The Insurance Act 2015: 10 months on…

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Introduction

- Act came into effect on 12th August 2016
- Pre August 2016 predictions not optimistic
- Talk will look at the statutory position, how the market has responded and where the risks and uncertainty lie

Fair presentation

- Disclosure needs to reasonably clear and accessible
- Disclosure of material circumstances
- Knowledge to come from senior management
- Reasonable search
- No need to include “insurer knowledge”

Market response

- Insurers asked to sign off that a fair presentation has been provided
- A need for a more collaborative process on substantive disclosure and search process
- Definition of senior management
- Insurers internally evidencing decisions
- Broker responsibilities and ToBAs

Insurer remedies for non-disclosure

- Proportionate remedies
- Insurers need to consider how they evidence their suggestion they would have acted differently
- Do the records exist?
- What about commercially sensitive information?

Market response

- Different policy wordings being introduced
- “One size does not fit all” – different insureds have different needs
- Brokers need to be alert to the risks and be aware of claims history
- Brokers need to give proper advice as to the suitability of the various clauses to insureds

Policy terms

- Act abolishes “basis of contract” clauses
- Breach of warranty does not discharge the insurer’s liability: remedy prior to loss = cover in place
- Contracting out

Market response

- Policies “Insurance Act complaint” or “warranty free”
- Watch out for Conditions Precedent!
- Section 11 terms – a high risk area?

Broker liability

- Café de Lecq v R A Rossborough [2012] JRC 053
- Fire at beach café – insured in breach of warranty
- Insurer declines claim
- Broker sued
- Court set out firm guidance on broker duties

Fraudulent claims after *Versloot* and the 2015 Act and The Enterprise Act 2016

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Topics covered

- The law on fraudulent claims before *Versloot* and the 2015 Act
- *Versloot Dredging v HDI Gerling*, "*The DC Merwestone*" July 2016
- Implications of *Versloot* and the new 2015 regime
- Enterprise Act

The law before *Versloot*

The fraudulent device rule

- Three main types of fraudulent presentation of insurance claim:
  - Falsifying a loss
  - Exaggerating a loss
  - Lying about the circumstances of a genuine loss ("fraudulent device")

The Aegeon

- Mance LJ took the opportunity to formulate rule:
  - Forfeiture if lie told to insurer before proceedings commenced
  - That is intended to improve insured's prospects of payment, greater payment or earlier payment
  - That is directly related to the claim
  - That would objectively yield a not insignificant improvement of insured's prospects

Rationale for the fraudulent device rule

- Three main justifications in case law:
  - Deterrence and the 'one-way bet'
    - e.g. *The Aegeon* at [14] and *The Star Sea* [62]
  - Reflection of the parties' bargain and duty of utmost good faith
    - e.g. *Orakpo v Barclays* [29915] LRLR 443, 451 and *The Aegeon* at [51]
  - Protection of insurer against risk of information imbalance
    - e.g. *Carter v Boehm* (1766) 3 Burr, 1905, 1911

The *Versloot* case

The *Versloot* case

- Claim by insured on H&M policy as a result of the partial flooding of the *DC Merwestone*
- Flooding caused by negligent failure to drain emergency fire pump in cold conditions at Klalpeda
- Circumstances were unclear: leak was slow and should not have caused the damage. Underwriters asked for Owners' explanation for the cause of the ingress

The *Versloot* case

- Insured's director (Chris Kornet) responded with a theory that the crew had heard the bilge alarm and ignored it because they attributed the alarm to rolling in heavy weather
- Concern negligent maintenance by crew would exclude cover
- This was a fraudulent device within the definition in *The Aegeon*, as held by Popplewell J at trial

The *Versloot* case: Supreme Court

- Majority of the Supreme Court agreed with the insured, overturning the Court of Appeal
- Leading judgment given by Lord Sumption:
  - 'Collateral lies', i.e. lies that it turns out did not need to be told, do not justify forfeiture
  - Unlike exaggeration cases, the insured is not trying to obtain anything that he is not entitled to under the policy. "*The lie is dishonest but the claim is not*" [25]
  - "*The insured gains nothing from the lie that he was not entitled to have anyway, and the insurer loses nothing if he meets a liability that he had anyway*" [20]

