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RISK CONTROL CLAUSES IN INSURANCE LAW— LAW REFORM AND THE FUTURE

Risk control clauses are often used in insurance contracts with a view to preventing the assured from altering the risk during the currency of the policy. An insurance warranty is the most commonly used risk prevention clause in practice. Having been subjected to severe criticisms for years, the legal regime concerning insurance warranties and other risk control clauses has recently been revamped by the Insurance Act 2015, which will enter into force in August 2016. This article intends to elaborate on the appropriateness of the reforms introduced by the 2015 Act from risk assessment and management perspectives. It is also intended to offer a critical analysis on the potential impact of the changes on insurance law and practice.

I. INTRODUCTION

English insurance law is fundamentally different than continental legal systems in that it allows a policyholder after attachment of the risk to alter its nature without the consent of the insurer.¹ In practice, however, risk control clauses are often employed to restrict this freedom. The main objective of a clause of this nature is to ensure that the risk is maintained by the assured at the same level agreed at the inception. Traditionally, warranties are the most common risk control clause² used in insurance law.³ In a technical sense, an insurance warranty is an undertaking by the assured⁴ that “some particular thing shall or shall not be done”, or that “some condition shall be fulfilled”,⁵ or whereby the assured “affirms or

¹ Chief Baron Pollock in *Baxendale v. Harvey* (1849) 4 H & N 445, at 449 and 452, famously said: “If a person who insures his life goes up in a balloon, that does not vitiate his policy.... A person who insures may light as many candles as he please[s] in his house, although each additional candle increases the danger of setting the house on fire.” Conversely, in German law by virtue of Art. 23–25 of *Versicherungsvertragsgesetz* (VVG), if the policyholder increases the risk in any way without the consent of the insurer, the cover ends at once in respect of any loss “influenced” by the increase, as well as any subsequent loss if the insurer so elects. A similar outcome follows in French Law by virtue of Art. L 113-2-3 of *Code d’assurance*.

² Other risk control mechanisms often used are: i) condition precedents to liability of the insurer (breach of such clauses either entitle the insurer to elect to discharge from the contract or prevent the assured from claiming for a particular loss); ii) suspensory provisions (also known as clauses delimiting the risk) which set out the circumstances in which the insurer is to be on risk and iii) exclusion clauses.

³ This is not the only function that an insurance warranty serves. Some warranties (i.e., affirmative warranties) intend to circumscribe the risk to which the insurer subscribes.

⁴ Section 33(1) of the *Marine Insurance Act* (MIA) 1906.

⁵ Such warranties relate to facts after the attachment of the policy and are often known as future (or continuing) warranties.

negatives the existence of a particular state of facts”.⁶ Although the legal regime relating to insurance warranties is set out in the MIA 1906, apart from the principles that are unique to a marine adventure (e.g., implied warranty of seaworthiness), these principles apply in other areas of insurance law by analogy.

Breach of an insurance warranty will have catastrophic consequences from the assured’s perspective, as it will enable the insurer to discharge itself from liability automatically from the moment of breach even if the breach is remedied before any loss arises.⁷ This reflects the fact that liability of an insurer was viewed as an obligation “dependent” on fulfilment of a warranty by the assured, back in the eighteenth century by Lord Mansfield.⁸ Over the years, the legal regime concerning insurance warranties has attracted relentless criticism both in judicial⁹ and academic circles.¹⁰ The most prominent problem identified with the law on warranties is that it permits the insurer to escape liability for technical breaches that have nothing to do with the loss in question¹¹ or that have been remedied prior to the loss.¹² The remedy for breach of a warranty, automatic discharge from liability, is also often considered to be disproportionately severe, in the light of the fact that the function of most warranties is to prevent any alteration of risk after the inception of the policy, and that in most cases alterations made in the risk do not have a lasting impact. For example, when a warranty that requires the insured premises to have a burglar alarm in a working condition is breached, obviously an alteration in the insured risk occurs; but in cases where the alteration lasts only a temporary period of time or when it does not create any dramatic consequences for the

⁶ A warranty of this nature is known as an affirmative warranty or a warranty that relates to a period before the attachment of the risk.

⁷ See, ss. 33(3) and 34(2) of the Marine Insurance Act (MIA) 1906.

⁸ *De Hanh v. Hartley* (1786) 1 T.R. 343. The contractual status of warranties and the role they play in insurance law have been described in a categorical fashion by Lord Goff in *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1992] 1 AC 233, at 262–263: “... if a promissory warranty is not complied with, the insurer is discharged from liability as from the date of the breach of warranty, for the simple reason that fulfilment of warranty is a condition precedent to the liability of the insurer. This moreover reflects the fact that the insurer only accepts the risk provided that the warranty is fulfilled.”

⁹ Lord Griffiths in *Forsikringsaktielselskapet Vesta v. Butcher* [1989] AC 852, at 893–4, famously said: “It is one of the less attractive features of English insurance law that breach of a warranty in an insurance policy can be relied upon to defeat a claim under the policy even if there is no causal connection between the breach and the loss.”

¹⁰ J. Birds, “The Effect of Breach of Warranty” (1991) L.Q.R. 540; T.J. Schoenbaum, “Warranties in the Law of Marine Insurance: Some Suggestions for Reform of English and American Law” (1999) Tulane M.L.J. 267; J. Hare, “The Omnipotent Warranty: England v. The World” in M. Huybrechts, E.V. Hooydonk and C. Dieryck (eds.), *Marine Insurance at the Turn of the Millennium (Vol 2)*, (Antwerp, 1999), 37 and B. Soyer, “Marine Warranties: Old Rules for the New Millennium?” in D.R. Thomas (ed.), *Modern Law of Marine Insurance (Vol 2)*, (London, 2002), 161.

¹¹ For example, if the assured under a motor policy warrants that he will maintain the insured vehicle in an “efficient” or “roadworthy” condition, the insurer who proves that the vehicle was not in that state at the time of the loss will have a defence to a claim arising out of an accident involving the insured vehicle, without going so far to prove that the poor condition of the vehicle caused or contributed to the accident. See, *Conn v. Westminster Insurance Co* [1966] 1 Lloyd’s Rep. 407.

