

Blowing their cover

Peter Tyldesley is looking forward to the Law Commission's much-needed proposals for the reform of insurance contract law

INSURANCE CONTRACT LAW is archaic and unfair. Many of its principles date from the eighteenth century and law developed for transactions in the coffee houses of Georgian London is unsurprisingly capable of causing injustice when applied to modern consumer contracts.

The real harm in insurance law is that it frequently provides a basis on which an insurer may deprive a consumer of the benefits of a policy, even where to do so is unreasonable and disproportionate. In particular, if the insurer was induced to enter into the contract by the misrepresentation or non-disclosure of a material fact it may avoid the policy from outset, or if the consumer breaches a warranty — a term of the policy akin to a promise — cover ceases immediately on the breach.

Regrettably at the very time cover is most needed, when a claim has arisen, a consumer may find the insurer intent on establishing that one of these grounds exists. There is an economic incentive to do so. By stripping the consumer of the benefits of the policy, the insurer can avoid liability for the claim.

An unbalanced relationship

Take, for instance, the case of *Cuthbertson v Friends Provident* in 2006. In 1999, Valerie Cuthbertson made a critical illness claim after being diagnosed with multiple sclerosis. The insurer requested access to Cuthbertson's medical records which, it said, would be given "careful and sympathetic consideration" in the course of assessing the claim. In subsequent litigation, however, the insurer admitted that the only purpose of obtaining the records had been to see whether there was any entry which might give grounds for setting aside the contract. Having found what it regarded as a misrepresentation the insurer avoided the policy and rejected the claim. It was seven years later that Cuthbertson won her court case and received payment.

The detail of the law is also weighted heavily against consumers. For example, a material fact is defined as one which would have an effect, not necessarily decisive, on the

mind of a prudent underwriter in assessing the risk. This requires the applicant to look into the mind of a prudent underwriter when deciding what to disclose. Few consumers have the knowledge or expertise to do so accurately. In *Lambert v Co-operative Insurance*



(1975), Brenda Lambert suffered a loss of jewellery. On investigating her claim, the insurer discovered that her husband had been convicted of a criminal offence prior to the policy last being renewed. At no point had the insurer indicated that it wished to be informed of such convictions. Nevertheless, it avoided the policy for non disclosure and rejected the claim. The court had little choice but to find in the insurer's favour, albeit with marked expressions of distaste.

Warranties are another potential source of difficulties. Most notably there is a pernicious practice of creating warranties by the use of basis of the contract clauses. If an application form for insurance states that the answers given shall form 'the basis of the contract', then those answers are converted into warranties. The impact of any inaccuracy is, therefore, that cover simply never commences. In *Mackay v London General Insurance* (1935), Hamish Mackay applied to insure a motor car using a proposal form containing a basis of the contract clause. After an accident he made a claim under the policy. The insurer discovered two minor inaccuracies on the proposal form relating to Mackay's earlier ownership of a motorcycle and rejected the claim. Again all the court could offer was sympathy.

The need for reform

Fortunately the Law Commissions has been

reviewing insurance contract law since 2006 and is expected to produce a final report on consumer matters with a draft Bill later this year. The review covers a range of issues including those outlined above. It seems that the Law Commissions is minded to base its

recommendations at least in part on the approach taken by the Financial Ombudsman Service. This makes good sense. The Ombudsmen make decisions based on what is fair and reasonable in all the circumstances of a case, and their guidance has been tried and tested over a number of years.

What recommendations may we expect from the Law Commissions on misrepresentation, non disclosure and breach of warranty? From the consultation paper issued in 2007,

the following steps seem likely:

- The remedy for misrepresentation will depend on the conduct of the consumer. Deliberate or reckless misrepresentation will entitle the insurer to avoid the policy and reject any claim. If the misrepresentation is negligent the remedy will be based on what the insurer would have done had it known the true facts – for example adding an exclusion or, if a higher premium would have been charged, settling a claim on a proportionate basis. If the consumer has been honest and careful, the policy will remain in force and any claim will be paid.
- The duty of disclosure will be abolished.
- 'Basis of the contract' clauses will be rendered of no effect.

Early implementation of these recommendations is desirable. Many insurers support change. They operate to high standards and do not rely on strict legal rights where it would be unfair to do so. However, other insurers are less scrupulous. As the recession bites, they may be inclined to take a harder line on claims. In any event, voluntary forbearance, while laudable, is insufficient. Insurance is intended to bring peace of mind — how can it do so if fair treatment remains at the discretion of the insurer?

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