in the reform process, but it looks to be a step in the right direction for policyholders.

**Problem areas**

The Law Commission has identified a number of problem areas which might be included in the review, but there are two specific issues which will definitely be included: non-disclosure and breach of warranty.

The issue of non-disclosure is of particular concern to policyholders because of its draconian consequences. A contract of insurance is a contract of the utmost good faith, which means that there is a duty on the policyholder to disclose all material facts to the insurer prior to inception of the risk. If the policyholder fails to disclose or misrepresents a material fact, and that failure induces the acceptance of the contract, the insurer is entitled to avoid the policy from inception.

The Law Commission considers there to be six areas of concern regarding the law in this area:

- the relative knowledge of insurer and insured in current times, and the fact that, while some facts will be solely within the knowledge of the insured, insurers now have far greater access to information and other data which may be relevant to the risk
- the test of materiality. The insured is required to disclose those facts which would affect the judgment of a prudent insurer in assessing the risk. The concern is that this gives rise to unfairness, because of the difficulty in predicting what information would influence the prudent underwriter
- the fact that there is no obligation on the insurer to ask specific questions, even about matters which have been found to be material. The result in practice is that the policyholder cannot simply assume that, by answering all the questions on the proposal form and providing any documents requested, the duty of disclosure has been discharged
- the ‘all or nothing remedy’ which enables the insurer to avoid the policy from inception, such that no further claims will be paid, even where the non-disclosure was entirely innocent
- the fact that there is no real distinction, in terms of the remedy applied, between innocent, negligent and fraudulent non-disclosure
- the lack of any required causal link between the facts which were not disclosed and any loss which occurs, such that the insurer is entitled to avoid the policy and refuse to pay the claim even if there is no connection.

The duty of disclosure is intended to be reciprocal, but, as the Law Commission points out, the type of information a policyholder is likely to be interested in include such matters as the insurer’s complaints record and any regulatory intervention, matters which insurers would no doubt argue are not material to the risk. Moreover, even if material non-disclosure on the part of the insurer could be established, it is likely to come to light after a policyholder has made a claim. It is unlikely in these circumstances that the policyholder will want to take advantage of the remedy of avoiding the policy, even if this results in the return of the premium.

In practice, the duty of utmost good faith provides little benefit to the policyholder but provides a real and significant advantage to the insurer, who is able to avoid the policy on the grounds of material non-disclosure which may be entirely innocent and wholly unconnected with any claim that has been
The time has come to introduce a more level playing field

- The position of joint insureds and the question of whether policies should in certain circumstances be construed as separate contracts with each co-insured, such that the defaults of one insured will not affect the cover available to another
- The issue of contract certainty and the delay in the production of policy wordings
- The post-contractual duty of good faith and the need for clarification as to the nature and extent of the duty and the impact of fraud
- Unjustifiable delays by insurers in settling insurance claims and the question of whether insurers should be required to pay interest on late payments and/or compensatory damages.

The issue of contract certainty, or rather the lack of it, has already been targeted by the FSA as insurance regulator. The FSA is looking to end the practice in the London insurance market of ‘deal now, detail later’, which can result in the agreement of precise policy terms and the production of policy wordings being delayed for weeks or months after the policy has gone on risk. The idea is that contract certainty will be achieved by the ‘complete and final agreement of all terms (including signed down lines) between the insured and insurers before inception’. The FSA had threatened regulatory action if the industry failed to find a market-driven solution to the issue of contract certainty by the end of 2006 but, as a result of the industry exceeding the targets set for 2005, the FSA has recently announced that it is putting the idea of regulatory intervention on the back burner.

The main focus of the FSA’s contract certainty initiative has been on the agreement of policy terms prior to inception, with the production of the policy wording promptly thereafter. The Law Commission is quite rightly asking the question of what is meant by ‘promptly’ and whether any remedies or penalties should be applied if the requirement is not met. In these days of electronic communication, there is no reason why ‘promptly’ should not be defined as a matter of days, rather than weeks or months, with penalties for non-compliance involving a corresponding reduction in the premium. The other question which the Law Commission ought to consider is whether simply speeding up the process is sufficient to protect the interests of policyholders. The danger is that policyholders will be pressed into agreeing the insurer’s standard terms in order to meet the contract certainty requirements, without having the policy terms properly explained to them and without fully understanding what they are agreeing to.

Commercial policyholders, in particular, should be given the time and the opportunity to negotiate any necessary changes to the policy wording (in the same way that they would with any other commercial contract) to ensure that their interests are properly protected.

The nature and extent of the post-contractual duty of good faith are clearly in need of clarification, including the extent of the duty owed by insurers and the remedies available for breach. If the concept of a post-contractual duty is to be retained, it should be applied in a similar way to the concept of good faith in the US, as a means of compensating the policyholder and promoting good conduct on the part of insurers. The duty of good faith should be applied to prevent insurers from unjustifiably delaying settlement of claims and from relying upon unmeritorious and unsustainable arguments with a view to negotiating a more favourable settlement.

Similarly, the insurers’ right to avoid the policy (if it is to be retained) should be subject to the duty of good faith, such that the insurer should not be entitled to avoid the policy and return the premium, without first giving the insured the opportunity to comment on the alleged non-disclosure or misrepresentation on which the insurer is seeking to rely. The appropriate remedy for a breach of the duty of utmost good faith in these circumstances would be the payment of interest and compensatory damages for any loss caused to the insured as a result of the insurer’s bad conduct.

The time has come to introduce a more level playing field and to redress some of the imbalances which cause unfairness to policyholders. The Financial Ombudsman Service (FOS) has already begun this process by adopting a ‘fair and reasonable’ approach to the determination of coverage disputes, but the FOS is only available to consumer and small business policyholders and it cannot decide the law. Similarly, while the FSA has introduced certain rules and principles, they are not all-encompassing and do not solve all of the problems.

While the insurance market may raise objections to reform, preferring to rely on voluntary codes rather than statutory intervention, the fact is that reform of the law may actually benefit insurers by creating greater certainty and by making the UK insurance market more attractive compared with foreign competitors. Some of the legal principles which cause unfairness to policyholders are unique to English law, and there may be benefits in making English law more consistent with European legal systems.

In short, the tide does appear to be turning in favour of policyholders, but this is only the start of the reform process and there is much work ahead. In the meantime, policyholders should be aware of the issues which currently favour insurers and ensure that they check prior to renewal, not only that full disclosure has been given, but that policy wordings do not include unnecessary warranties, conditions precedent or other terms which may have severe and unexpected adverse consequences.

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