¹² In *De Hahn v. Hartley* (1786) 1 T.R. 343, when the insured vessel commenced the intended voyage without having the warranted number of crew on board, the insurer was held not to be liable although the warranted number of crew had been recruited before the vessel sailed on the leg of the voyage during which the casualty occurred.

insurer, one finds it difficult to justify why the assured is deprived of his insurance cover automatically by operation of law without having the opportunity to rectify the breach.

Against this background, it comes as no surprise that reforming this area of law has been on the agenda for some time.¹³ The end product of the most recent reform initiative led by the English and Scottish Law Commission (the Law Commissions)¹⁴ is the Insurance Act 2015, which received Royal Assent on 12 February 2015 and will enter into force on 12 September 2016. The Act will modify key aspects of the warranty regime¹⁵ but also will have a serious impact on how other risk control clauses, such as condition precedents—clauses delimiting the risk and exceptions—operate; as the draftsmen have appreciated that restricting the reform to the warranty regime would simply encourage the insurers to utilise other risk control mechanisms to achieve the same result prior to the reform, hence undermining the changes introduced.

In a nutshell, the Insurance Act 2015 will introduce the following changes to the regime that regulates risk control clauses:

- i) Section 10 of the Insurance Act 2015 abolishes any rule of law to the effect that breach of a warranty in a contract of insurance results in the discharge of the insurer's liability under the contract. Instead, in case of breach of a warranty the liability of the insurer will be suspended but the risk reattaches once the breach is remedied.
- ii) Section 11 of the Act stipulates that if compliance with a term of a contract of insurance would tend to reduce the risk of i) loss of a particular kind, ii) loss at a particular location and iii) loss at a particular time, a breach of that term would not suspend liability if the assured shows that non-compliance with the term could not have increased the risk of loss which actually occurred in the circumstances in which it occurred. The objective of this provision is to prevent insurers from denying a claim that arises during the period when a warranty is breached if

¹³ In 1980, the Law Commission prepared a report advocating a reform of the warranty regime: Law Commission Report No. 104, *Insurance Law—Non-Disclosure and Breach of Warranty*, Cmnd. 8064 (1980). The striking feature of this report is the fact that marine, aviation and transport insurance has been excluded from the scope of a possible reform. Although a draft Bill was introduced to the Parliament for the reform of the regime regulating non-marine warranties, the draft Bill was withdrawn after the Government reached agreement with the Association of British Insurers (ABI) that ABI would take up the Law Commission's recommendations on a self-regulatory basis. Extending the debate to marine and commercial insurance, the Australian Law Reform Commission (ALRC) in 2001 proposed substantial amendments to the Australian Marine Insurance Act 1909 (which is the equivalent of the MIA 1906), including the regime regulating marine insurance warranties; see: Australian Law Reform Commission, *Review of the Marine Insurance Act 1909* (Report 91, 2001). As of today, no action has been taken with regard to the proposals made in this Report.

¹⁴ The process commenced in 2006 with a scoping paper. In the course of 9 years a series of Issues and Consultation Papers have been published by the Law Commissions. The exercise has also led to the enactment of the Consumer Insurance (Disclosure and Representations) Act 2012, which has fundamentally overhauled the pre-contractual duty of utmost good faith as it had previously applied to consumer insurance contracts. This Act came into force on 6 April 2013 (SI 405/2013).

¹⁵ The Act also introduces changes with regard to pre-contractual good faith duties of the assured in non-consumer insurance contracts and also stipulates the remedies available to an insurer in case of submission of a fraudulent claim in consumer and non-consumer insurance contracts. These aspects of the 2015 Act will not be deliberated in this article.

compliance with the warranty would not have had any impact on the loss occurring. This provides an additional protection to the assured in cases where the warranty breached was not designed to deal with the risk which caused a particular loss. This provision will apply not only to warranties as traditionally understood but also to other risk control clauses.

- iii) For consumer policies, the rules mentioned above will be mandatory in the sense that a contract term which would put the assured in a worse position than under the Act will not be permitted.¹⁶ For non-consumer policies, the relevant provisions of the Insurance Act 2015 can be excluded subject to important transparency safeguards as set out in s. 17.
- iv) The use of “basis of contract” clauses in non-consumer insurance contracts which convert the policyholder’s answers and declarations into contractual warranties is abolished by s. 9(2).¹⁷

The objective of this article is two-fold. In the first instance, it is intended to discuss whether the changes introduced by the Insurance Act 2015 enjoy a theoretical backing from the perspective of risk assessment. Then evaluating the changes from a critical standpoint, it is intended to ponder whether they would work in practice. In the course of this analysis, the author with the aid of hypothetical examples will try to identify legal problems that might occupy the courts in the years to come following the entry of the Act in force.

II. ALTERING THE CONSEQUENCE OF BREACH OF AN INSURANCE WARRANTY

The main change that has been introduced by s. 10 of the Insurance Act 2015 is an alteration of the legal consequence for breach of a warranty so that the cover is suspended for the duration of the breach, and liability of the insurer is restored if the breach is remedied. This is not a novel solution¹⁸ and it represents the position in some American states.¹⁹

Taking into account the rationale for incorporating warranties into insurance contracts and their function in risk assessment and management, it is submitted that the new remedy introduced, namely suspension of cover, is justifiable. Take, for example, a warranty that relates to future conduct of the assured requiring him to ensure regular surveys of security systems are carried out every two months at the insured premises and any recommendations made by the surveyor are complied with. If surveys are not carried out as stipulated, the cover

¹⁶ Section 15 of the Insurance Act 2015.

¹⁷ Section 6(2) of the Consumer Insurance (Disclosure and Representation) Act 2012 abolishes the use of such clauses in consumer insurance contracts.

¹⁸ This was put forward as one of the potential solutions to the problem in B. Soyer, *Warranties in Marine Insurance*, 2nd ed., (London, 2006), at p. 213.

