

Insurance

Reform at last?

In the first of two articles reviewing proposals to reform insurance law, **Peter Tyldesley** is optimistic about the momentum for change

IN BRIEF

- The government has taken the first steps towards the implementation of the Law Commissions' 2009 proposals for consumer insurance law reform.
- The proposals deal with non-disclosure, misrepresentation and basis of the contract clauses and the new law could be brought into force as early as 2013.
- Reform has been long awaited and the current patchwork of unsatisfactory law, codes, rules and ombudsman guidance has proven to be an inadequate substitute.

The Consumer Insurance (Disclosure and Representations) Bill was introduced into the House of Lords by Lord Sassoon and received its first reading on 16 May 2011. Based on a report jointly published by the English and Scottish Law Commissions on 15 December 2009, the Bill amends three areas of consumer insurance law which have been subject to particular criticism: non-disclosure, misrepresentation and basis of the contract clauses. If passed, the new law can be brought into force not less than a year and a day later. It is therefore possible that the commencement date could be as early as 2013.

The introduction of the Bill is a significant achievement for the Law Commissions. Insurance law has long been recognised as archaic, unclear and unfair (159 NLJ 7376, p 961-962 & 159 NLJ 7387, p 1358-1360) but earlier proposals for reform from the Law Reform Committee in 1957 and from the English Law Commission in 1980 were never implemented.

Basis of the contract clauses

The poor state of the current law is amply illustrated by the impact of basis of the contract clauses. Most consumers would be surprised to learn that a minor error in stating, say, their telephone number, could result in their insurance policy being

declared invalid. A telephone number is unlikely to be material, and the insurer will therefore be unable to avoid the policy for non-disclosure or misrepresentation. However, the application form may include a declaration stating that the answers given will form the basis of the contract. If so, the answers become warranties (*Dawsons v Bonnin* [1922] 2 AC 413). A warranty is a particularly onerous term of an insurance policy and breach discharges the liability of the insurer immediately and automatically (*Bank of Nova Scotia Appellants v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1992] 1 AC 233). If an answer relating to a past or present fact is incorrect the consequence is that cover simply never commences—though both consumer and insurer may be oblivious to this until a claim arises and investigations are conducted.

Unsurprisingly, the use of basis of the contract clauses has attracted judicial criticism for over 150 years. For instance, in *Mackay v London General Insurance* (1935), a consumer motor insurance case, Swift J found in favour of an insurer which relied on such a clause, but made clear his concerns: "I am extremely sorry for the plaintiff in this case. I think he has been very badly treated—shockingly badly treated...But I cannot help the position. Sorry as I am for him there is

nothing that I can do to help him. The law is quite plain."

Elephant traps

A further trap for consumers is set by the fact that a warranty formed by a basis of the contract clause may be implied into subsequent periods of insurance. The consumer may thus find themselves bound by a warranty which appears in neither the renewal documentation nor the policy document. In *Wilkie v Direct Line* [2009] CSIH 70 the consumer, Stuart Wilkie, effected a household policy in July 1991. In the application form, which contained a basis of the contract clause, he confirmed that the property would be kept in a good state of repair. It was held that the resulting warranty was breached in September 1991. The court allowed the insurer to reject the fire claim which arose in December 1992, after renewal in July 1992. No reference was made to the dissenting judgment of Winn J in *Magee v Pennine Insurance Co Ltd* [1969] 2 QB 507 which sets out factors which might be considered in deciding whether warranties should be carried forward in this way.

Alternatives to law reform

Is there any alternative to law reform which will effectively address these problems? Regrettably self-regulation, statutory regulation and the existence of an ombudsman scheme have failed to offer a full solution.

Self-regulation

In return for an exemption from the Unfair Contract Terms Act 1977 the British Insurance Association, forerunner to the Association of British Insurers (ABI), promulgated a self-regulatory code: the Statement of General Insurance Practice (SGIP). SGIP was later strengthened in 1986 in return for non-implementation of the Law Commission's 1980 report, with the changes including a bar on the use of basis of the contract clauses. However, SGIP was not legally binding, there was no monitoring of compliance and membership of the Insurance Ombudsman Bureau which could enforce its provisions was voluntary. There is no doubt that basis of the contract clauses continued to be used,

see for instance *Economides v Commercial Assurance Co Plc* [1998] QB 587.

Statutory regulation

SGIP was withdrawn when statutory conduct of business regulation for general insurers was introduced on 14 January 2005. Some provisions were taken in amended form into the rules made by the Financial Services Authority (FSA), and can now be found in the Insurance Conduct of Business Sourcebook (ICOBS). Unfortunately the bar on the use of basis of the contract clauses was abandoned.