After *Versloot*

After *Versloot*: fraudulent devices

- Clearly the fraudulent device defence is dead and buried
- If an insured did not need to lie, and his lie relates to the circumstances but not the value of the claim, there is no defence to the claim based on the lie
- Therefore it will not be possible to determine liability based on the lie: will need to see if it was necessary

After *Versloot*: fraudulent exaggeration

- But the fraudulent exaggeration defence survives
- This is on a statutory footing from 12 August 2016. Under section 12 of the Insurance Act 2015, the insurer is not liable to pay a "*fraudulent claim*"
- Following Versloot, a fraudulent claim is a fraudulently exaggerated claim or an entirely false claim only

After *Versloot*: fraudulent exaggeration

- Under section 12, insurer can recover any sums paid under in respect of the claim
- Insurer may treat the policy as terminated from the date of the fraudulent act
- No rescission of the policy so still liable for prior claims, but need not return premiums

After *Versloot*: fraudulent exaggeration

- Exaggeration must be "*substantial*" or "*material*" to forfeit claim
- 11% was sufficient in *Galloway v Guardian* [1999] Lloyd's Rep. 209, justified by need for deterrence and the egregious breach of duty of good faith
- Given the rejection of the (similar) justifications for the fraudulent device rule, query whether this test will be more strictly applied – will 11% exaggeration still be enough?

After *Versloot*: express clauses

- Fraudulent device defence is "*disproportionately harsh*" according to *Versloot*

- Can insurers get round this by inserting express clauses?

After *Versloot*: express clauses

- The clause could arguably be a penalty – seeking to punish the lie by disproportionate sanction of withholding payment

  cf. *Cavendish v Makdessi* [2015] 3 WLR 1373 at [170]
- Likely to be ineffective in consumer contracts anyway under s.62 of the Consumer Rights Act 2015
- UCTA usually irrelevant: section 15

After *Versloot*: summary

- No common law defence of fraudulent device
- Express clauses might work, but will need (at least) to be set out in clear and unambiguous terms
- Fraudulent exaggeration will still forfeit the good part of the claim if "*material*" / "*substantial*"
- Potential for the Courts to apply fraudulent exaggeration defence more restrictively than before *Versloot*

The Enterprise Act

"It is absolutely vital that insurance companies also pay out quickly… unnecessary delays by insurers can spell the end for vulnerable businesses."

Sajid Javid
Former Business Secretary

What it means for Insurance

- Amended the Insurance Act 2015
- Adds an implied term into every policy incepting after 4 May 2017
- If an insurer unreasonably delays payment of a claim, introduces a right to claim damages.
- Insurers may be liable beyond the policy limit.

Key Changes

- Previously no action in law for insurers delaying payment of claims
  - Sprung v Royal Insurance [1997]
- Act establishes a new cause of action
- Can claim **unlimited** damages

Limitations

- It is not a *penalty* for late payment
- Insured needs to prove that the loss suffered was caused by the unreasonable delay in claims payment
- Claim must be brought within 1 year of the payment

Implications

- Survey results;
  - 59% think there will be an increased use of interim payments by insurers
  - 30% think it will speed up claims payments
  - 50% think soft market will prevent insurers recouping any additional costs by increased premium
  - 66% think that insurers will look to recover payments from TPAs

Claim Investigations

- Potential for insurers to curtail investigations because of a late payment threat
- May reduce profitability of insurer because unlikely to recoup additional costs from insureds
- Less claims investigations less adjusting/legal fees

Subscription market

- Issues for lead underwriters as they owe common law duty to follow market.

- Follow market may claim against leader if;
  - Successful claim for unreasonably delay;
  - If claim paid without making reasonable investigations

Contracting Out

- Possible to contract out of the Enterprise Act
- Anecdotal evidence insurers are attempting to contact out of the consequences of The Enterprise Act usually by capping liablity
- Need to meet S17 of the Insurance Act i.e. be clear and unambiguous as to its effect

Summary

- Too early to fully test the Insurance Act
- Insurers interpreting the Insurance Act differently
- Definition of fraud has been confirmed
  - Fraudulent device is no longer grounds to refuse
- New action for negligent late payment of claims
- Only covers damage suffered by the delay
- 1 year time limit for bringing claims

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