¹⁹ *Fireman’s Fund Insurance Co v. Cox* 742 F Supp. 609 (M.D. Fla. 1989) (Florida law); *Lineas Aereas Colombianas Expresas v. Travelers Fire Insurance Co* 257 F. 2d 150 (5th Cir. 1958) (Louisiana law) and *Commercial Union Insurance Co of N.Y. v. Daniels* 343 F. Supp. 674 (S.D. Tex. 1972) (Texas law).

will be suspended. The purpose of incorporating this kind of warranty into the contract is to protect the insurer against alteration of the insured risk; so it is understandable that no cover will be available from the moment the risk is altered. However, if the survey is later completed with some delay and all recommendations are complied with, from the insurer's perspective the risk is normally reduced to the level that he was content with at the time when he agreed to undertake the risk. Therefore, from the perspective of risk management no objection can be raised by the insurer to the prospect of him coming back onto the risk.

The position is entirely different when dealing with affirmative warranties. By a warranty of this type the assured affirms or negatives the existence of a particular state of facts at the time of contracting. Imagine that the policy contains a warranty to the effect that a specific type of security system is in place to protect the insured premises. If this does not hold true at the time when the policy attaches, the cover will be suspended from the outset without having any possibility to remedy this kind of breach.²⁰ It is submitted that this is in accord with the function that warranties of this type perform. An affirmative warranty assists an underwriter in rating the scope of the proposed insured risk. The insurer agrees to undertake the risk relying on the contractual undertaking that forms the basis of such a warranty. In case of breach, therefore, the insurer is misled as to the extent of the risk and it is in that case understandable why he will not come on the risk at all.

However, it is apparent that some future warranties due to their nature cannot be remedied. For example, a warranty requiring the insured corporation to maintain confidentiality in their business dealings cannot be remedied once confidentiality has been compromised. Likewise, in some instances it may not be possible to bring the risk back to the level which the insurer was content with simply by remedying the breach. Put differently, in some instances an alteration in the insured risk caused by the breach continues to have an adverse impact on the risk even though the breach is remedied. Imagine, for example, that the assured is in breach of a warranty that obliges the insured vessel not to undertake towage or salvage services under a contract previously arranged. As soon as the insured vessel engages in such a service the cover will be suspended and remain so until the operation is completed; but in its unmodified form under s. 10, the insurer is expected to come on the risk as soon as the pre-arranged towage or salvage service comes to an end. If the insured vessel at a later stage develops a structural defect attributable to the contractual salvage operation she has undertaken under a prearranged contract and as a result of this sinks in moderate weather conditions, it is evident that the risk has not in that case been reduced to the level which the insurer expected it to be, despite the fact that the breach has been remedied.

The fact that in some cases remedying the breach will not necessarily reduce the risk to the level acceptable to the insurer has been appreciated by the draftsmen who decided to stipulate in s. 10(2) that the insurer will have no liability in respect of any loss "occurring, or attributable to something happening, after a warranty in the contract has been breached but before the breach has been remedied." The words used in this sub-section "something happening" invites a close scrutiny and it is likely that the insurer needs to establish a causal relationship between an event occurring during the period of suspension and loss that arises after the cover is reinstated. It is submitted that this will not be a straightforward exercise. Imagine that the motor insurance policy contains a warranty indicating that the insured

²⁰ Technically speaking, breach will result in the insurer never coming on risk, as compliance with this kind of warranty will be viewed as a condition contingent to the attachment of the risk. See comments made by Lord Mansfield in *De Hahn v. Hartley* (1786) 1 T.R. 343, at 345–6, to that effect. It is submitted that the contractual analysis will remain the same despite the change in the proposed remedy.

vehicle will not be used in racing competitions. If the vehicle is used on a Sunday for racing purposes and in the week following the race an engine breakdown arises, to deny liability the insurer will be required to prove that “something happened” during the race, for example, the engine endured excessive pressure, which led to the mechanical breakdown after the cover was reinstated. The fact that the insured vehicle took part in a race on its own is not enough to afford a defence to the insurer under s. 10(2). In other words, it is essential to demonstrate that the risk has acquired new characteristics as a result of the breach, and the loss that results after the breach is remedied is attributable to these new characteristics.

A very interesting question in this context is at what point the breach is deemed to be “remedied” for the purposes of s. 10 of the Insurance Act 2015. The general presumption adopted by s. 10(5)(b) is that for most warranties a breach is remedied if the assured ceases to be in breach of the warranty. What is apparent is that this provision does not invite any causal examination, and in some cases this could work against the insurer. Let us assume that a marine policy contains a warranty prohibiting the insured vessel from traveling through an area where attacks from pirates is very common. The insured vessel, nevertheless, travels through this area and comes out of it suffering no loss (e.g., no attack from pirates). The cover is suspended during the period when the vessel is in the prohibited area but under s. 10(5)(b) it will be reinstated as soon as she leaves the area prohibited by the warranty. Also assume that the outcome of the breach committed is to shorten the voyage by a few days—as navigating through the prohibited area proves to be a more direct route for the voyage contemplated. If after coming out of the prohibited area, the insured vessel finds herself in the middle of a storm and is lost, the insurer will be liable even though it is evident that there is a kind of causal link between breach of the warranty (i.e., shortening of the voyage), and the loss resulting; since getting caught in the middle of the storm would have not occurred if the area with piracy risk had been avoided, as this would have added to the duration of the voyage. On the other hand, one appreciates that introducing a causal test in this context would have created additional complications leading to a degree of uncertainty. The draftsmen perhaps found it appropriate that the cost of avoiding any uncertainty should be borne by insurers in cases where breach, even though remedied, changes the course of events prospectively leading to a loss.

That said, a very different approach has been taken with regard to warranties that require by an ascertainable time that something is to be done (or not done), or a condition is to be fulfilled, or something is (or is not) to be the case. For this kind of warranty, a breach is deemed to be remedied if the risk to which the warranty relates becomes essentially the same as that originally contemplated by the parties.²¹ This will require the courts to consider the purpose for which the warranty was inserted in the contract and analyse whether that purpose has been frustrated as a result of the breach which was later remedied. If so, any loss that arises will be avoided. Conversely, if as a result of the actions taken to remedy the breach of warranty, the original purpose is still in substance fulfilled and the risk profile is restored to that which the insurer was content with at the outset, then the breach is deemed to be remedied under s. 10(5)(a) of the Act. With this formulation it is acknowledged that in the context of time-specific warranties breach of a warranty in certain occasions will have an everlasting impact and accordingly it will not be possible to bring the risk profile to a level as it stood at the outset.²² In a case where the policy contains a warranty stipulating that “the insured

²¹ See, s. 10 (5)(a) and 10(6) of the Insurance Act 2015.