Under ICOBS 8.1.2 insurers should not reject a claim for breach of warranty unless there is a connection between the breach and the loss. However, this rule addresses only one criticism of basis of the contract clauses and the mechanism by which it is intended to operate is unclear. As recognised in *HH Casualty & General Insurance v AXA Corporate Solutions* [2002] EWCA Civ 1253 there is no scope for an insurer to waive a breach of warranty by election, it is automatically discharged from liability upon breach and so has no such choice to make. In any event a breach of the rule does not assist the consumer with the original claim, rather it opens up the possibility of a more complex action for breach of statutory duty under s 150 of the Financial Services and Markets Act 2000 (FiSMA).

Reliance on a basis of the contract clause may also be a breach of Principle 6 of the FSA's Principles for Businesses – the obligation to treat customers fairly. This could form the basis of a referral to the Financial Ombudsman Service (FOS)—see *R (on the application of British Bankers' Association) v Financial Services Authority and Financial Ombudsman Service* [2011] EWHC 999—but would seem to add little to a straightforward complaint regarding the insurer's actions.

Financial Ombudsman Service

Under s 228(2) of FiSMA the FOS is required to determine complaints under its compulsory jurisdiction in accordance with what it regards as fair and reasonable in the circumstances. The FOS has not commented on basis of the contract clauses in its regular publication *Ombudsman News*, but in 2010 one of longest-serving ombudsmen, Mark Sceeny, confirmed its approach: “There is nothing objectionable in an insurer pointing out that material information disclosed at application will form the basis of the insurance and that a failure to answer such questions honestly

may invalidate cover; that is simply a statement of fact and, indeed, insurers are obliged to point this out so as to warn customers about the importance of taking care over the application. That is not the same as a clause purporting to turn every statement in a proposal into a warranty of fact such that any mistake, however innocent or irrelevant, discharges the insurer from liability. We would obviously regard such a clause as unfair...”

However, there are a number of restrictions on the jurisdiction of the FOS. It cannot make binding awards in excess of £100,000 (though this will be increased to £150,000 on 1 January 2012), leaving a consumer with a loss in excess of this figure with the grim choice of abandoning the remainder of their claim or going to court and facing the full harshness of the law (*Andrews v SBJ Benefit Consultants* [2010] EWHC 2875).

In addition the rules under which the FOS operates provide a range of grounds on which cases may be dismissed without consideration of the merits. More generally, despite a range of initiatives the reach of

the FOS still seems limited. In 2008 the Hunt Review concluded that the FOS looks “too much like a middle-class service, for middle-class people”. It cannot in any event be regarded as satisfactory that consumers are obliged to make a complaint before they are assured of fair treatment.

The need for reform

Not only does this complex layering of contradictory law, codes, rules and ombudsman guidance offer an incomplete solution to flaws in the law, it is also a recipe for confusion and conflict. There is now the opportunity to sweep away the muddle and replace it with fair, clear and modern law. Will the Consumer Insurance (Disclosure and Representations) Bill achieve this objective? NLJ

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In Part 2, Peter will examine the Bill in detail.

Consumer insurance contract law

Reasons to be cheerful

Although the proponents of reform have previously been disappointed there are five factors which give rise to increasing optimism that change will now occur:

- The Law Commissions have produced a well-researched and convincing report with practical solutions to the problems identified in the three areas of law considered: non-disclosure, misrepresentation and basis of the contract clauses.
- The Financial Ombudsman Service has been operating since 2001 enabling the Law Commissions to draw on tried and tested approaches—the proposed reforms are not a leap in the dark.
- Consumer bodies are supportive of the Law Commissions' proposals as are those organisations representing classes of consumers who are particularly affected by the current law. At a meeting of the All-Party Parliamentary Group on Insurance and Financial Services on 4 December 2010 a joint position statement urging implementation was presented on behalf of Age UK, the British Heart Foundation, Consumer Focus, Macmillan Cancer Support, the MS Society, the Trading Standards Institute, UNLOCK and Which?.
- There has been a welcome change in the stance taken by the Association of British Insurers (ABI), the main trade body for insurers. Initially the ABI appeared to be against reform, but on 27 September 2010 it wrote to HM Treasury confirming that subject to three issues being addressed or clarified it supports the Law Commissions' proposals.
- As from 2010, a new Parliamentary procedure is available for use with non-controversial Law Commission bills. Such bills may be introduced in the House of Lords with the second reading debate taking place in Committee, and consideration by a Special Public Bill Committee after the second reading. This enables worthwhile measures to be implemented even if they would not otherwise secure time on the floor of the House.