²² As discussed above, a similar situation might arise with regard to other warranties—the breach might change the course of events and lead to loss even though it is remedied. However, by virtue of s. 10(5)(b) the risk will be reinstated and the loss will be recoverable in such cases. It has been assumed by the draftsmen that

premises shall not be left unoccupied more than 21 days in a year”, the cover will be suspended on the 22nd day when the premises remained unoccupied. Let us imagine that the assured remedies this breach 45 days later by ensuring that the premises are occupied as originally stipulated during the remaining part of the policy period. Keeping the premises unoccupied for 45 days more than initially envisaged by the parties could potentially have drastic consequences. For example, a lengthy period of vacancy might make the insured property vulnerable by making it a target for burglars operating in the area. In that case, even though the breach is remedied, one could argue that the commercial purpose of the relevant warranty is frustrated as a result of the breach so that it cannot be remedied. On the other hand, this will not be the case if the contract contains a warranty requiring the fire alarm at the insured premises to be inspected every 30 days. If the inspection is delayed by a few days, during that period there will be no cover; but as soon as an inspection is carried out, the risk is reduced to the level acceptable to the insurer at the outset. Hence, cover will be available from the moment the delayed inspection is carried out, as the breach will be deemed to have been remedied from that point onwards. The special regime created for time-specific warranties takes into account the fact that the time factor in such warranties is critical, and that non-compliance within a specified period could potentially alter the risk beyond the bounds of acceptability from the insurer’s perspective.

Lastly, it will be appropriate to comment briefly on potential implications of the introduction of suspension of cover for breach of insurance warranties, as the new remedy on various legal doctrines. One consequence of the current remedy of automatic discharge is that any waiver by the insurer should take the form of “estoppel” rather than “election”. It is believed that the insurer has no election to make given that the breach of warranty discharges him from liability automatically.²³ Rooted in the law of equity, waiver by estoppel is a rather different concept which requires unequivocal representation on the part of the insurer that he would not endorse his right of relying on automatic discharge as a remedy. It is also essential to show that the assured has relied upon this representation and it would be inequitable for this promise to be withdrawn.²⁴ Given that under s. 10 of the Act a breach of warranty would merely suspend the cover, this means that “waiver by election” will be available for the assured given that the cover will remain, enabling the insurer to make a choice between two alternative and inconsistent causes of action open to him. Furthermore, in appropriate instances waiver by estoppel will also be available.

On the other hand, adoption of the new remedy is unlikely to lead to any change in law and practice when it comes to the obligation of the assured to make premium payments. Currently, in cases where a warranty that needs to be complied with at one certain point after the attachment of the risk (e.g., a navigation warranty) is breached, the premium is not

remediating the breach is capable of bringing the risk to the original level, perhaps for the sake of avoiding uncertainty.

²³ This was affirmed by the Court of Appeal in *Kosmar Villa Holidays Plc v. Trustees of Syndicate 1243* [2008] EWCA Civ 147; [2008] Lloyd’s Rep. I.R. 489 at [38].

²⁴ The elements of waiver by estoppel in this context have been summarised by deputy judge Sheer QC in *HIH Casualty & General Insurance Ltd v. Axa Corporate Solutions* [2002] Lloyd’s Rep. I.R. 325, at [24], in the following fashion: “Waiver by estoppel or promissory estoppel, as it is more commonly described, involves a clear and unequivocal representation that the reinsurer (or insurer) will not stand on its right to treat the cover as having been discharged on which the insurer (or insured) has relied in circumstances in which it would be inequitable to allow the reinsurer (or insurer) to resile from its representation.”

returnable (or remains payable if not paid in full at the outset) as long as the risk insured against is entire and indivisible.²⁵ Lord Goff was explicit on this point in *The Good Luck*:²⁶

It is possible that there may be obligations of the assured under the contract which will survive the discharge of the insurer from liability, as for example a continuing liability to pay a premium.

The position is different if a warranty that needs to be complied with before the attachment of the risk (e.g., an affirmative warranty) is breached. In that case, the insurer in the absence of fraud or illegality is expected to return the premium to the assured; as the risk never attaches, and, borrowing the wording of s. 84(1) of the MIA 1906, the consideration for the payment of the premium totally fails.

Replacing the remedy of automatic discharge with the remedy of suspension of cover should not have any impact on the relevant legal principles discussed above. Breach of a navigation warranty will suspend the cover, but given that the insurer has been on risk unless the risk insured against is apportionable, the premium agreed will not be returnable if paid in advance or will still remain payable if part of it is not paid in advance. Similarly, if the warranty breached is an affirmative warranty, the insurer will not come on risk at all, meaning that the premium, if paid in advance, needs to be returned for total failure of consideration. That said, it is perfectly possible that the contract might contain a clause that in the event of irremediable breach, cancellation or termination, the premium will be returned pro-rata. A clause of that nature is often incorporated into commercial insurance contracts, and if it is made a part of the contract, the assured might be able to recover part of the premium even if a warranty that needs to be complied with at one certain point after the attachment of the risk is breached.

III. LOSS OCCURRING DURING THE PERIOD OF SUSPENSION DUE TO BREACH OF A WARRANTY (TERM) UNRELATED TO THE LOSS

Even though altering the remedy for breach of an insurance warranty provides an increased level of protection for the assured, the proposed solution is still a crude one, and it remains a realistic possibility that the assured will be deprived of his cover in cases where there is no causal connection between the warranty (term) breached and the loss. For instance, if the warranty requires the assured to keep the burglar alarm at the insured premises in operation throughout the policy period, the assured will not be able to recover for loss emerging from fire arising at a time when the burglar alarm was out of order. Section 11 of the Insurance Act has been designed to improve the position of the assured in such a case.²⁷ It, therefore, stipulates that the assured will be indemnified for a loss occurring at a time when a warranty (or term) is not complied with if i) compliance with the warranty (or term) in question would tend to reduce the risk of loss of a particular kind, loss at a particular location or loss at a particular time; and ii) the assured demonstrates that non-compliance

²⁵ See, s. 84(2) of the MIA 1906.

²⁶ [1992] 1 A.C. 233, at 263.

²⁷ It is worth noting that this provision was omitted from the Bill as first presented to Parliament even though it formed part of the Final Report published in July 2014: (*Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment*, Cm 8898, SG/2014/131). A slightly amended version of the clause was put to the Committee in December 2014 shortly before the hearings commenced and it was strongly embraced by the Committee.

with the warranty (or term) could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

It is envisaged that s. 11 can be utilised by the assured in cases where the loss arises during the period of breach of a warranty (or term). To seek refuge in this section, the assured in the light of the loss arising must first establish that the warranty (or term) that is breached is intended to reduce the risk of loss of a particular type or at a particular location or at a particular time. The test that is introduced here is an objective one and it essentially attempts to identify whether compliance with the warranty (or term) be thought to reduce the chances of the particular type of loss being suffered. Turning to the example above, the assured would possibly be able to establish that the relevant warranty would objectively tend to reduce the risk of break-in (and related events such as arson and vandalism). This will mean that the insurer's liability in respect of break-in would be suspended during the period of breach. If, however, a loss arises as a result of fire that is not connected to unauthorised entry into the premises, that loss will be covered, as the assured in all probability will be able to demonstrate that non-compliance with the warranty (i.e., the burglar alarm not being in operation) could not have increased the risk of loss caused by fire.

The purpose of introducing this convoluted test by s. 11 is to prevent insurers from relying on breaches of irrelevant warranties—that is, where the type of loss which occurred is not one which compliance with the warranty or term could have had any chance of preventing. In doing so, the Law Commissions were determined to avoid being drawn into an inquiry involving a causation test.²⁸ However, it is submitted that the alternative test introduced will inevitably create uncertainties, as identifying whether compliance with a warranty (or term) could have increased the risk of the loss which actually occurred in the circumstances in which it occurred might not often be a straightforward task. Imagine that an insurance policy on a restaurant contains a warranty requiring that all waste or refuse outside the building be stored in non-combustible lidded and lockable containers. Also, assume that a number of containers in use are high-density plastic and one evening a fire starts in the kitchen as a result of an electrical fault destroying the restaurant completely. The assured in that case would tend to argue that the warranty in question tends to reduce the risk of loss caused as a result of fire occasioned from any of the containers outside the building, so that cover is suspended for this type of risks. The insurer, on the other hand, is likely to contend that the particular warranty tends to reduce the risk of loss by fire generally, and given that the cause of the loss in this case is fire, the burden passes to the assured to prove that non-compliance with the warranty (i.e., not using non-combustible containers) could not have increased the risk of loss which actually occurred in the manner in which it occurred. Other examples can easily be provided, but what this exercise reveals is that as far as most warranties are concerned, the proposal would necessitate detailed factual enquiry into the purpose of the term in question. It is a safe bet to assume that the assured in most instances would be tempted to argue that compliance with a particular warranty would tend to reduce the risk of loss in a narrow fashion, with insurers taking a different stance on the matter.²⁹ One cannot help thinking that the effect of s. 11 will be to introduce causation by the back

²⁸ The introduction of a causal link requirement in this context between breach and loss is deemed to be problematic. M. Clarke, "Insurance Warranties: The Absolute End?" [2007] LMCLQ 474, at p 487, said: "... may it be observed in passing that the history of English law on questions of causation is not encouraging."

²⁹ The Law Commissions are fully aware of the difficulties that this change might introduce and admit that there might be borderline cases that turn on their particular facts (Law Commission and Scottish Law Commission, *Insurance Contract Law; the Business Insured's Duty of Disclosure and the Law of Warranties* (LCCP No 204; ScLCDP No 155: 2012) at p 186). With respect, it is submitted that they have considerably downplayed the difficulties that can arise with respect to several types of promissory warranties.

door, but time will show the true impact of this provision. It is a genuine concern that the test introduced has the potential to increase transaction and litigation costs.

A significant difference between s. 11 and s. 10 is that the latter applies only to warranties as traditionally understood, whilst the remit of s. 11 is much wider and it is intended to apply to any term which is designed with the intention of reducing the risk of a particular type of loss, or loss at a particular location or time. This is a sensible approach, as other contractual terms such as condition precedents, suspensory provisions or exclusions could perform a risk-controlling function similar to insurance warranties. If a reform were to be restricted to warranties, the changes adopted could have been undermined by insurers introducing similar risk control mechanisms detrimental to the interest of the assured under a different label. For example, instead of stipulating with a warranty that a burglar alarm at the insured premises must be in operation at all times, the insurers could have achieved an outcome that is similar to the current position by stipulating that “losses caused when the burglar alarm is not in operation are excluded from cover.” In that case, in the absence of s. 11 the assured would fail to recover for a loss arising when the burglar alarm was not in operation even though the loss was occasioned from an unrelated peril such as flooding. The extension of s. 11 to similar types of terms is, therefore, a positive development and intends to offer a more holistic approach to risk management clauses in English insurance law, discarding technical categorisation of contractual terms. It should also be noted that this imposes a restriction on freedom of contract in consumer insurance. However, it is worth remembering that in non-consumer insurance it is possible to contract out of the new regime, thus giving full effect to freedom of contract.³⁰

As a final point, it is essential to identify boundaries and precise impact of s. 11 upon different types of clauses and obligations. It is abundantly clear that this section will not affect terms which have no bearing on the risk of loss. The most obvious example is a premium warranty³¹ whereby the assured warrants to make payment of the premium by a particular date. If the payment is not made by the agreed date, the cover will be suspended and remain so until the breach is rectified. If loss arises before the breach is rectified, the assured will not be able to seek indemnity.³² Equally, the section will not apply to affirmative warranties given that they are not aimed at a specific type of loss and used for the purposes of describing the risk generally at the outset. For example, if a warranty in a yacht policy stipulates that the person identified as the master of the yacht passed formal examinations, the cover will be suspended from the outset if he does not have such qualifications, and it will be immaterial whether a loss arises later for reasons associated with the master not having the required qualifications or otherwise.

More challenging questions are likely to arise on the issue of whether a warranty (or term) serves the purpose of describing the limits of the cover as a whole, or whether it is a (warranty) term aiming to reduce a particular risk-increasing event/circumstance. The former type of warranty (term) is excluded from the application of s. 11 on the premise that such a term will have a general limiting effect not linked to a specific risk.³³ Put differently, the function of a term of that nature is to assist risk assessment and hence it relates to the contract

³⁰ This point will be further deliberated below in IV.

³¹ For a case concerning a premium warranty see, *JA Chapman & Co Ltd v. Kadirga Denizcilik ve Ticaret* [1998] Lloyd's Rep. IR 377. Such warranties are occasionally used in commercial insurance policies in order to ensure that premium payments are made in a timely manner.

³² A similar outcome will follow in a case like *Overseas Commodities Ltd v. Style* [1958] 1 Lloyd's Rep. 546, where it was warranted that the insured cargo (tins of canned pork) was marked by the manufacturer with a code for verification of date of manufacture.

(and risk) generally. In case of its breach, therefore, the risk assessment undertaken by the insurer at the outset is in tatters. That explains why it is pointless to enter into any debate as to whether or not non-compliance could have increased a particular risk in the manner in which a loss occurred. Consider a warranty that the vessel remains at all times during the duration of the cover with a particular classification society. This warranty clearly goes to the definition of the risk, and in case of non-compliance all coverage should be suspended for the duration of the breach. Similarly, if a term stipulates that the vehicle is insured “for pleasure purposes only”, at a period when the vehicle is not used for pleasure purposes the cover should be suspended as during that period the risk originally undertaken by the insurer is altered dramatically.

So far so good. However, it is not going to be plain sailing all the way. There is little doubt that a clause that requires the vehicles owned by the assured company to be kept “in a roadworthy condition at all times” aims to reduce the risks associated with using vehicles that are not roadworthy. If a loss is caused when the vehicle is used in an unroadworthy state, there will be an inquiry by virtue of 11(3) as to whether non-compliance could have increased the risk of the loss which actually occurred in the manner in which it occurred. However, what happens if the same policy states on the front page under the heading “risk definition” that: “This policy applies only when the insured vehicle is kept in a roadworthy condition”? The insurer, in that case, would be able to argue at least that this is a term defining the risk as a whole and s. 11 has no role to play. One should not be surprised to see an increase in the use of this kind of alternative formulation instead of promissory warranties by the insurers in the future after the Insurance Act 2015 comes into force. When an issue of this nature reaches the court, it will be rather interesting to see what stance the judiciary will take. Essentially, the issue here is a matter of construction. The language used will have a role to play but “the factual matrix” cannot be ignored.³⁴ The changes introduced to the current legal system by the Insurance Act 2015 will form part of the legal matrix, and it is possible that courts would appreciate the fact that the principal objective behind reallocating this kind of risk control clauses into the part of the contract that deals with risk definition is to sidestep the potential impact of s. 11 of the Act. Particularly, in the context of commercial insurance contracts there is no reason why the courts will not embrace the fact that the intention of the parties was changing the nature of the term with a view to achieving a particular outcome (or avoiding an outcome stipulated by the Insurance Act 2015). If courts fail to appreciate the conscious decision taken by the parties in reclassifying such clauses as risk defining clauses, there is a risk that this will be viewed as an attempt to rewrite the bargain for the parties, which is permissible only if the literal meaning of the words leads to commercial absurdity;³⁵ but that is hardly the case here, given that defining the limits of the cover making the cover available only when the vehicle is roadworthy is not an outcome that defies commercial common sense. It goes without saying that the assured is likely to bring a counter argument to the effect that adopting a purposive approach, the above mentioned clause should be viewed as a risk control clause rather than a risk defining clause in order not to present an opportunity to insurers to bypass the effect of the legislation by playing on the wording. That is also a

³³ *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment*, Cm 8898, SG/2014/131, at para. 18–35.

³⁴ Especially in the light of the statement of Lord Hoffmann in *Investor Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 W.L.R. 896, at 912–13.

³⁵ *Rainy Sky SA v. Kookmin Bank* [2011] U.K.S.C. 50; [2012] 1 Lloyd's Rep. 34 at [21], Lord Clarke speaking for the entire court commented: “The language used by the parties will often have more than one potential meaning... If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other.”

plausible argument that could find a receptive ear, especially in the context of a consumer insurance policy.

IV. CONTRACTING OUT

By virtue of s. 15, a contractual term that would put the assured in a worse position than under the Insurance Act 2015 is not permitted for consumer policies. On the other hand, with an exception aside³⁶ in non-consumer policies the parties should be free to contract out of the provisions of the Act³⁷ subject to transparency safeguards as set out in s. 17. Party autonomy is at the heart of English commercial law, and ability to alter default rules and respond to needs of the assured and changes that occur in law and practice have enabled the market, in particular in the fields of marine energy and transport, to flourish and establish itself as a leading insurance centre over the course of the last decade. That being the case, it would have been a huge blow for the non-consumer market had the Act introduced any constraint on party autonomy. Also, there are good reasons justifying treatment of non-consumer policies different than treatment of consumer ones. Commercial risks often involve a much greater variety of unusual risks than those covered by consumer insurance, making it essential from a risk management perspective to make use of risk control tailor-made clauses. Take for example, an insurance policy providing cover against loss of business as a result of a blow-out in an offshore oil-well. The risk is so different than the risk an insurer providing car insurance undertakes, and to ensure that it is retained and managed in accordance with the expectations of an insurer it is vital to provide the parties with the utmost degree of freedom of contract. Also, in non-commercial insurance market the bargaining position of the parties is more balanced, making it rather difficult for the insurers to exploit the vulnerability of the assureds by insisting on terms detrimental to the interests of the insurer. Of course, the balance is tilted in favour of insurers in cases where they contract with small or medium sized businesses but, as will be evaluated in the following paragraph, this does not cause serious difficulties for such assureds, as inequalities in the bargaining positions of the parties will be taken into account in applying the transparency requirements, making it rather difficult for the insurers to contract out of the default regime. Also, it is the case that the insurers still have an inherent advantage, as they are in a position to know about the niceties of insurance law more than an average assured would; but there is no doubt that the intensive use of professional intermediaries when placing commercial risks helps enormously in bridging the knowledge gap.

In non-consumer policies a term that puts the assured in a worse position than he would be under the Insurance Act 2015³⁸ is enforceable if the insurer takes sufficient steps to draw disadvantageous term to the attention of the assured before the contract is entered into,³⁹ and if such term is clear and unambiguous as to its effect.⁴⁰ The first limb of the transparency requirements is drafted very broadly, taking into account the fact that the characteristics of the assured of the kind in question and the circumstances of the transaction will be decisive in determining whether the disadvantageous term has been sufficiently brought to the attention

³⁶ It is not permitted to use basis of contract clauses even in non-consumer insurance policies (s. 16(1)).

³⁷ Section 16(2) of the Insurance Act 2015.

³⁸ The Act refers to a term of this nature as a disadvantageous term.

³⁹ Section 17(2) of the Insurance Act 2015.

⁴⁰ Section 17(3) of the Insurance Act 2015.

of the assured at the outset. Therefore, in the context of a marine policy negotiated through several brokers, attracting the attention of the placing broker to the disadvantageous terms should be deemed sufficient.⁴¹ Conversely, if a small business owner obtains insurance cover for his premises online, it might not be adequate to satisfy the transparency requirements simply by offering the assured the opportunity to view under a window all of the standard terms containing disadvantageous ones.

Turning to the need to have clear and unambiguous wording, it is debateable whether it would be sufficient to state that “s. 10 and 11 of the Insurance Act 2015 do not apply to this contract” or whether it will be necessary to stipulate specifically the legal effect of this: that is, that breach of any warranty under this policy will discharge the insurer from liability automatically regardless of whether there is any causal link between the breach and the loss, and regardless of whether the breach is material to the loss or not. At their final report, the Law Commissions expressed the view that it would normally be necessary to stipulate the legal effect of not making certain sections of the Act applicable for the purposes of the present contract.⁴² In the light of the fact that in determining whether the requirement of this sub-section is satisfied, it is essential to take into account the characteristics of the insured persons of the kind in question and the circumstances of the transaction,⁴³ the author disrespectfully disagrees with the view expressed by the Law Commissions. For example, in a market where standard clauses are often used, such as marine insurance, given the fact that a typical assured is likely to be a corporate entity who is assisted by in-house lawyers and brokers, it is difficult to see why a mere reference indicating the provisions of the Act that are displaced should not be adequate. On the other hand, if the assured is a small-sized business obtaining cover through the Internet, it is appropriate that the insurer should spell out in a clear fashion the consequences for displacing the relevant provisions of the Act. It is expected that disputes on the transparency requirements might arise after the Act comes into force, but in all probability such disputes will settle rather quickly once a judicial view on the matter is expressed.

V. BASIS OF CONTRACT CLAUSES

For many years, insurers both in consumer and commercial insurance have made use of basis of contract clauses to convert the policyholder’s answers and declarations into contractual warranties.⁴⁴ The practice empowers the insurers to refuse claims when the policyholder makes a mistake in answering the questions, no matter how minor or immaterial the mistake might be. This is because when the answers are declared to be the basis of the contract, this means that their truth is made a condition, exact fulfilment of which is rendered by stipulation as essential to its enforceability.⁴⁵ It has been often suggested that basis of contract clauses operate as traps,⁴⁶ and their removal from the legal landscape was

⁴¹ This is endorsed by s. 17(5) of the Act which stipulates that the insured will not be able to rely on any failure by the insurer to draw a disadvantageous term to its attention if the assured (or its agent) had actual knowledge of the disadvantageous term at the time the contract was entered into.

⁴² *Insurance Contract Law: Business Disclosure; Warranties; Insurer’s Remedies for Fraudulent Claims; and Late Payment*, Cm 8898, SG/2014/131, at para. 29.50.

⁴³ Section 17(4) of the Insurance Act 2015.

⁴⁴ This is done typically by the policyholder signing a statement on the proposal form stating that his answers form the basis of the contract.

⁴⁵ *Dawsons v. Bonnin* [1922] 2 A.C. 413, at 425, per Viscount Haldane.

⁴⁶ *Zurich General Accident & Liability Ins Co Ltd v. Morrison* [1942] 2 K.B. 53, 58, per Lord Greene, MR.

recommended by the Law Commission back in 1980.⁴⁷ The Consumer Insurance (Disclosure and Representations) Act 2012 abolished basis of the contract clauses in consumer insurance.⁴⁸

Section 9 of the Insurance Act 2015 is designed to ensure that non-consumer insurance contracts follow suit; and the use of a term in a proposal form, contract or accompanying document which states that the policyholder warrants the accuracy of the statements given or that the answers form the basis of the contract is prohibited. This will prevent presentations made at the pre-contractual stage to be converted into warranties by means of a general declaration on a proposal form. The objective here is promoting transparency and insuring that the assured appreciates what type of undertaking he is committing himself to. Some might suggest that particularly in the context of commercial and marine insurance, the assureds are often large corporations which will have the backing of a professional legal team, so it is a slim possibility that they will be caught by such clauses. That is correct to a certain extent, but large corporations are not the only purchaser of business insurance. When it comes to small corporations, it is not an overstatement to suggest that most would not be in a position to appreciate the legal significance of such clauses. Besides, the proposed change does not amount to an enormous restriction on freedom of contract. It will still be possible for the insurer to include specific warranties of fact in a policy dealing with similar issues to matters dealt with in the application form. Therefore, if answers given at the pre-contractual stage are particularly important to the insurers, the proposed reform does not prevent appropriate warranties from being included in the main body of the insurance policy.

VI. CONCLUSION

At the outset, two positive aspects of the reform carried out in this area of law should be stressed. First, it is praiseworthy that the Insurance Act 2015 aspires to provide a more holistic approach to risk control clauses by extending the scope of the reform beyond warranties as traditionally understood. It goes without saying that this imposes a restriction on freedom of contract to a certain extent; but any possible adverse effect of such restriction especially in non-consumer insurance contracts has been limited by allowing parties to those contracts to contract out of the default regime subject to transparency requirements. Second, the Law Commissions' stance on not allowing insurers to contract out of the default regime set out in ss. 10 and 11 of the Act in consumer insurance contracts is justifiable, given that there is a huge imbalance in terms of bargaining power of consumer assureds and insurers, and the former—often not assisted by a broker—is not in a situation to appreciate the precise impact of legal jargon incorporated into standard contracts.⁴⁹

⁴⁷ Law Commission, *Insurance Law—Non-Disclosure and Breach of Warranty*: Law Com No. 104 (Cmnd 8064, 1980), para. 7.5.

⁴⁸ See, s. 6(2) of the 2012 Act.

⁴⁹ A different regime in relation to warranties has been in application for a considerable amount of time in the context of consumer insurance. For instance, the Financial Conduct Authority Handbook: Conduct of Business sourcebook (ICOBS) provides a regulatory safeguard in relation to warranties for consumers. ICOBS 8.1.2 states: “A rejection of a consumer policyholders’ claim is unreasonable, except where there is evidence of fraud, if it is ... (3) for breach of warranty or condition unless the circumstances of the claim are connected to the breach...”. This provision is designed to offer a different and more assured friendly regime for consumers; and even though it cannot be applied in court, it is possible for a consumer to bring action for an insurer that acts contrary to this rule for breach of statutory duty under s. 138 of the Financial Services and Markets Act 2000 (as amended). In similar fashion, the Financial Ombudsman Service (FSO), which has jurisdiction to hear

Turning to potential impact of the changes introduced on law and practice, the following observations are in order. There is little doubt that the significance of insurance warranties in insurance practice will diminish in future. That is because classifying a risk control clause as a “warranty” will not anymore provide a very powerful statutory remedy for insurers. However, considering that warranties have been embedded into insurance practice for centuries, it will be premature to suggest that they will be removed from the legal landscape altogether. Also, it is possible that in the context of commercial insurance the present warranty regime will be retained for some risks, given that it is possible to contract out of the new default regime. It is very difficult at this stage to predict to what extent the insurers will opt to contract out of the provisions of the Insurance Act 2015. The transparency requirements will increase administrative costs for those who decide to opt out. More significantly, opting out of the default regime might create a reputational hazard for insurers by sending a wrong type of message to the market.

When it comes to determining how effective the proposals will be in reducing the transaction and legal costs, this is not an easy question to answer, either. Under the current legal regime, disputes centre around two questions: i) whether a term is a warranty or not⁵⁰ and ii) if so, what the scope of the warranty is.⁵¹ Assimilating the legal regime concerning insurance warranties with other terms dealing with risk control (e.g., exclusion clauses, condition precedents) will certainly help to reduce litigation on demarcation of insurance terms; but as highlighted earlier, litigation will be inevitable on issues concerning whether a term tends to reduce the risk of a particular loss or it is a term defining the risk generally. Put differently, whilst the proposed changes will likely reduce disputes concerning characterisation and interpretation of warranties, it is very likely that the battleground will shift to issues concerning what particular objective the warranty (or term) intends to serve. Only time will show whether the changes introduced will amount to a net decrease in litigation costs. One should also not lose sight of the fact that one-off transitional costs of familiarisation will be associated with any law reform.

Considering the substance of the changes introduced, it is beyond doubt that for the case of breach of a risk control clause, more balanced remedies have been introduced by the 2015 Act as opposed to the current legal regime. However, in advancing this agenda it is inevitable that some sacrifices need to be made from certainty. It has been highlighted in this article that s. 11 is likely to be a source of uncertainty and, although the Law Commissions

complaints from consumers and micro-businesses, has often overruled an insurer’s decision to reject a claim where the breach the insurer relied on did not cause the loss in question. The Insurance Act 2015 will afford a similar protection to consumers which can be enforced not only by the FSO but also by courts.

⁵⁰ See, for example, *Kler Knitwear Ltd v. Lombard General Insurance Co Ltd* [2000] Lloyd’s Rep. I.R. 47.

⁵¹ In many cases, the courts have used interpretative principles to relieve the harsh effects of the warranty regime. See, *Hide v. Bruce* (1779) 3 Doug KB 213. Saville, LJ, in *Hussain v. Brown* [1996] 1 Lloyd’s Rep. 627, 630, said: “... it must be remembered that a continuing warranty is a draconian term. As I have noted, the breach of such a warranty produces an automatic cancellation of cover, and the fact that a loss may have no connection at all with the breach is simply irrelevant. In my view, if the underwriters want such a protection, then it is up to them to stipulate for it in clear terms.” More recently, see *Pratt v. Aigaion Insurance Co SA* [2008] EWCA Civ. 1314; [2009] 1 Lloyd’s Rep. 225 and *Sugar Hut Group Ltd and Others v. Great Lakes Reinsurance (UK) plc* [2010] EWHC 2636 (Comm); [2011] Lloyd’s Rep. I.R. 198.

have developed this provision with a view to avoiding negative effects of a causation test, it is very likely that this provision will re-introduce causation into the enquiry from the back-door.

These difficulties aside, it is fair to say that the changes introduced will achieve a fairer regime in domestic insurance markets for risk control clauses akin to the solutions adopted by most continental legal systems. When it comes to international insurance business, such as marine, transport, aviation and reinsurance, introducing a more assured friendly regime will increase confidence in the UK law and possibly present a very effective weapon to London brokers who are currently facing tough competition from other emerging international insurance markets. It is too early to speculate about potential impact of the changes in the market, but the author is of the view that the changes introduced are built on solid theoretical foundations and they seem to enjoy the support of a majority of the stakeholders in the market.⁵² There is every reason to be hopeful of the future.

⁵² See, *Insurance Contract Law: Business Disclosure; Warranties; Insurer's Remedies for Fraudulent Claims; and Late Payment*, Cm 8898, SG/2014/131, at pp. 167–170.